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Principles of International Commercial Contracts
Working Group on Long-Term Contracts

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Contracts with open terms [*]

(Draft prepared by Sir Vivian Ramsey)

[*] Cf. Study L – Doc. 127, Issue (b).

ARTICLE 2.1.14

(Contract with terms deliberately left open)

(1) If the parties intend to conclude a contract, the fact that they intentionally leave a term to be agreed upon in further negotiations or to be determined by one of the parties or by a third person does not prevent a contract from coming into existence.

(2) The existence of the contract is not affected by the fact that subsequently

(a) the parties reach no agreement on the term; ~~or~~

(b) the party who is to determine the term does not do so; or

(c) the third person does not determine the term,

provided that there is an alternative means of rendering the term definite that is reasonable in the circumstances, having regard to the intention of the parties.

COMMENT

1. Contract with terms deliberately left open

A contract may be silent on one or more issues because the parties simply did not think of them during the negotiations. Provided that the parties have agreed on the terms essential to the type of transaction concerned, a contract will nonetheless have been concluded and the missing terms will be supplied on the basis of Articles 4.8 or 5.1.2 (see Comment 1 on Article 2.1.2). Quite different is the case dealt with in this Article: here the parties intentionally leave open one or more terms because they are unable or unwilling to determine them at the time of the conclusion of the contract, and refer for their determination to an agreement to be made by them at a later stage, or to a determination to be made by one of them or by a third person.

This latter situation, which is especially frequent in, although not confined to, long-term ~~transactions~~contracts, gives rise in essence to two problems: first, whether the fact that the parties have intentionally left terms open prevents a contract from coming into existence and second, if this is not the case, what will happen to the contract if the parties subsequently fail to reach agreement or if the party or third person ~~fails~~who is to make the determination does not do so.

2. Open terms not in themselves an impediment to valid conclusion of contract

Paragraph (1) states that if the parties intended to conclude a contract, the fact that they have intentionally left a term to be agreed upon in further negotiations or to be determined by one of the parties or by a third person does not prevent a contract from coming into existence.

In cases where it is not expressly stated, the parties' intention to conclude a contract notwithstanding the terms left open may be inferred from other circumstances, such as the non-essential character of the terms in question, the degree of definiteness of the agreement as a whole, the fact that the open terms relate to items which by their very nature can be determined only at a later stage, the fact that the agreement has already been partially executed, etc.

Illustration

1. A, a shipping line, enters into a detailed agreement with B, a terminal operator, for the use of B's container terminal. The agreement fixes the minimum volume of containers to be discharged or loaded annually and the fees payable, while the fees for additional containers are left to be determined if and when the minimum volume is reached. Two months later A learns that B's competitor would offer better conditions and refuses to perform, claiming that the

agreement with B never resulted in a binding contract because the question of the fees had not been settled. A is liable for non-performance because the detailed character of the agreement as well as the fact that both A and B began performance immediately indicate clearly that their intention was to enter into a binding agreement.

3. Failure of mechanism provided for by parties for determination of open terms

If the parties are unable to reach agreement on the open terms or if the party or the third person who is to make the determination does not ~~determine them~~do so, the question arises as to whether or not the contract comes to an end. According to paragraph (2) of this Article the existence of the contract is not affected "provided that there is an alternative means of rendering the term definite that is reasonable in the circumstances, having regard to the intention of the parties". ~~A first alternative exists whenever the missing term can be supplied on the basis of Article 5.1.2; if~~

The alternative means of supplying the missing term will generally be application of the "gap-filling" provisions in Section 1 of Chapter 5 and Section 1 of Chapter 6, for example, by determining the price under Article 5.1.7(1) or by fixing the time for performance under Article 6.1.1 where those provisions can appropriately supply the relevant term. There may be situations, particularly in respect of long-term contracts, where those provisions may not be appropriate even where they cover the subject matter of the missing term. In such situations, the term will be supplied by Article 4.8 or Article 5.1.2.

