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**Draft Chapter
on
Unwinding of Failed Contracts**

by

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Unwinding of Failed Contracts

I. Restitution following termination

ARTICLE 1

(Contracts to be performed at one time)

(1) On termination of a contract to be performed at one time either party may claim restitution of whatever it has supplied under the contract, provided that such party concurrently makes restitution of whatever it has received under the contract.

(2) If restitution in kind is not possible or appropriate, an allowance has to be made in money whenever reasonable.

(3) The recipient of the performance does not have to make an allowance in money if the impossibility to make restitution in kind is attributable to the other party.

(4) Compensation may be claimed for the necessary expenses linked to the performance received. Compensation for other expenses linked to the performance received may be claimed as far as the other party is enriched by them.

COMMENT

1. Contracts to be performed at one time

The present article refers only to contracts to be performed at one time. A different regime applies to contracts to be performed over a period of time (see Art. 2). The most common example of a contract to be performed at one time is an ordinary contract of sale where the entire object of the sale has to be transferred at one particular moment. Instalment sales (i.e. contracts of sale where the purchase price is to be paid in instalments) therefore fall under the present article.

2. Entitlement of parties to restitution on termination

Para. (1) of this article provides for a right for each party to claim the return of whatever it has supplied under the contract provided that it concurrently makes restitution of whatever it has received.

Illustration 1

A sells a Constable painting to B for 2,000,000 Euro. B does not pay for the painting when it is delivered, and A therefore terminates the contract. A can claim back the painting.

The rule also applies when the aggrieved party has made a bad bargain. If, in the case mentioned in illustration 1, the true value of the painting is 3,000,000 Euro, A may still require the return of the painting.

The present article also applies to the situation where the aggrieved party has supplied money in exchange for property which it has not received or which is defective.

Illustration 2

The Constable painting for which B has paid 2,000,000 Euro was not a Constable but a copy. On termination of the contract, B can claim back the money and must return the copy to A.

3. Restitution not possible or appropriate

Restitution must normally be in kind. There are, however, instances where instead of restitution in kind, an allowance in money has to be made. This is the case first of all where restitution in kind is not possible. The allowance will normally amount to the value of the performance received.

Illustration 3

A sells a Constable painting to B for 2,000,000 Euro. The true value of the painting is 3,000,000 Euro. B does not pay for the painting when it is delivered, whereupon A terminates the contract. In the meantime, B had already sold and delivered the painting to C who has vanished. B has to pay an allowance of 3,000,000 Euro to A.

An allowance is further envisaged by para. (2) of this article whenever restitution in kind would not be appropriate. This is so in particular when returning the performance in kind would cause unreasonable effort or expense.

Illustration 4

A sells 300 boxes of avocados to B. B does not pay for the avocados when the 300 boxes are delivered to him, and A thereupon terminates the contract. In the meantime, B had sold and delivered the boxes to C who is in the process of shipping them to another country. Although it would be possible to get C to order the return of his ship and to unload the boxes, this cannot reasonably be expected of B. Since retransfer in kind of the 300 boxes of avocados would cause unreasonable effort and expense, B may return the value of these boxes.

The purpose of specifying that an allowance has to be made in money “whenever reasonable” is to make it clear that an allowance only has to be made if, and to the extent that, the performance received has conferred a benefit on the party claiming restitution. That is not the case, for example, where the defect which gives the recipient of the performance a right to terminate has only become apparent in the course of processing the object of that performance.

Illustration 5

A sells to B who wants to paint his house ten litres of paint. While B is using the paint it becomes apparent that it does not stick to the wall of the house. B can terminate and reclaim the purchase price but it would not be reasonable to expect him to make good the value of the paint.

4. The allocation of risk

Obviously, the rule contained in para. (2) implies an allocation of risk: it imposes a liability on the recipient of the performance to make good the value of that performance if it is unable to make restitution in kind. The rule in para. (2) applies no matter whether the recipient has been responsible for the deterioration or destruction of what it had received. Such allocation of the risk of deterioration or destruction is justified, in particular, because there should be correspondence between risk and control. Of course, there is no liability to make good the

value where the deterioration or destruction is attributable to the other party: either because it has been due to the other party's fault, or due to a defect inherent in the performance.

