The Unwinding of Failed Contracts in the UNIDROIT Principles 2010

Reinhard Zimmermann *

I. – DICHOTOMY OF RESTITUTION REGIMES

There can hardly be a country where as much has been written about the unwinding of failed contracts as Germany.¹ The attention devoted to the topic in that country is due to a number of factors. Chief among these is a characteristic bifurcation of remedies. If a contract is void, or has been avoided, the law of unjustified enrichment applies.² If it has been terminated, or if a consumer has exercised a right of withdrawal, a special winding-up regime has been put in place by the draftsmen of the German Civil Code (hereinafter: BGB) that is usually conceived to be of a contractual nature;³ in the case of withdrawal, it is subject to considerable modifications.⁴ And while the German law of unjustified enrichment (§§ 812 ff. BGB) is of a bewildering complexity,⁵ the rules constituting the contractual winding-up regime were widely regarded as one of the most unsatisfactory parts of the German law of obligations: bungled from the point of view of legal drafting, and highly questionable as far as legal policy is concerned.⁶ The “modernisation” of the German law of obligations in 2002 has not done much to remedy this

² §§ 812 ff. BGB.
³ §§ 346 ff. BGB.
⁴ § 357 BGB.
situation.\textsuperscript{7} In particular, it has perpetuated the traditional dichotomy of restitution regimes. Yet, it is widely recognised that the considerations on which the relevant rules have to be based are essentially the same in both cases. That is why, under the old law, the so-called \textit{Saldotheorie} was the subject of so much dispute and criticism;\textsuperscript{8} for by placing the risk of accidental destruction or deterioration on the purchaser (his claim for the retransfer of the purchase price has to be reduced to the extent that he himself is unable to render restitution), it ran counter to what used to be recognised with regard to termination under § 350 BGB. Even under the old law, therefore, efforts were made to adjust restitution in terms of §§ 812 ff. and §§ 946 ff. BGB to each other.\textsuperscript{9} The draftsmen of the new §§ 346 ff. BGB, too, were inspired by a desire to ensure a maximum degree of harmony between the two restitution regimes.\textsuperscript{10} None the less, even today, there is no perfect correspondence.\textsuperscript{11} Perfect correspondence can only be achieved by devising a uniform set of restitution rules covering all types of failure of contracts.

Given this somewhat unfortunate history, it is not perhaps surprising that comparative lawyers from Germany have been at the forefront of the battle for such a uniform regime.\textsuperscript{12} They have been joined by lawyers from other legal systems who are equally unhappy with the prevailing doctrinal distinctions.\textsuperscript{13} However, the establishment of a uniform regime appears to run counter to a deeply established pattern of thinking in German law (as well as in many other legal systems) according to which any transfer made without legal

\begin{itemize}
\item \textsuperscript{7} Reinhard Zimmermann, “Restitution after Termination for Breach of Contract: German Law after the Reform of 2002”, in: A. Burrows / Lord Rodger of Earlsferry (Eds.), \textit{Mapping the Law: Essays in Memory of Peter Birks} (2006), 323 ff.
\item \textsuperscript{8} Ph. Hellweg, \textit{Die Rückabwicklung gegenseitiger Verträge als einheitliches Problem} (2004), 106 ff.
\item \textsuperscript{9} C.-W. Canaris, “Die Gegenleistungskondiktion”, in: \textit{Festschrift für Werner Lorenz} (1991), 19 ff.
\item \textsuperscript{10} Bundesminister der Justiz (Ed.), \textit{Abschlussbericht der Kommission zur Überarbeitung des Schuldrechts} (1992), 185.
\item \textsuperscript{11} G. Wagner, “Mortuus Redhibetur im neuen Schuldrecht?”, in: \textit{Festschrift für Ulrich Huber} (2006), 592 ff.
\item \textsuperscript{13} E. Bargelli, \textit{Il sinallagma rovesciato} (2010); D. Visser, \textit{Unjustified Enrichment} (2008), 90 ff., 475 ff.
\end{itemize}
ground has to be restored under the rules of the law of unjustified enrichment. A performance made in order to discharge a contract that subsequently turns out to be invalid is thus governed by the same rules as a payment made to the wrong recipient. It is the same thinking pattern on which the regulation contained in the Draft Common Frame of Reference (hereinafter: DCFR) is based. For here we find, as in German law, one set of rules governing the “reversal of unjustified enrichment” 14 (which is applicable when performances have been made under a contract that is void or that has been avoided 15) and another, self-contained, one on “restitution” 16 (which applies in cases of termination and to which, once again as in German law, the provisions on withdrawal from consumer contracts refer 17).

The dichotomy both in German law and under the DCFR appears to be based on the idea that if “a juridical act or legal relationship” (to use the terminology of the DCFR)18 is void, it is “automatically of no effect from the beginning”.19 Avoidance leads to the same result because it is conceptualised as a “process” as a result of which “a juridical act or legal relationship” is rendered “retrospectively ineffective from the beginning”.20 A contract that has been avoided is therefore considered never to have existed.21 Termination, on the other hand, only operates prospectively. Of course, both parties are released from their obligations to effect performance, for upon notice of termination these obligations “come to an end”.22 None the less, the parties can still rely on arbitration clauses contained in the contract, or on any other contractual term that was intended to operate even after termination.23 Also, termination does not preclude a claim for damages for non-performance.24 To some extent, therefore, the contract continues to be