Where the parties have deferred the determination of the missing term to a third person to be nominated by ~~an instance~~a named institution or person such as the President of ~~the~~a Tribunal, or ~~of the~~a Chamber of Commerce, etc., ~~it may also consist in the appointment of~~if the nominated third person does not determine the term, a new third person~~.~~ may be nominated. The cases in which ~~a given contract may be upheld by resorting~~it will be necessary to ~~such alternative means will, however,~~nominate a new third person are likely to be quite rare in practice. Few problems should arise as long as the term to be implemented is of minor importance. If, on the other hand, the term in question is essential to the type of transaction concerned, there must be clear evidence of the intention of the parties to uphold the contract: among the factors to be taken into account in this connection are whether the term in question relates to items which by their very nature can be determined only at a later stage, whether the agreement has already been partially executed, etc.

Illustration

2. The facts are the same as in Illustration 1, except that when the minimum volume of containers to be loaded or unloaded is reached the parties fail to agree on the fees payable in respect of the additional containers. A stops performing, claiming that the contract has come to an end. A is liable for non-performance, since the fact that the parties have started performing without making future agreement on the missing term a condition for the continuation of their business relationship is sufficient evidence of their intention to uphold the contract even in the absence of such agreement. The fees for the additional containers will then generally be determined according to the criteria laid down in Article 5.1.7.

4. Open terms in long-term contracts

As stated above and particularly in the case of long-term contracts, the parties may leave a term to be agreed when that term applies only to obligations at a later stage of the contract. For example, the parties may agree a price which is only to apply during the first year of the contract, leaving open the price to apply for the second or subsequent years. Equally, the parties may leave open the date for delivery because, for instance, the delivery of a piece of machinery may depend on the completion of a building before it is delivered. In such circumstances the term as to price

may not be appropriately supplied by reference to Article 5.1.7 nor may time of performance be appropriately supplied by reference to Article 6.1.1. The appropriate term would then be supplied by Article 4.8 or Article 5.1.2.

Illustrations

3. The facts are the same as in Illustration 1, except that the fees payable in respect of the additional containers are fixed for the first year but there is no provision as to the fees to be charged for the second or subsequent years. In such a case it may not be appropriate to determine the fees in accordance with Article 5.1.7 by reference to a price "at the time of the conclusion of the contract". Instead, it may be appropriate to fix a fee by reference to the date at the end of the first year. A term to that effect could be supplied under Article 4.8 or Article 5.1.2.

4. X is a power company and has decided to construct a new power station. X is purchasing a generator from Y. The generator will be installed directly onto the foundations in the generator building at the power station after that building has been completed. A generator can be delivered no earlier than 3 years after it is ordered. X has not yet entered into a construction contract for the power station but the generator building will only take 6 months to complete once the construction contract starts. X places a contract now for the generator so that it will be ready in time but cannot yet fix a time for delivery. The parties leave the date of delivery as "to be agreed". If they do not agree a date for delivery, it may not be appropriate to determine the time for delivery as being "within a reasonable time after conclusion of the contract" between X and Y, in accordance with the provisions of Article 6.1.1. It may be appropriate to fix a term by reference to the completion of the generator building. A term to that effect could be supplied under Article 4.8 or Article 5.1.2.

ARTICLE 4.8
(Supplying an omitted term)

(1) Where the parties to a contract have not agreed with respect to a term which is important for a determination of their rights and duties, a term which is appropriate in the circumstances shall be supplied.

(2) In determining what is an appropriate term regard shall be had, among other factors, to

(a) the intention of the parties;

(b) the nature and purpose of the contract;

(c) good faith and fair dealing;

(d) reasonableness.

COMMENT

1. Supplying of omitted terms and interpretation

Articles 4.1 to 4.7 deal with the interpretation of contracts in the strict sense, i.e. with the determination of the meaning which should be given to contract terms which are unclear. This Article addresses a different though related issue, namely that of the supplying of omitted terms. Omitted terms or gaps occur when, after the conclusion of the contract, a question arises which the parties have not regulated in their contract at all, either because they preferred not to deal with it or simply because they did not foresee it.

However, in other cases the parties may intentionally leave open terms, with the terms to be agreed upon in further negotiations or to be determined by one of the parties or by a third person. This will occur with particular frequency in long-term contracts. If the parties fail to agree or the party or third person fails to determine the term, Article 2.1.14 applies.