Illustration 6

A sells and delivers to B a Lamborghini. The Lamborghini has defective brakes; it therefore crashes into another car and is destroyed as a result of this accident. Since the Lamborghini was unfit to be used for its intended purpose, B can terminate the contract and reclaim the purchase price. He does not have to make an allowance for not being able to return the Lamborghini.

The recipient's liability to make good the value of the performance received is not excluded in cases where the deterioration or destruction would also have occurred had the performance not been rendered.

Illustration 7

A factory building has been sold and transferred to the purchaser; it is subsequently destroyed by a violent thunderstorm. The purchaser terminates the contract because of a defect attaching to the building. He can reclaim the purchase price but, at the same time, has to make an allowance for the value of the factory.

Obviously, the question of risk allocation only arises in cases where the deterioration or destruction occurs *before* termination of the contract. If what has been performed deteriorates or is destroyed *after* termination of the contract, the normal rules on non-performance apply. For after termination, the recipient of the performance is under a duty to return what he had received. Any non-performance of that duty gives the other party a right to claim damages according to Art. 7.4.1, unless the non-performance is excused under Art. 7.1.7 (*force majeure*).

Illustration 8

A sells and delivers to B a Peugeot with a leaking roof. Since the Peugeot is unfit to be used for its intended purpose, B can terminate the contract. As a result, he can reclaim the purchase price but is under a duty to return the Peugeot. Before he can return the car it is destroyed by an accident resulting from the fact that the Peugeot also had defective brakes. A cannot claim damages because B is excused under Art. 7.1.7.

5. Compensation for expenses linked to the performance

The recipient of a performance may have incurred expenses for the maintenance and improvement of the object of the performance. It appears to be reasonable to allow him to claim compensation for such expenses in cases where the contract is unwound and where, therefore, the parties have to return what they have received.

Illustration 9

A has sold and delivered a horse to B. Some time later it becomes apparent that the horse is not, as it was supposed to be, a descendant of a particular stallion. B terminates the contract. He can claim compensation for the costs that he has incurred in feeding the horse.

The rule always applies with regard to necessary expenses (as in illustration 8). Compensation for other expenses linked to the performance received, i.e. those which are merely useful, or constitute a luxury, may only be claimed as far as they actually benefit the other party.

Illustration 10

A has sold and transferred a piece of property to B. B converts the land from a fen into an agricultural property. After he has repeatedly failed to pay the last instalment of the purchase price, A terminates the contract. He does not intend to use the property for agricultural purposes. B cannot claim compensation for the amelioration of the property.

ARTICLE 2

(Contracts to be performed over a period of time)

On termination of a contract to be performed over a period of time restitution can only be claimed for the period after termination has taken effect, provided the contract is divisible.

COMMENT

1. Contracts to be performed over a period of time

Contracts to be performed over a period of time are at least as important, commercially, as contracts of sale where the object of the sale has to be transferred at one particular moment. They include complex equipment leases, construction contracts, contracts for services, and agency contracts. The present rule also covers contracts of sale where the object of the sale has to be delivered in instalments. Performances under such contracts can have been made over a long period of time before the contract is terminated, and it may thus be inconvenient to unravel these performances. Also, of course, termination is a remedy with merely prospective effect. Restitution can, therefore, only be claimed in respect of the period after termination.

Illustration 1

A contracts to service B's computer hardware and software for a period of five years. After three years of regular service A is obliged by illness to discontinue the services and the contract is terminated. B, who has paid A for the fourth year, can claim return of the advance payment for that year but not for the money paid for the three years of regular service.

This rule only applies if the contract is divisible.

Illustration 2

A undertakes to paint ten pictures depicting a historical event for B's festival hall. After delivering and having been paid for five paintings, A abandons the work. B can claim return of the advances paid to A and must return the five paintings to A.

(For further examples, see Appendix B)

I. Restitution following avoidance

ARTICLE 3

(Restitution following avoidance)

(1) On avoidance either party may claim restitution of whatever it has supplied under the contract, or the part of it avoided, provided that such party concurrently makes restitution of whatever it has received under the contract, or the part of it avoided.