14 Arts. VII.-1:101 ff. DCFR.
15 Arts. II.-7:212, II.-7:303 DCFR.
16 Arts. III.-3:510 ff. DCFR.
17 Art. II.5:105 DCFR.
20 von Bar / Clive, supra note 19, 66.
21 von Bar / Clive, supra note 19, 524.
22 Art. III.-3:509 (1) DCFR.
23 Art. III.-3:509 (2) DCFR.
24 Art. III.-3:509 (3) DCFR.
effective. German law attempts to rationalise this by saying that the contract undergoes “a transformation”: it no longer aims at implementing what was contractually agreed upon; instead it aims at unwinding the relationship between the parties. 25 Like many other questions of a doctrinal nature, this has never been expressly stated in the BGB itself. It was a view that started to gain ground from the 1920s onwards. 26 Originally, it had been held that termination brings to an end, rather than merely transforms, the contract; 27 and it is remarkable that §§ 346 ff. BGB had therefore been regarded as modified enrichment rules. And, indeed, as far as contracts to be performed at one time (or “instantaneous contracts”) 28 are concerned, it cannot make any difference whether they have to be unwound because they “have come to an end”, have been transformed into an unwinding relationship of a contractual nature, or have been “of no effect from the beginning”: the parties should not be allowed to keep what they have received under the contract. That is the general principle 29 just about universally recognised, and it makes all the more pertinent the question why it should not be possible to devise, on that basis, a uniform restitution regime for the unwinding of failed contracts, no matter why the contract may have failed.


One should have thought that the drafting of model rules at a European or international level would have offered an opportunity for doing just that, particularly in view of the fact that, apart from the DCFR (and the Avant-projet d’un Code Européen des Contrats 30), those model rules focus on contract law and do not, therefore, provide a general unjustified enrichment regime. The United Nations Convention on Contracts for the International Sale of Goods (hereinafter: CISG) is of limited value for our purposes since its rules on the unwinding of contracts (Articles 81 ff.) are geared towards cases of termination.

27 THIER, supra note 26, §§ 346-359, n. 38.
(termed “avoidance” in the CISG) on the ground of breach of contract. Issues relating to the validity of the contract are excluded from the sphere of application of the CISG. Moreover, it is widely acknowledged that this is “one of the few areas where the Convention’s attempt to provide for a reasonable and modern solution has failed.” This is particularly apparent when one looks at the risk regime laid down in Article 82 CISG. Matters are different as far as the Principles of European Contract Law (hereinafter: PECL) are concerned. For these do not only deal with termination for breach of contract (termed “non-performance”) but also with avoidance, as well as with situations where a contract is “ineffective”. The problem, however, is that all three situations have separate provisions dealing with the restitution of performances that have been exchanged by the parties. Two of these provisions, or sets of provisions – those relating to contracts that have been avoided and that are ineffective because of illegality – are largely (but not completely) identical, whereas the third is based on an entirely different approach. This discrepancy can be explained by the fact that the PECL were prepared in three successive stages: Part I, containing what are now Articles 9:305 ff. PECL, appeared in 1995; Part II with Article 4:115 PECL was published in 2000; and Article 15:104 PECL is included in Part III from 2003. But it is hardly justifiable on rational grounds. In addition, in the one case the draftsmen of the PECL have not dealt with important issues such as the distribution of risk, while in the other case they have drawn their inspiration from a model devised in English law (restitution as a result of failure of consideration) that has, in the meantime, been subjected to rigorous criticism even in its country of origin.

More promising, therefore, as a starting point, were the rules contained in Articles 3.17 (2) and 7.3.6 UNIDROIT Principles of International Commercial Contracts (hereinafter: PICC) for avoidance and termination respectively.

31 Art. 4(a) CISG.
33 R. ZIMMERMANN, supra, note 12, 729 f.
34 Arts. 4:115, 9:305 ff., 15:104 PECL.
35 ZIMMERMANN, supra note 12, 720 ff.
These rules, drafted by one and the same Working Group,\textsuperscript{37} are substantially similar, as far as contracts to be performed at one time are concerned, and can thus be seen as a confirmation of the view that both situations essentially raise the same problems. So far, however, the PICC had not included rules on illegality. Illegality was one of the topics to be dealt with by the (third) UNIDROIT Working Group on the PICC established in 2005. Since the verdict of illegality can also lead to the return of the performances exchanged by the parties, the unwinding of failed contracts was bound to be on the Working Group’s agenda, too. The opportunity was used to look at the issue comprehensively and to provide for a consistent and systematically satisfactory overall regulation.\textsuperscript{38} This entailed that the two existing rules were to be scrutinised and amended, if necessary, or even to be absorbed into a chapter on the unwinding of failed contracts in general.\textsuperscript{39}

The discussions in the UNIDROIT Working Group (both in the Plenary Sessions in Rome and in the Drafting Committee in Hamburg) were initially dominated by the concern that general rules on the unwinding of failed contracts would not fit the termination of long-term contracts.\textsuperscript{40} It was therefore decided to discuss this practically very important type of situation separately.\textsuperscript{41} The general restitution rules eventually agreed upon are therefore geared towards contracts “to be performed at one time”.\textsuperscript{42} The paradigmatic example is an ordinary contract of sale where the object of the sale has to be transferred at one particular moment. Since the new rules on illegality, due to the change of \textit{rapporteur} midway, were only drafted, and agreed upon, at a comparatively late stage, discussions focused on avoidance and termination. This is still reflected in the systematic design of the rules on restitution in the UNIDROIT PICC 2010.\textsuperscript{43}

\begin{footnotesize}
\begin{enumerate}
\item They were already contained in the first edition of the PICC (1994).
\item The topic was “the one most widely supported among the experts consulted” for the new Working Group: UNIDROIT 2006 – Study L – Doc. 99, para. 11.
\item UNIDROIT 2006 – Study L – Misc. 26 (Secretariat Memorandum), paras. 34-83.
\item UNIDROIT 2007 – Study L – Misc. 27 (Summary Records of the 2\textsuperscript{nd} Session), paras. 236 ff.; UNIDROIT 2008 – Study L – WP. 18 (Minutes of the Drafting Committee (March 2008) relating to UNIDROIT 2008 – Study L – WP. 15), paras. 1 ff.
\item See below, VIII.
\item On what this means, see below, text to note 111 ff.
\item See below, IX.
\end{enumerate}
\end{footnotesize}
III. — RIGHT OF PARTIES TO RESTITUTION