2. When omitted terms are to be supplied

In many cases of omitted terms or gaps in the contract the Principles will themselves provide a solution to the issue (see, for example, Articles 5.1.6 ~~(*Determination of quality of performance*),~~, 5.1.7 ~~(*Price determination*),~~, 6.1.1 ~~(*Time of performance*),~~, 6.1.4 ~~(*Order of performance*),~~, 6.1.6 ~~(*Place of performance*)~~ and 6.1.10 ~~(*Currency not expressed*). See also, in general, Article 5.1.2 on implied obligations).~~). However, even when there are such ~~suppletive, or "stop~~ "gap~~", rules of a general character~~ filling" solutions which may be generally applicable, they may not ~~be applicable~~apply in a given case, particularly in long-term contracts because they would not provide a solution appropriate in the circumstances in view of the expectations of the parties or the special nature of the contract. This Article then applies~~.~~ (but see also Article 5.1.2).

3. Criteria for the supplying of omitted terms

The terms supplied under this Article must be appropriate to the circumstances of the case~~.~~, particularly in relation to long-term contracts. In order to determine what is appropriate, regard is first of all to be had to the intention of the parties as inferred from, among other factors, the terms expressly stated in the contract, any preamble to the contract, prior negotiations or any conduct subsequent to the conclusion of the contract.

Illustration

1. The parties to a construction contract agree on a special interest rate to be paid by the purchaser in the event of delay in payment of the price. Before the beginning of the work, the parties decide to terminate the contract. When the constructor delays restitution of the advance payment the question arises of the applicable interest rate. In the absence of an express term in the contract dealing with this question, the circumstances may make it appropriate to apply the special interest rate agreed for delay in payment of the price by the purchaser also to delay in restitution by the constructor.

If the intention of the parties cannot be ascertained, the term to be supplied may be determined in accordance with the nature and purpose of the contract, and the principles of good faith and fair dealing and reasonableness.

Illustration

2. A distribution franchise agreement provides that the franchisee may not engage in any similar business for a year after the termination of the agreement. Although the agreement is silent on the territorial scope of this prohibition, it is, in view of the particular nature and purpose of the franchise agreement, appropriate that the prohibition be restricted to the territory where the franchisee had exploited the franchise.

ARTICLE 5.1.2

(Implied obligations)

Implied obligations stem from

(a) the nature and purpose of the contract;

(b) practices established between the parties and usages;

(c) good faith and fair dealing;

(d) reasonableness.

COMMENT

This Article describes the sources of implied obligations. Different reasons may account for the fact that they have not been expressly stated. The implied obligations may for example have been so obvious, given the nature or the purpose of the obligation, that the parties felt that the obligations "went without saying". Alternatively, they may already have been included in the practices established between the parties or prescribed by trade usages according to Article 1.9. Yet again, they may be a consequence of the principles of good faith and fair dealing and reasonableness in contractual relations.

Illustrations

1. A rents a full computer network to B and installs it. The contract says nothing as to A's possible obligation to give B at least some basic information concerning the operation of the system. This may however be considered to be an implied obligation since it is obvious, and necessary for the accomplishment of the purpose of such a contract, that the provider of sophisticated goods should supply the other party with a minimum of information (see Article 5.1.2(a)).

2. A broker who has negotiated a charterparty claims the commission due. Although the brokerage contract is silent as to the time when the commission is due, the usages of the sector can provide an implied term according to which the commission is due, for example, only when the hire is earned, or alternatively when the charterparty was signed, regardless of whether or not the hire will effectively be paid (see Article 5.1.2(b)).

3. A and B, who have entered into the negotiation of a co-operation agreement, conclude an agreement concerning a complex feasibility study, which will be most time-consuming for A. Long before the study is completed, B decides that it will not pursue the negotiation of the co-operation agreement. Even though nothing has been stipulated regarding such a situation, good faith requires B to notify A of its decision without delay (see Article 5.1.2(c)).

ARTICLE 5.1.7

(Price determination)

(1) Where a contract does not fix or make provision for determining the price, the parties are considered, in the absence of any indication to the contrary, to have made reference to the price generally charged at the time of the conclusion of the contract for such performance in comparable circumstances in the trade concerned or, if no such price is available, to a reasonable price.