(2) If restitution in kind is not possible or appropriate, an allowance has to be made in money whenever reasonable.

(3) The recipient of the performance does not have to make an allowance in money if the impossibility to make restitution in kind is attributable to the other party.

(4) Compensation may be claimed for the necessary expenses linked to the performance received. Compensation for other expenses linked to the performance received may be claimed as far as the other party is enriched by them.

COMMENT

1. Entitlement of parties to restitution on avoidance

According to para. (1) of the present article either party may claim restitution of what it has supplied under the contract or the part of it avoided. The only condition for such restitution is that each party makes restitution of whatever it has received under the contract or the part of it avoided.

Illustration 1

A sells and transfers a painting to B for 2,000,000 Euro. He has made B believe that it is a Constable whereas in reality it is a cheap copy. After he has discovered that B avoids

the contract. B can claim back the purchase price of 2,000,000 Euro while himself having to return the painting that he has received.

2. Restitution not possible or appropriate

Restitution must normally be in kind. There are, however, instances where instead of restitution in kind, an allowance in money has to be made. This is the case first of all where restitution in kind is not possible. The allowance will normally amount to the value of the performance.

Illustration 2

A commissions B to paint his house. B had induced A to conclude the contract by claiming that the price demanded by him is much cheaper than that of a competitor. In fact, it is the other way round. After having discovered the fraud, A avoids the contract. He can claim back the price demanded by B while himself being under a duty to pay for the value of having had his house painted.

An allowance is further envisaged by para. (2) of this article whenever restitution in kind would not be appropriate. This is so in particular when returning the performance in kind would cause unreasonable effort or expense.

Illustration 3

A has painted a fresco which has been mounted on a wall in B's house. Subsequently it turns out that A is not the famous painter who has painted a similar fresco that B has seen in a museum. B avoids the contract. He can claim back the price that he has paid to A. A in turn cannot claim back the fresco but only an allowance representing its value.

The purpose of specifying that an allowance has to be made in money "whenever reasonable" is to make it clear that an allowance only has to be made if, and to the extent that, the performance received has conferred a benefit on the party claiming restitution.

Illustration 4

A has undertaken to decorate a bedroom suite for B. After he has completed about half of the decorations B discovers that A is not the well-known decorator who he has held

himself out to be. B avoids the contract. Since the decorations so far made cannot be returned, and have no value for B, A is not entitled to any allowance for the work done.

3. The allocation of risk

Obviously, the rule contained in para. (2) implies an allocation of risk: it imposes a liability on the recipient of the performance to make good the value of that performance if it is unable to make restitution in kind. The rule in para. (2) applies no matter whether the recipient has been responsible for the deterioration or destruction of what it had received. Such allocation of the risk of deterioration or destruction is justified, in particular, because there should be correspondence between risk and control. Of course, there is no liability to make good the value where the deterioration or destruction is attributable to the other party: either because it has been due to the other party's fault, or due to a defect inherent in the performance.

Illustration 5

A fraudulently induces B to buy a Jaguar car that is defective. As a result of the defect the car is destroyed. B can rescind the contract on the ground of fraud. He can claim back the purchase price but does not have to make good the value of the car.

The recipient's liability to make good the value of the performance received is not excluded in cases where the deterioration or destruction would also have occurred had the performance not been rendered.

Illustration 6

A factory building has been sold and transferred to the purchaser; it is subsequently destroyed by a violent thunderstorm. The purchaser avoids the contract because of a relevant mistake. He can reclaim the purchase price but, at the same time, has to make an allowance for the value of the factory.

Nor is the recipient's liability to make good the value of the performance excluded in cases where he has been led to conclude the contract by the other party's fraudulent representation.

Illustration 7

The antique dealer A has fraudulently induced the garage owner B to swap A's ramshackle car against a valuable ancient Greek vase belonging to B. The car is

accidentally destroyed while standing in B's garage. If B rescinds the contract, he can claim the vase back but has to make good the value of the car.

Art. 3.8 PICC (fraud) merely wants to make sure that B is not bound by the contract that he has entered into: that is why a right of avoidance is given to him; and to make sure that B is not saddled with the consequences of a bad bargain that A has induced him to make: that is why there has to be restitution. But the rule on fraud does not intend to protect B against accidents. It is not the substitute for an insurance policy.