According to Article 3.17(1) PICC 2004 (= Article 3.2.14 PICC 2010), avoidance takes effect retroactively. This means, as the Official Comment explains, that the contract is considered never to have existed.\textsuperscript{44} If, therefore, something has been performed under the contract, it has been performed without legal ground. It consequently has to be returned. That is why Article 3.2.15 PICC 2010 (in conformity with Article 3.17 PICC 2004) states that “[o]n avoidance either party may claim restitution of whatever it has supplied under the contract …”. The same must be true for termination (of a contract to be performed at one time). This is the case in spite of the fact that termination does not entail that the contract is treated as never having been made. If something has been transferred under the contract it has not been transferred without legal ground. But the legal ground justifying that transfer has now ceased to exist. Article 7.3.6(1) PICC 2010 therefore states that “[o]n termination … either party may claim restitution of whatever it has supplied under the contract ….” This is identical to the legal consequence envisaged in Article 3.2.15 PICC 2010 and, apart from one amendment of a purely editorial nature, it also conforms to Article 7.3.6(1) PICC 2004.

In many cases both parties will have supplied what they had promised under the contract. Here it would obviously be unjust to require only one of the parties to make restitution; or to require the one to make restitution before the other has done so. Both parties thus have to render restitution concurrently. Again, this applies both to avoidance and to termination, and therefore both Article 3.2.15(1) and Article 7.3.6(1) PICC 2010 continue: “… provided that such party concurrently makes restitution of whatever it has received under the contract.” This rule mirrors the way in which contractual obligations normally have to be performed, \textit{i.e.}, it is a reflection of the synallagmatic link between performance and counter-performance. As a result, either party may withhold performance of its restitutionary obligation, until the other party tenders performance of its restitutionary obligation.\textsuperscript{45}

There is one difference between Articles 3.2.15(1) and 7.3.6(1) PICC 2010 in that the former rule specifically refers to the situation that only part of the contract is avoided; restitution may then, of course, only be claimed with respect to that part of the contract. Article 7.3.6(1), on the other hand, does


\textsuperscript{45} See Arts. 7.1.3, 6.1.4 PICC (2010).
not refer to the situation that only part of the contract has been terminated. This difference results from the fact that while the PICC contain a specific provision on partial avoidance, they do not have a parallel rule on partial termination. Yet, just as a contract can be partly avoided, it can be partly terminated. It may be assumed that this is recognised by the PICC even if it is not specifically spelt out. As a result, under those circumstances, restitution may only be claimed of what has been received under the part of the contract that has been terminated. The difference between Articles 3.2.15(1) and 7.3.6(1) PICC 2010 is thus apparent rather than real. The reason why the latter rule was not amended to bring it in line with the former (as originally suggested) is that such amendment would have necessitated the drafting of a rule on partial termination corresponding to Article 3.2.13 PICC 2010.

IV. – RESTITUTION IN KIND

Restitution must normally be in kind. This principle, on which already the rules of Articles 3.17(2) and 7.3.6(1) PICC 2004 had been based, was not questioned in the deliberations of the Working Group. This is hardly surprising, since the alternative would be a return of values: the seller has to return the purchase price, and the purchaser the value of the object sold, with the result that just a claim for the balance will be brought. Effectively, therefore, the seller would be forced to accept one of the main consequences of a transaction that is to be unwound, i.e., that he has to part with the object sold. That would hardly appear to be right.

In certain situations, in the nature of things, restitution in kind is impossible. Thus, the object that has been sold may have been destroyed, or may have deteriorated. Another typical example are services that have been rendered. Both Articles 3.2.15(2) and 7.3.6(2) PICC 2010 state that under these circumstances “an allowance” has to be made in money. The term “allowance” had already been used in Articles 3.17(2) and 7.3.6(2) PICC 2004.

46 Art. 3.2.13 PICC (2010).
47 See P. Huber, in: S. Vogenauer / J. Kleinheisterkamp (Eds.), Commentary on the UNIDROIT Principles of International Commercial Contracts (2009), Art. 7.3.1, n. 95; cf. also Art. 51(1) CISG.
It has been criticised as being “rather obscure”. The French and German versions of both rules were taken to indicate that the value of what has been received has to be paid. Several members of the third Working Group shared this criticism. Thus, it was proposed to use the formula “compensation for value” instead of “allowance” and to state in the Official Comments that this was to be understood as the objective (or market) value rather than the value of the performance for the specific recipient. The majority of the Working Group, however, was in favour of retaining the term “allowance” which was said to be regularly used in the Uniform Commercial Code without having given rise to any problems. “Allowance”, as under U.S. law, should be taken to correspond to “value” either in a subjective or objective sense, depending on the circumstances. The drafting of the PICC thus reflects, in this as in many other cases, the idea, particularly forcefully expressed by the common lawyers within the Working Group, that “the more general and flexible the Principles the greater their utility.” None the less, the Official Comment now states that the allowance “will normally amount to the value of the performance received.” The flexibility inherent in Articles 3.2.15(2) and 7.3.6(2) PICC 2010 is further emphasised by the fact that an allowance has to be made in money “whenever reasonable”. This qualification had been contained in Article 7.3.6 PICC 2004 but not in Article 3.17(2) PICC 2004. The Working Group was unanimous in its desire to align the two provisions with each other by either deleting these words from the former or by adding them to the latter provision. The majority was in
favour of the latter alternative. The phrase “whenever reasonable” is supposed to make clear that an allowance only has to be made if, and to the extent that, the performance received constitutes a benefit for the recipient. This – together with Illustrations 4 to Article 3.2.15 and 6 to Article 7.3.6 – may be read to endorse the view that normally the “subjective” value of the performance is relevant.