(2) Where the price is to be determined by one party and that determination is manifestly unreasonable, a reasonable price shall be substituted notwithstanding any contract term to the contrary.

(3) Where the price is to be fixed by one party or a third person, and that party or third person ~~cannot or will~~does not do so, the price shall be a reasonable price.

(4) Where the price is to be fixed by reference to factors which do not exist or have ceased to exist or to be accessible, the nearest equivalent factor shall be treated as a substitute.

COMMENT

1. General rule governing price determination

A contract usually fixes the price to be paid, or makes provision for its determination. If however this is not the case, paragraph (1) of this Article presumes that the parties have made reference to the price generally charged at the time of the conclusion of the contract for such performance in comparable circumstances in the trade concerned. All these qualifications are of course significant. The provision also permits the rebuttal of the presumption if there is any indication to the contrary.

This Article is inspired by Article 55 CISG. The rule has the necessary flexibility to meet the needs of international trade.

It is true that in some cases the price usually charged on the market may not satisfy the reasonableness test which prevails elsewhere in this Article. Recourse would then have to be made to the general provision on good faith and fair dealing (see Article 1.7), or possibly to some of the provisions on mistake, fraud and gross disparity (see Chapter 3, Section 2).

Some international contracts relate to operations which are unique or at least very specific, in respect of which it is not possible to refer to the price charged for similar performance in comparable circumstances. According to paragraph (1) the parties are then deemed to have made reference to a reasonable price and the party in question will fix the price at a reasonable level, subject to the possible review by courts or arbitral tribunals.

Illustrations

1. A, a firm specialised in express mailing throughout the world, receives from B a parcel to be delivered as soon as possible from country X to country Y. Nothing is said as to the price. A should bill B with the price usually charged in the sector for such a service.

2. The next order which A receives from B is one to deliver another parcel as soon as possible to remote and not easily accessible country Z, where a team of explorers is in need of urgent supplies. Again, nothing is said as to price, but since no possible market comparison can be made A must act reasonably when fixing the price.

2. Determination of price by one party

In some cases the contract expressly provides that the price will be determined by one of the parties. This happens frequently in several sectors, for example the supply of services. The price cannot easily be determined in advance, and the performing party is in the best position to place a value on what it has done.

In those cases where the parties have made such a provision for determining the price, it will be enforced. To avoid possible abuses however, paragraph (2) enables judges or arbitrators to replace a manifestly unreasonable price by a reasonable one. This provision is mandatory.

If the party does not determine the price, paragraph (3) provides that the price, possibly determined by judges or arbitrators, shall be reasonable.

3. Determination of price by third person

A provision that the price will be determined by a third person can give rise to serious difficulty if that third person is unable to accomplish the mission (not being the expert he or she was thought to be) or ~~refuses to~~does not do so. Paragraph (3) provides that the price, possibly determined by judges or arbitrators, shall be reasonable. If the third person determines the price in circumstances that may involve fraud, threat or gross disparity~~ or threat~~, Article 3.2.8(2) may apply.

The parties are free to fix the standards or procedure with which the third person must comply in determining the price. The parties can challenge the determination if it does not comply with those standards or that procedure. The parties may also set out the grounds on which the determination of a price by a third person can be challenged, which may vary depending on the nature of the determination. As an example, if the agreed standard concerns an opinion as to "market price" the parties may agree that the price determined by an expert can be challenged on the basis that it is "manifestly unreasonable". In another case, if the standard concerns the ascertainment of a fact, such as "mid-point of an index", the parties may agree the price can be challenged if it is "erroneous".

4. Determination of price by reference to external factors

In some situations the price is to be fixed by reference to external factors, typically a published index, or quotations on a commodity exchange. In cases where the reference factor ceases to exist or to be accessible, paragraph (4) provides that the nearest equivalent factor shall be treated as a substitute.

Illustration

> 3. The price of a construction contract is linked to several indexes, including the "official index of charges in the construction sector", regularly published by the local Government. Several instalments of the price still have to be calculated when that index ceases to be published. The Construction Federation, a private trade association, decides however to start publishing a similar index to replace the former one and in these circumstances the new index will serve as a substitute.