4. Compensation for expenses linked to the performance

The recipient of a performance may have incurred expenses for the maintenance and improvement of the object of the performance. It appears to be reasonable to allow him to claim compensation for such expenses in cases where the contract is unwound and where, therefore, the parties have to return what they have received.

Illustration 8

A has sold and delivered a horse to B. After some time B realizes that A has fraudulently concealed from him the true parentage of that horse. B avoids the contract. He can claim compensation for the costs that he has incurred in feeding the horse.

This rule always applies with regard to necessary expenses (as in illustration 8). Compensation for other expenses linked to the performance, i.e. those which are merely useful, or constitute a luxury, may only be claimed as far as they actually benefit the other party.

Illustration 9

A, a farmer, has sold and delivered a horse to B, the owner of a riding stable. After some time B realizes that A has fraudulently induced him to believe that the horse has been fathered by the famous championship horse Deister. He rescinds the contract. He cannot claim compensation for the costs that he has incurred to train the horse for steeple-chase competitions.

Appendix A

Benefits

I. An issue to which considerable discussion was devoted in Rome is whether the duty to return what has been performed should include the benefits derived from such performance. The Unidroit Principles, so far, are silent on the matter. The position paper proposed a rule relating to benefits (“... any performance received under it, as well as the benefits derived from such performance, have to be returned”). Art. 84 CISG takes the same view: the seller has to pay interest on the price that he is bound to refund, and the buyer must account to the seller “for all benefits which he has derived from the goods or part of them”. This essentially corresponds to III.-3:511 (5) DCFR: “The obligation to return a benefit extends to any natural or legal fruits received from the benefit”. (The term benefit is here used to describe the money, or the object, or the services, etc. that the one party has received as a result of the other’s performance.) In Rome, there was some support for a rule along these lines but also strong opposition.

Before the matter could be taken further, I was asked to provide examples so that the Working Group might be able better to assess the relevance of the rule, and to discuss possible limitations or exceptions. These examples are provided at the end of this appendix. They deal with what civilian lawyers refer to as natural fruits (a), indirect fruits (or civil fruits) (b), legal fruits (c), interest (d), and value for the use of a thing (e) - (g). The solutions take their cue from the way in which Art. 84 CISG is interpreted (with the exception that legal fruits = proceeds of a right are not, of course, covered by Art. 84 CISG because CISG only deals with the sale of goods). Natural and indirect fruits have to be handed over, as far as they have actually been derived (though for indirect fruits the actual remuneration received is said to be relevant only as long as it remains within the normal commercial limits: Schlechtriem/Schwenzer/Hornung Art. 84, n. 18). Legal fruits should be dealt with in the same way as natural fruits. Concerning interest, it will have to be decided whether it is payable only as far as it has actually been received, or whether a certain rate of interest is to be due, in any event, where a sum of money has to be returned. In the latter case one might have to have a special rule concerning interest; see Art. 84 CISG. Benefits of use: the mere possibility of being able to use an object has a value. That value, measured objectively, i.e. by reference to the market rate, has to be paid, after termination, by the purchaser to the seller.

This does not include a duty to hand over any income derived from the recipient having had the car at his disposal. It will have to be determined whether an attempt should be made to provide a detailed regulation along the lines suggested above or whether the matter should be dealt with by a single, comprehensive formula which would then have to be elucidated in the comments; the latter course would be in tune with CISG and the DCFR. The question then is, however, whether the term “benefits derived from such performance” captures adequately what is meant.

Closely associated with the former point is the question whether there should be a rule according to which there should be a duty to pay compensation for value for the benefits that a party fails to derive from the performance in accordance with ordinary business practice. The problem is not dealt with in Art. 84 CISG and is, consequently, disputed. In the position paper it was suggested to include such rule; see rule (4) as well as the position paper sub 16. The majority in Rome came out against this rule.