Finally, Articles 3.2.15(2) and 7.3.6(2) PICC 2010 do not only cover the situation where restitution in kind is not possible but also where it is “not appropriate”. This is the case, particularly, where returning the performance in kind would cause unreasonable effort or expense (e.g., having to recover gold coins, or silver-plated rings, from the bottom of the sea).

V. – THE ALLOCATION OF RISK

1. The general rule

The rule contained in Articles 3.2.15(2) and 7.3.6(2) PICC 2010, of course, applies in cases where the impossibility to make restitution in kind is due to the recipient of the performance. But does it apply more generally, i.e., irrespective of whether the recipient was responsible for the deterioration or destruction of what he has received? This raises the question of risk allocation. The example usually given (concerning termination) is the defective car that has been bought and transferred to the purchaser, and that is subsequently destroyed or seriously damaged in a road accident for which neither the defect nor any fault on the part of the purchaser was responsible, or as a result of a violent thunderstorm while standing in the parking place of the purchaser’s factory. The problem of risk allocation raises two issues. How is the risk of destruction or deterioration to be allocated? And which device is to be used in order to effect whatever risk allocation is regarded as equitable?

The discussion of the first question has, for a long time, been overshadowed by the heritage of Roman law. Mortuus redhibetur is the famous tag

58 UNIDROIT 2007 – Study L – Misc 27 (Summary Records of the 2nd Session), paras. 317-320.
60 In the PICC (2004), the phrase “or appropriate” was only contained in Art. 7.3.6(1) and appears to have had a different rationale (UNIDROIT Principles of International Commercial Contracts 2004 (2004), 230). For comment, see UNIDROIT 2007 – Study L – Doc. 100 (Position Paper by the Rapporteur), para. 11; HUBER, supra note 47, Art. 7.3.6, No. 7.
extracted from the sources. It is a fiction with which the Roman jurists operated in cases of restitution under the actio redhibitoria. The situation has to be treated as if the purchaser had been able to return the (living) slave or animal. On that supposition, however, he was able to claim back his purchase price even though the slave or animal had in fact died and could not be returned. Effectively, therefore, the risk that the object of the sale has perished was placed on the shoulders of the seller. The question why the Roman lawyers employed this fiction, and with it the risk regime just mentioned, has not yet found a satisfactory answer. None the less, it was perpetuated, in a generalised form, in some of the modern civil codes.

Over the years, a number of criteria have been suggested in order to determine the question of risk allocation on a more rational basis. But some of these (the will of the parties, reliance) just hide the relevant normative considerations behind a convenient façade. Others (the passing of ownership) are insufficiently system-neutral: for how and under which circumstances ownership passes, e.g., under a contract of sale, has – in line with the CISG – not been determined by the PICC. It is widely agreed upon today, and has been accepted by the Working Group, that the correspondence between risk and control should be the determining factor. After delivery, the object of the sale is in the purchaser’s sphere of influence and control. He has the advantage of being able to use the object and, as a corollary, also has to carry the risk. The situation, in that respect, does not change as a result of termination of the contract: the object has been in the purchaser’s sphere, and thus there is no reason why the risk should be allowed “to jump back” to the seller. In addition it may be pointed out that it is the recipient of the performance who has the possibility of taking out insurance concerning the risk of accidental destruction or deterioration.

If, therefore, the PICC place the risk of accidental deterioration and destruction on the recipient of the performance, i.e., in our standard example: the purchaser, it should not be objected that the reason why the contract has been terminated will often have been non-conformity of the object delivered

62 For Germany see, e.g., H.G. Leser, Der Rücktritt vom Vertrag (1975), 179 ff.
63 For an overview, see Ph. Hellwege, “Unwinding mutual contracts: restitutio in integrum v. the defence of change of position”, in: Johnston / Zimmermann, supra note 36, 270 ff.
64 Art. 4 (b) CISG.
65 See, e.g., Hellwege, supra note 8, 520 ff.; Visser, supra note 13, 498 ff.
and received. First of all, liability for non-conformity is not based on fault. And secondly: non-conformity and the impossibility to make restitution are not intrinsically related to each other. If one were to have a rule that would make the risk jump back to the seller in cases of termination, the non-conformity would be a lucky coincidence for the purchaser: he would be better off if the car he received is defective than he would have been had the car not been defective. That would be distinctly implausible.

2. CISG

It should be noted that the risk allocation envisaged by the PICC does not tie in with the solution adopted in the CISG. According to Article 82 CISG, the purchaser loses the right to terminate the contract if it is impossible for him to make restitution of the goods substantially in the condition in which he received them (Article 82(1)). That does not, however, apply if the impossibility of making restitution is not due to his act or omission (Article 82(2)(a)). These rather involved provisions place the risk of accidental destruction at least very largely, and contrary to first appearances, on the seller: for if the purchaser retains the right to terminate, provided the impossibility to return is not due to his act or omission, he may claim back his purchase price even though he is unable to return the object received. But when is the impossibility to return due to the purchaser’s “act or omission”? This is a vague criterion rendering the risk rule’s scope of application unnecessarily uncertain. What appears to be the general rule (Article 82(1)) turns out to be the exception, after all. And the general policy of saddling the seller with the risk is highly questionable (see above). These are three of the reasons why the risk regime of Article 82 CISG is widely criticised in comparative legal literature and can hardly be regarded as a model for the PICC.

3. Implementation

This leads to the second, more technical question, i.e., how best to implement the risk regime. Essentially, two options are available to the draftsmen of such regime. First, they can exclude the right of termination wherever the person who wants to terminate the contract is supposed to carry the risk. For, since he

---

is not allowed to terminate, he will not be able to reclaim whatever he has given (in our standard example: the purchase price). The CISG uses this device, as does the English common law.67 Alternatively, the law can still allow (in our standard example) the purchaser to terminate the contract, and thus to reclaim the purchase price, but at the same time impose a liability on him to make good the value of the object received. The main difference is that, if the right of termination is excluded, the values remain as exchanged under the contract of sale; but if restitution in kind is simply replaced by a liability to make good the value received, the values are retransferred to the status quo ante. In other words: under the restitution-of-value regime the purchaser can escape from a bad bargain. That may be regarded as an undeserved windfall. More compelling, however, is another consideration: as long as a legal system is prepared to grant a right of termination on account of breach of contract/non-performance, and as long as it imposes duties to make restitution following termination, it accepts that there has to be a retransfer of values. The situation should not be different merely as a result of the fact that one party is unable to make restitution in kind.