It was suggested in Rome by Paul Crépeau that the benefit rule should be amended in line with Art. 1704 of the Civil Code of Québec: the benefits of the property received should remain with the recipient if he was in good faith, i.e. if he did not know the reason for the contract being terminated. There was some discussion about this proposed amendment but no decision was reached. The Crépeau amendment would constitute a deviation from both CISG and the DCFR. Also, the Crépeau amendment would, in a way, turn the benefit rule on its head. In a sale situation it is often the purchaser who terminates the contract because of non-conformity. He is, however, always in good faith, for otherwise he would not have been able to terminate the contract (see Art. 35 (3) CISG); that point was made in Rome by Roy Goode. Moreover, the seller also, very often, will be unaware of the non-conformity; thus, he is also in good faith and would, according to the Crépeau-rule, not have to pay any interest on the purchase price either. If the contract is terminated for other reasons both parties are also usually in good faith until the moment when the terminating event occurs. Acceptance of the Crépeau amendment would, therefore, lead to just about all cases listed in Appendix C having to be decided differently. The general rule would be: benefits do not have to be returned unless the recipient has not been in good faith. In other words: the duty to hand over the benefits is seen as a kind of penalty which would be unfair on someone who is in good faith. But I do not think that this is the proper way of conceptualizing the benefit-rule. If, in case scenario a) (infra) F has to return not only the sheep but also the lambs, he is not being penalized. He just has to return what he has received. And he has received both the sheep and

the product of the sheep. On the contrary: one would have to ask what it is that should entitle F to keep the lambs even though he has to return the sheep. Certainly not the contract, for that is being “unwound”. It can no longer serve as a justification for any transfer of value to F.

It is not, perhaps, without significance that the Crépeau-rule was misunderstood by a number of participants in the debate. Thus, it was suggested that what was at stake was the prohibition of inconsistent behaviour (see Art. 1.8): a party may not ask for restitution of the benefits if he knows that the other party had reasonably acted in reliance on the validity of the contract. But that is not what the Crépeau-rule intends or implies. Nor indeed is there anything inconsistent in claiming back something which the recipient has received in good faith, i.e. not knowing that he might have to hand it over to the person now claiming that object. The only possible worry one can have concerning a benefits rule such as the one suggested in the position paper, in Art. 84 CISG, or in III.-3:511 (5) DCFR is that the recipient may have made investments in producing or maintaining the fruits: in example a) the costs for a vet who has to attend the sheep while giving birth, the costs for nourishing the lambs, etc. That, however, is taken care of by the rule on compensation for expenses. Under III. of the present appendix you will find a memorandum which Paul Crépeau kindly sent me in February and in which he states the case in favour of his proposed rule.

I have, in the meantime, have had some consultations with various members of the Working Group on whether or not there should be a rule on benefits. On the basis of these consultations it appeared to me that there would continue to be strong opposition to a rule on benefits: it would, so it is said, engender litigation and would unduly complicate matters. Joachim Bonell kindly undertook to ask Christine Chappuis to obtain some input from businesses and practicing lawyers on this point. For the time being, therefore, I have not included any benefit rule in the text of the draft articles. I continue to think that a rule is needed but do not unduly want to press the point.

II. Here are the examples I was asked to supply:

a) F has bought ten sheep guaranteed to be pregnant by a particular type of ram. When the lambs are born it is clear that they are of another type. F terminates for fundamental non-performance, and reclaims the price. F must return both the sheep and the lambs (example taken from CFR, Official Comments to III.-3:511, H).

b) B purchases from A a house which he then lets on lease to a third person. After termination of the contract between A and B, B has to retransfer the house plus the rent that he has received.

c) D purchases from C the licence to print and distribute a book. After six months C terminates for breach of contract. D has to hand over the income he has made by exploiting the licence.

d) H sells a car to J. The car is delivered and the purchase price is paid. Six months later it turns out that the car is defective. J terminates the contract. As a result, H has to pay back the purchase price plus interest from the date on which the price was paid. Legal systems take a different view as to whether (i) interest only has to be paid if, and to the extent that, it has actually been earned (as a result of the purchase price having been paid into the recipient's bank account), (ii) interest has to be paid always, no matter whether the recipient has actually earned interest or not (e.g. A has to pay the customary interest rate at the seller's place of business; that is the solution according to CISG), or (iii) interest has to be paid to the extent that the purchaser has received interest or has failed to receive it in accordance with ordinary business practice.

e) The facts are as under d) but this time we are looking at J's duty to return the car. It includes a compensation for the value of having been able to use the car every day for commuting between his home and his place of work.

f) The facts are as under d) and e), but J has used the car as a taxi. It is generally agreed that J does not have to hand over the profits he has made. These profits have been made by means of using the car; they are not the equivalent of the mere fact of having a car at one's disposal.

g) A Limousine Company buys ten new cars. One of the cars blows up after two months because of a defect in the petrol tank which affects all ten cars. The Limousine Company terminates the contract for that reason. We are only concerned here with the nine "surviving" cars. These cars will have to be returned plus the value for the use during two months. The Limousine Company will not have to hand over the income derived from renting out the nine cars during those two months (example kindly supplied by Professor Chappuis).

III. Professor Crépeau's memorandum

Our positions differ as far as Benefits are concerned.

Your position, as I understand it, is based on the logic of the maxim: *Accessorium sequitur principale*. As is indicated in the Summary Records (para. 270, p. 34):

“The rationale of the rule [1] was that if an object is to be returned, it has been retained without good cause and consequently that also all the benefits deriving from that object have to be returned”.

In my view of Retroactivity, a distinction ought to be drawn, in so far as restitution is concerned, between the return of the *object* (property or prestation) itself and that of the *Benefits* derived from it.

The reason is that, in the case of a bilateral contract, such as in your illustration, a sale of a car, the purchaser, under normal circumstances, becomes the owner of the object of the contract and, in that capacity, is in a position to make use of it as he sees fit within the limits provided by law. He may reap benefits and must bear losses from it; he may alienate or even destroy it. Now, if because of Retroactivity resulting from Avoidance or Termination, Restitution must occur, one must, first of all, remember that our present rules provide a restrictive content to the concept of Restitution. Art. 3.17 P.I.C.C. provides for the “... restitution of *whatever it* [either party] *has supplied* [or] *has received* ...” Art. 7.3.6 P.I.C.C, in the case of termination, provides identical terminology¹.

Clearly, we are here only dealing with the “*whatever*” or the *property* or *prestation* referred to in the contract.

As far as Benefits or Revenues, such as natural or civil fruits, which may or may not have been produced by the object of the contract, it would seem to me that, in case of retroactivity, the most reasonable and fair regime should be based on the “Good Faith” principle, that is, the

¹ See also Art. 1699 C.C.Q.:

Restitution of prestations takes place where a person is bound by law to return to another person the *property he has received*, either unlawfully[†] or by error, or under a juridical act which is subsequently annulled retroactively or under which the obligations become impossible to perform by reason of superior force. ...

La restitution des prestations a lieu chaque fois qu'une personne est, en vertu de la loi, tenue de rendre à une autre des *biens qu'elle a reçus* sans droit[†] ou par erreur, ou encore en vertu d'un acte juridique qui est subséquemment anéanti de façon rétroactive ou dont les obligations deviennent impossibles à exécuter en raison d'une force majeure.

knowledge or lack of knowledge of the facts leading to the avoidance or termination of the contract.

In the case you have given of the sale of a car, if the purchaser is totally unaware of the facts which later allow him to seek the avoidance of the contract, he has all along acted as a bona fide purchaser of the car and should in all fairness be allowed to rely on that status. It would, therefore, seem to me quite unjust to impose upon him the restitution of the benefits derived from the use of the car as a taxi driver.

The “Good faith” doctrine in relation to possession is well known in the civilian tradition². It seems to me to be still³ an appropriate regime based on equity and fairness. It has been applied in the New Quebec Civil Code Unitary Regime on Restitution (art. 1699 - 1707 C.C.Q.)⁴ in dealing with several effects of retroactivity such as

- total loss or alienation of property subject to restitution (art. 1701 C.C.Q.)
- partial loss (art. 1702 C.C.Q.)
- expenses incurred (art. 1703 C.C.Q.)
- *fruits and revenues* (art. 1704 C.C.Q.)
- costs of restitution (art. 1705 C.C.Q.)
- protected persons (art. 1706 C.C.Q.)
- third party rights (art. 1707 C.C.Q.)