It is widely agreed that, as between the two possible solutions, the imposition of a liability to make good the value is more subtle than the exclusion of the right of termination.68 Thus, in particular, it would hardly be appropriate to exclude the right of termination in all cases of deterioration of the object received. That is why it is often limited to instances of “significant deterioration”.69 However, it is not always easy to determine when a deterioration is significant, nor does there appear to be a good reason to draw a sharp, and necessarily arbitrary, line in order to attribute the risk either one way or the other. But the right to terminate can only be either excluded or not excluded. It must be all or nothing. The purchaser’s liability to make good the value, on the other hand, can be flexibly adjusted depending on the extent to which there has been a deterioration.

---


68 Hellweg, supra note 8, 564 ff.; Wagner, supra note 11, 606; Zimmermann, supra note 7, 330 ff.; Fountoulakis, supra note 32, Art. 82, nn. 3 f.; Du Plessis, supra note 50, Art. 3.17, n. 12.

69 See, on the de minimis rule contained in Art. 82 CISG (“... substantially in the condition in which the buyer received [the goods]”), Fountoulakis, supra note 32, Art. 82, nn. 6 ff.
4. Exceptions?

It is obvious that there has to be an exception to the rule that, wherever restitution in kind is not possible or appropriate, the value of the performance has to be made good in money, and that it has to cover cases where the object deteriorates, or is destroyed, as a result of a defect inherent in it. Even though the defectiveness of the object supplied, and hence the deterioration or destruction resulting from that defectiveness, may not be due to the seller’s fault, it is still true to say that the risk of deterioration or destruction emanates from his sphere. A seller, in other words, who creates the risk which has to be distributed, cannot reasonably complain if he finds himself burdened with it. In order to cover this and related situations it has been regarded as appropriate to exclude the duty to make good the value in all cases where the impossibility (or inappropriateness) to make restitution in kind is attributable to “the other party” (i.e., the seller). The illustrations to Articles 3.2.15(3) and 7.3.6(3) PICC 2010 refer to the situation where the object of the sale has been destroyed due to the sellers’ negligence or as a result of a latent defect.

Another situation for which the duty to make good the value should arguably also be excluded is when the deterioration or destruction would also have occurred had the object still been with the seller. A sells and transfers a car to B. The car is subsequently destroyed by a tsunami that floods the properties of both A and B. B terminates the contract because of a defect attaching to the car. An exception to the restitution-of-value rule would appear to be based on the consideration that the deterioration or destruction is not intrinsically related to the fact that the object, as a result of the executed contract of sale, has been in the purchaser’s sphere of influence. Thus, there is no specific reason to burden the purchaser with the risk of deterioration or destruction by imposing on him an obligation to make good the value. On the other hand, however, it may be argued that at the moment when the object deteriorated or was destroyed, it was after all in the purchaser’s sphere of control and influence; and it was he who was able to take out insurance for any accidental deterioration or destruction. These considerations have been accepted by the Working Group as tipping the scale against the purchaser, and thus against accepting such exception.70

The formulation “... if the impossibility to make restitution in kind is attributable to the other party” in Articles 3.2.15(3) and 7.3.6(3) PICC 2010 can be taken to refer not only to cases of impossibility stricto sensu, but also to the alternative “or inappropriate” mentioned in Articles 3.2.15(2) and 7.3.6(2) PICC 2010. And it can also be taken to imply that, in cases where the impossibility to make restitution in kind is attributable to both parties (the car has been destroyed as a result of a collision with another car because it suffered from a defect and because the purchaser had been driving it too fast), the risk has to be distributed equitably between the two parties concerned. The situation, insofar, is similar to the one envisaged in Article 7.4.7 PICC: “... if” in Articles 3.2.15(3) and 7.3.6(3) PICC 2010 therefore implies “insofar as”.

Two further issues relating to the risk regime have to be considered. It has often been argued that in cases of avoidance another exception has to be recognised in order to protect minors. Minors, so it is said, have to be protected against the detrimental consequences of legal transactions which they may have concluded. They should, therefore, not be burdened with the risk of accidental destruction of an object that they have received. However, the PICC do not deal with invalidity arising from lack of capacity (Article 3.1.1). That means that they do not offer any protection against claims arising from a contract which minors may have concluded. Under these circumstances it would be odd for the PICC’s restitution rules to concern themselves with the protection of minors.

More important therefore, in the present context, is the question whether an exception to the general risk rule has to be recognised in order to protect the position of a recipient who has been led to conclude the contract by the other party’s fraudulent representation. What would be the result of the introduction of such an exception? (a) 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 avoids the contract under Article 3.2.5 PICC, B can claim the vase back, while A can neither claim the car nor its value. The result, therefore, is that A has to carry the risk of destruction concerning the car. (b) The antique dealer A has fraudulently induced the garage owner B to swap A’s ramshackle car against a valuable Greek vase belonging to B. The vase is accidentally destroyed while standing in A’s home. B can claim the value of the vase from A; at the same time, he has to return the car to A. In

71 For discussion, see HELWEGE, supra note 8, 555 ff.
other words, A also has to carry the risk concerning the vase. Thus, we would have a cumulation of risks in the person of A. Such cumulation of risks, however, does not appear to be required by the protective purpose of Article 3.2.5 PICC. What is required is merely for the law to make sure that B is not bound by the contract he has entered into (hence the right of avoidance), and that B is not saddled with the consequences of a bad bargain that A may have induced B to make (hence the right to restitution). But the rule on fraud does not intend to protect B against accidents. A’s fraudulent behaviour and the destruction of the car are quite unrelated to each other.\(^2\) A cumulation of risks in the person of A could only conceivably be justified as a penalty for A’s fraud. That would, however, be alien to the law of contract. Moreover, the penalty would be quite arbitrary, if viewed from the perspective of the person to be penalised, i.e., A: he would be subject to a penalty if the car is accidentally destroyed while in B’s possession, but not if B is able to return it.

5. **Non-performance**

Discussions in the Working Group were initially overshadowed by some uncertainty as to which type of situation the risk rule covers.\(^3\) The question of the recipient’s liability to pay the value of the performance only arises if the deterioration or destruction occurs before avoidance or termination of the contract. If what has been performed deteriorates or is destroyed after avoidance or termination of the contract, the recipient of the performance is under a duty to return what he has received. Any non-performance of that duty gives the other party a right to claim damages according to Article 7.4.1 PICC, unless the non-performance is excused under Article 7.1.7. In other words: from the moment of termination the normal rules on non-performance apply. It was regarded as expedient to spell this out in the Comments to both Articles 3.2.15 and 7.3.6 PICC.\(^4\)


\(^{3}\) See, e.g., UNIDROIT 2007 – Study L – Misc. 27 (Summary Records of the 2nd Session), paras. 321 ff.

VI. — BENEFITS

1. Problems relating to a rule on benefits

It can take some time before a contract is avoided or terminated. In the meantime, the parties will often have derived some benefits from whatever they have received: the sheep that have been sold and delivered have produced lambs, the purchaser of a house has received some rent on account of a lease of that house to a third person, the purchaser of a licence to print and distribute a book has made some income by exploiting the licence, the purchaser of a car has been able to use that car every day to commute between his home and his place of work, or the seller has invested the purchase price and has thus received some interest.75 For all these cases it may be argued that, since the contract has to be unwound, the recipient must return not only the performance received but also the benefits derived from that performance: for if he had not received the performance, he would not have been able to derive any benefits. This may be particularly obvious in cases of avoidance where the contract is considered never to have existed and where, therefore, both performance and benefits have been received without legal ground.76 But it is also traditionally taken to be appropriate in cases of termination.77

In spite of the intuitive appeal of such a solution, the matter was particularly controversial within the Working Group.78 And indeed, even the term “benefit” itself is open to doubt and misunderstanding, at least on an international level. Thus, while Article 84 (2) CISG establishes a rule for benefits derived by the purchaser from the goods delivered to him, Article III.-3:510 DCFR means the money, or the object, or the services received by one party as a result of the other’s performance, when it refers to the “restitution of benefits received”, and it extends the obligation to return “a benefit” to any “natural or legal fruits” received “from the benefit”. The DCFR thus invokes a

75 These are some of the examples provided in Appendix A to UNIDROIT 2008 – Study L – Doc. 105 (Draft Chapter on Unwinding of Failed Contracts), II.

76 See, e.g., DU PLESSIS, supra note 50, Art. 3.17, n. 9.

77 See, e.g. Art. 84 CISG; Art. III.-3:510 (5) DCFR.

traditional civilian distinction 79 in order to cover, or at least partly to cover, what Article 84(2) CISG describes as “benefits”. The DCFR, however, immediately prompts the question: but what about indirect (or “civil”) fruits? 80 And what about the value of the use of a thing (sometimes also described as “benefit of use”)? 81 “Benefit” in the sense of Article 84(2) CISG appears to cover also the latter two items. But it does not cover the benefits derived from the use of money because there is a special provision for interest in Article 84(1). Article III.-3:510 DCFR, on the other hand, appears to apply also to interest 82 (in line with, e.g., German law 83). Predominantly, the Working Group followed the Rapporteur’s suggestion to use the term “benefit” in a comprehensive way, so as to cover all types of fruits, benefits of use, and interest.84 But the terminological ambiguity still, occasionally, left its traces in the discussions.

A whole range of more specific, substantive issues were raised. One of these relates to the benefits of use. The mere possibility of being able to use an object has a value. Is it that value, measured objectively, i.e., by reference to the market rate, that has to be paid, following termination or avoidance, by the purchaser to the seller? Or does the duty to restore the benefits derived from the use of an object also include the income derived from the recipient having had the car at his disposal?85 Another problem relates to the interest that may be payable on account of a sum of money that has been received. Is


80 From von Bar / Clive, supra note 19, 895 it appears that the term “legal fruits” may have been used by the draftsmen of the DCFR to refer to what are usually termed “fructus civiles” rather than “fructus legales”.

81 FOUXTOLAKIS, supra note 32, Art. 84, n. 26. For the PICC (2004, cf. also HUBER, supra note 47), Art. 84, n. 20 (“allowance for the actual use made of the object”). Huber reads this into the “general principle underlying Art. 7.6.3, namely that restitution should be made for any benefit [!] which has actually been received.”

82 von Bar / Clive, supra note 19, 895 (“interest”).

83 D. KAISER, in: J. von Staudinger’s Kommentar zum Bürgerlichen Gesetzbuch (Neubearbeitung 2004), § 346, n. 222. – For the position under the ius commune, see RÜFNER, supra note 79, §§ 90-103, n. 46.