Should a unitary regime be adopted by our Group, some such rules on problems which have not yet been addressed might be considered. The Catala Report might also be considered.

² See Art. 549, 550 C.N.:

549 Le simple possesseur ne fait les fruits siens que dans le cas où il possède de bonne foi. Dans le cas contraire, il est tenu de restituer les produits avec la chose au propriétaire qui la revendique ; si lesdits produits ne se retrouvent pas en nature, leur valeur est estimée à la date du remboursement.

550 Le possesseur est de bonne foi quand il possède comme propriétaire, en vertu d’un titre translatif de propriété dont il ignore les vices.

Il cesse d’être de bonne foi du moment où ces vices lui sont connus.

See also art. 549, 550 C.C. Belgium; art. 990, 993 BGB (1992, Goren Translation; we are expecting the new BGB LTS English Translation in February); art. 938, 940 C.C, Switzerland; art. 1147-1148 C.C. Italy; art. 3.118 et s. C.C. Netherland; art. 486-487 C.C. Louisiana; art. 2422 et s. C.C. Argentina; art. 716-718 C.C. Columbia; art. 810 C.C. Mexico; art. 931, 932 C.C. Québec. You are, however, most probably aware of the fact that the Catala *Avant-Projet de réforme du droit des obligations*, 2005, suggests adopting a different regime - similar to your Rule 1 - based on an objective character of restitutions without regard to the good or bad faith of the parties (Art. 1164-2). The argument, which I do not find very convincing, has been inspired by C. Guelfucci-Thibierge’s doctoral thesis: *Nullité, restitutions et responsabilité*, Paris, L.G.D.J., 1992, n° 802, p. 459-460. See, in the Catala Report, the presentation of the argument by Y.-M. Serinet, *Restitution après anéantissement du contrat*, 43, at p. 48.

³ http://www.henricapitant.org/article.php3?id_article=47

⁴ See in Annex, *infra*, p. 2.

Illustrations

I. A, through fraudulent misrepresentations (art. 3.8 P.I.C.C), induces B to buy a second hand limousine for \$50,000, which he uses as a taxi on special occasions. B, the innocent purchaser, discovers the fraud and avoids the contract.

B

- must make restitution in kind of the limousine;
- may claim restitution of the purchase price;
- should be able to keep the revenues derived from the use of the car.

II. A taking unfair advantage of B's inexperience and lack of bargaining skill (art. 3.10 P.I.C.C.) buys, at an excessively low price, a piece of land on which he grows vegetables and perennials and sells them on various markets. B, the innocent seller, avoids the contract.

B

- must return the purchase price.

A the buyer

- must return the land
- ought to return the crops, the fruits and the proceeds of the sales.

In the context of the termination of a contract, the "Good faith" regime would apply equally, under article 7.3.6 P.I.C.C, but, of course, taking into account the case envisaged in the second paragraph (performance extending over a period of time), whereby Restitution would only operate "for the period after termination has taken place".

Appendix B

Further illustrations concerning the operation of restitution following termination of contracts to be performed over a period of time

- a) A leases equipment to B for three years at a rental of 10,000 Euro a month. B pays punctually for the first two months but then fails to make any further payments despite repeated requests by A. After the lapse of five months A terminates the lease. A is entitled to retain the 20,000 Euro already received (Art. 2) and to recover the 30,000 Euro accrued due (on the basis of the contract of lease which is terminated only *pro futuro*), together with damages for the present value of the future rentals (Art. 7.3.5 (2) PICC).
- b) O engages company C to build a factory for the sum of 20 million Euro over a period of two years. Payment is to be made in stages against architects' certificates stating the value of the work carried out for the stage in question. Architects' certificates are issued during the first 12 months of the contract for a total of 8 million Euro, of which O has paid 7 million Euro. C then stops work because it has been offered a more lucrative contract elsewhere, and O terminates his contract with C. O is entitled to retain the benefit of the work performed so far (Art. 2), to have it completed by another contractor (that follows from the fact that the contract with C has been terminated and that O is therefore free to obtain the services of another contractor) and to recover any additional costs thereby incurred, together with damages for any delay (Art. 7.4.1 in conjunction with Art. 7.3.5 (2) PICC). C is entitled to retain the 7 million Euro it has received (Art. 2) and to be paid the 1 million Euro it is still owed (this is based on the original contract which has only been terminated *pro futuro*).
- c) H, a hospital, engages C to carry out cleaning services for the hospital, the contract to run for three years. After a year C informs H that it cannot continue with the cleaning services unless the price is doubled. H refuses to agree and C ceases to provide the service. On terminating the contract H can recover damages for any additional expense it incurs in hiring another cleaning firm (Art. 7.4.1 in conjunction with Art. 7.3.5 (2) PICC), while C is entitled to retain the payments it has received for services already provided (Art. 2).