85 See Appendix A to UNIDROIT 2008 – Study L – Doc. 105 (Draft Chapter on Unwinding of Failed Contracts), I, read with illustration (g)).
such interest payable only as far as it has actually been earned by the recipient, or is a certain rate of interest due, in any event, where a sum of money has to be returned? 86 Closely associated with the latter point is the question whether there would have to be a rule according to which compensation must be made for benefits that a party has failed to derive from the performance in accordance with ordinary business practice. 87 That question is not dealt with in Article 84 CISG and is, consequently, open to dispute. 88 The German Civil Code traditionally contains such a rule 89 but it has never been easy to rationalise, at least not in this general form. 90 How can there be a liability for the recipient of a performance who did not know that the contract might one day be terminated by the other party? The majority of the Working Group did in fact come out against such rule. 91

Some members of the Working Group argued that the benefits received should remain with the recipient if he was in good faith, i.e., if he did not know the reason on which a right of avoidance or termination might be based. 92 Such an amendment to the benefit rule, inspired by Article 704 of the Civil Code of Québec, 93 would have constituted a deviation from both the CISG and the DCFR. Moreover, it was pointed out that it would, essentially, turn the benefit rule on its head. 94 In a contract of sale it will often be 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

87 UNIDROIT 2007 – Study L – Doc. 100 (Position Paper by the Rapporteur), para. 16.
88 See, e.g., FOUSTOUALKIS, supra note 32, Art. 84, n. 36.
89 See, today, § 347 I 1 BGB.
91 UNIDROIT 2007 – Study L – Misc. 27 (Summary Records of the 2nd Session), paras. 354-371.
92 The suggestion originally came from P.-A. CRÉPEAU: UNIDROIT 2007 – Study L – Misc. 27 (Summary Records of the 2nd Session), para. 271; see also para. 291. And see the memorandum submitted by Professor CRÉPEAU, Appendix A to UNIDROIT 2008 – Study L – Doc. 105 (Draft Chapter on Unwinding of Failed Contracts), III.
93 For France see, most recently, MARTENS, supra note 90, 700 ff.
94 Appendix A to UNIDROIT 2008 – Study L – Doc. 105 (Draft Chapter on Unwinding of Failed Contracts), I.
terminate the contract. Moreover, the seller will also often be unaware of the non-conformity; thus, he is also in good faith and would, according to the proposed amendment, not have to pay any interest on the purchase price either (unless an abstract interest rate were to be fixed). Essentially, therefore, the rule would have been: benefits do not have to be restored unless the recipient has not been in good faith. The duty to hand over the benefits would then, in a way, have to be conceptualised as a penalty which it would be unfair to impose on someone who is in good faith. The majority of the Working Group was unable to reconcile itself with this way of looking at things.

2. The solution adopted

Eventually, however, an even more radical solution was adopted, for it was decided to abandon the idea of a benefit rule altogether. In commercial transactions it is often difficult to determine the value of the benefits (including the benefits of use) derived from a performance, and any regulation concerning benefits is therefore likely to engender rather than avoid litigation. Moreover, normally both parties will have derived benefits from the performance received by them, or could at least have derived such benefits, and the law may thus simply, though in a somewhat generalising manner, set them off against each other. This approach, strongly advocated by the common lawyers, was also supported by input from legal practice. Thus, consultation with the Groupe de travail contrats internationaux revealed that parties in commercial litigation “are normally satisfied to get back what they have delivered under the contract and in the rare case that one party intends to claim in addition compensation for the benefits the other party has received from that performance, such a claim would be part of the claim for damages.” This was confirmed by an enquiry at the ICC concerning awards mentioning restitution of benefits: over the last ten years only four awards

95 See Art. 35(3) CISG.
96 UNIDROIT 2008 – Study L – Misc. 28 (Summary Records of the 3rd Session), para. 64.
97 Cf. also the comparative analysis by MARTENS, supra note 90, 689 ff., leading to the same conclusion.
98 UNIDROIT 2008 – Study L – Misc. 28 (Summary Records of the 3rd Session), para. 53; cf. also paras. 55, 57.
were found in which restitution of benefits had been claimed by one of the parties.99

VII. – COMPENSATION FOR EXPENSES

A purchaser who has received the object of the sale may have incurred expenses for its maintenance and improvement. This issue is dealt with by Articles 3.2.15(4) and 7.3.6(4) PICC. Originally a rule allowing parties to claim “the necessary expenses” incurred on the object received had been envisaged while it had been suggested to provide for compensation for other expenses “as far as the other party is enriched by them.” 100 This rule, inspired by the civilian distinction between necessary, useful and luxury expenses,101 went through a number of permutations. Thus, it was first decided to delete the second part of the rule and to replace it by a comment stating that the PICC “do not take a position as far as expenses are concerned that are merely useful or constitute a luxury.” 102 Eventually, however, a comment was included to the effect that compensation cannot be claimed for expenses which are not required to preserve or maintain the performance received, even if they are reasonable.103 This reflects a change made to the first part of the rule which no longer deals with “necessary” expenses, but with expenses “reasonably required to preserve or maintain the object received.” 104 This change “aims at accommodating the feeling … that lawyers, especially from a common law background, might find it problematic to determine which expenses are really

99  UNIDROIT 2008 – Study L – Misc. 28 (Summary Records of the 3rd Session), para. 56.
104  UNIDROIT 2008 – Study L – Misc. 28 (Summary Records of the 3rd Session), para. 70; UNIDROIT 2009 – Study L – Misc. 29 (Summary Records of the 4th Session), paras. 40, 64.
necessary.” Moreover, the reasonableness standard is used throughout the PICC.

VIII. – CONTRACTS TO BE PERFORMED OVER A PERIOD OF TIME

It will have been noted that, so far, the two restitution regimes laid down in Articles 3.2.15 and 7.3.6 PICC 2010 are identical. There is, however, one very distinctive difference. The latter rule only applies to contracts “to be performed at one time”, whereas the former is applicable to contracts in general. For contracts “to be performed over a period of time”, the section of the PICC on termination (but not the one on avoidance) contains a rule according to which restitution can only be claimed for the period after termination has taken effect. In other words: restitution for performances made in the past is excluded. This rule, which had a predecessor in Article 7.3.6(2) PICC 2004, is mainly based on the idea that it may be inconvenient to unravel performances that may have been made, in the past, over a long period of time. The same would appear to be true in cases of avoidance (except that in some situations the result may be in conflict with the protective purpose of the rule granting a right of avoidance). The original suggestion to introduce such a rule was given surprisingly short shrift. “In case of avoidance there is no point in distinguishing between the past and the future,” it was held, and this can only be based on a somewhat dogmatic distinction between avoidance as a remedy entailing retroactivity and termination operating prospectively.