Appendix C

DRAFT COMMON FRAME OF REFERENCE

Subsection 4: Restitution

III.-3:511: Restitution of benefits received by performance

(1) On termination under this Section a party (the recipient) who has received any benefit by the other's performance of obligations under the contract is obliged to return it. Where both parties have obligations to return, the obligations are reciprocal.

(2) If the performance was a payment of money, the amount received is to be repaid.

(3) To the extent that the benefit (not being money) is transferable, it is to be returned by transferring it. However, if a transfer would cause unreasonable effort or expense, the benefit may be returned by paying its value.

(4) To the extent that the benefit is not transferable it is to be returned by paying its value in accordance with III.-3:513(Payment of value of benefit).

(5) The obligation to return a benefit extends to any natural or legal fruits received from the benefit.

III.-3:512: When restitution not required

(1) Restitution is not required where the performance was due in separate parts or was otherwise divisible and what was received by each party resulted from due performance of a part for which counter-performance was duly made.

(2) Paragraph (1) does not, however, apply if what was received by the terminating party was properly rejected under III. -3:510 (Property reduced in value) or if the value of a non-transferable benefit received by the terminating party has been eliminated or fundamentally reduced as a result of the other party's non-performance.

III. - 3:513: Payment of value of benefit

(1) The recipient is obliged to:

- (a) pay the value (at the time of performance) of a benefit which is not transferable or which ceases to be transferable before the time when it is to be returned; and
- (b) pay recompense for any reduction in the value of a returnable benefit as a result of a change in the condition of the benefit between the time of receipt and the time when it is to be returned.

(2) Where there was an agreed price the value of the benefit is that proportion of the price which the value of the actual performance bears to the value of the promised performance. Where no price was agreed the value of the benefit is the sum of money which a willing and capable provider and a willing and capable recipient, knowing of any non-conformity, would lawfully have agreed.

(3) The recipient's liability to pay the value of a benefit is reduced to the extent that as a result of a non-performance of an obligation owed by the other party to the recipient:

- (a) the benefit cannot be returned in essentially the same condition as when it was received: or
- (b) the recipient is compelled without compensation either to dispose of it or to sustain a disadvantage in order to preserve it.

(4) The recipient's liability to pay the value of a benefit is likewise reduced to the extent that it cannot be returned in the same condition as when it was received as a result of conduct of the recipient in the reasonable, but mistaken, belief that there was no non-conformity.

111.-3:514: Use and improvements

(1) The recipient is obliged to pay a reasonable amount for any use which the recipient makes of the benefit except in so far as the recipient is liable under III. - 3:513 (Payment of value of benefit) paragraph (1) in respect of that use.

(2) A recipient who has improved a benefit which the recipient is obliged under this Section to return has a right to payment of the value of improvements if the other party can readily obtain that value by dealing with the benefit unless:

- (a) the improvement was a non-performance of an obligation owed by the recipient to the other party; or
- (b) the recipient made the improvement when the recipient knew or could reasonably be expected to know that the benefit would have to be returned.

111.-3:515: Liabilities arising after time when return due

(1) The recipient is obliged to:

- (a) pay the value (at the time of performance) of a benefit which ceases to be transferable after the time when its return was due: and
- (b) pay recompense for any reduction in the value of a returnable benefit as a result of a change in the condition of the benefit after the time when its return was due.

(2) If the benefit is disposed of after the time when return was due, the value to be paid is the value of any proceeds, if this is greater.

(3) Other liabilities arising from non-performance of an obligation to return a benefit are unaffected.