Most of the discussion, by far, concerning what was to become Article 7.3.7 PICC focused on the question how contracts to be performed at one time and over a period of time are to be distinguished; “turnkey”
contracts played a particularly prominent role in this debate.\textsuperscript{112} The results of the Working Group’s deliberations are set out in the Comments to both Article 7.3.6 and Article 7.3.7 PICC 2010. In particular, it is clarified that while a contract of sale where the goods have to be delivered in instalments is a contract to be performed over a period of time, a contract of sale where the purchase price has to be paid in instalments is not. The distinction thus depends on whether the “characteristic performance” has to be made over a period of time.\textsuperscript{113}

\textbf{IX. – ARRANGEMENT OF THE RESTITUTION RULES}

There are now two more places in the PICC where the issue of restitution is raised. If restitution is granted in cases of contracts infringing a mandatory rule, it follows the rules set out in Article 3.2.15 PICC 2010.\textsuperscript{114} If restitution has to be made on fulfilment of a resolutive condition, this is determined by the rules of Articles 7.3.6 and 7.3.7 PICC (except where the parties have agreed that the resolutive condition is to operate retroactively, in which case reference is made to Article 3.2.15 PICC 2010).\textsuperscript{115} The result in all these cases is exactly the same, as far as contracts to be performed at one time are concerned. Concerning contracts to be performed over a period of time, restitution following the fulfilment of a resolutive condition cannot normally be claimed for past performances. The question which of the two restitution regimes is referred to thus obviously depends on the distinction between retrospectivity and prospectivity.

One may ask whether it might not have been better to collect the rules on restitution in one new section, or chapter, of the PICC 2010 rather than to have them at four different places. That had, in fact, originally been envisaged.\textsuperscript{116} Eventually, however, the present arrangement was chosen, in spite of the fact that it entails a certain amount of repetition and is bound to obscure that, except for one issue, the PICC 2010 have actually established a...
uniform regime for the unwinding of failed contracts.\textsuperscript{117} The reasons were that this has the advantage of causing only a minimum amount of disruption within the Principles in their 2004 form and that it would be more convenient for users to be informed about the consequences of termination, avoidance, illegality, and fulfilment of a resolutive condition at the same place where termination, avoidance, illegality, and fulfilment of a resolutive condition are dealt with. Ultimately, therefore, this was a pragmatic decision.

X. – POSTSCRIPT: THE “FEASIBILITY STUDY”

After this article had been completed, the “Feasibility study for a future instrument on European Contract Law” was published.\textsuperscript{118} This study is the result of the work of an Expert Group, entrusted by the European Commission with the task of selecting those parts of the DCFR which are “of direct relevance to contract law” and “to simplify, restructure, update and supplement the selected content”\textsuperscript{119}; in the process, the expert Group was asked to take into consideration, inter alia, the PICC. The feasibility study, prepared on an “as if” basis,\textsuperscript{120} is a text “which strives to constitute a complete set of contract law rules covering those issues which, at a practical level, are relevant in a contractual relationship in the internal market of the European Union.”\textsuperscript{121} In particular, and contrary to the PICC, it also covers contracts between businesses and consumers. It is interesting to see that the

\begin{footnotesize}
\begin{enumerate}
\item[117] Unidroit 2007 – Study L – Misc. 29 (Summary Records of the 4\textsuperscript{th} Session), paras. 76-104.
\item[120] This means that the Expert Group had to draft a study that could be used “in different scenarios”: A European contract law for consumers and businesses, supra note 118, 5. These scenarios are set out in the Green Paper from the Commission of 1 July 2010, COM(2010) 348 final, on which see Max Planck Institute for Comparative and International Private Law, “Policy Options for Progress Towards a European Contract Law”, 75 Rabels Zeitschrift für ausländisches und internationales Privatrecht (2011), 371 ff.
\item[121] A European Contract Law for Consumers and Businesses, supra note 118, 8.
\end{enumerate}
\end{footnotesize}
text, a draft code, contains a part devoted to “restitution”. The rules contained in it show a remarkable structural similarity to the regime contained in the PICC 2010. They apply both to avoidance and termination and thus (in view of the fact that the text produced by the Expert Group does not deal with illegality and conditions) they constitute the nucleus of a uniform restitution regime for failed contracts. As in the PICC, there is a special provision dealing with contracts which are not to be performed at one time (contracts “for performance in instalments or parts”), and as in the PICC, this provision only applies to termination. Restitution has to be in kind, but if that is impossible, or would cause unreasonable effort or expense, restitution may be made by paying the monetary value.

But there are also differences. The rule on “natural and legal fruits” has been taken over from the DCFR, and there is a fairly detailed provision on “payment for use and interest on money received”. “Compensation for expenditure” is also dealt with in greater detail than compensation of expenses in the DCFR. The concerns motivating Articles 3.2.15 (3) and 7.3.6 (2) PICC are possibly taken care of by the general clause entitled “equitable modification” contained in Article 180.

It has just been said that Articles 176-180 of the Expert Group’s text contain “the nucleus” of a uniform restitution regime. The qualification is necessary in view of the fact that consumer contracts may not only fail because of avoidance or termination but also because the consumer exercises his right to withdraw from the contract. For this situation, the Expert Group proposes a separate restitution regime contained in the rather lengthy Article 40. The Group does not, therefore, appear to agree with the proposition that the general restitution rules, with only a few amendments, can also be applied to the unwinding of consumer contracts following the exercise of a right of withdrawal.

---

122 Part VII Restitution ( = Arts. 176-180).
123 Art. 176(3) Feasibility Study.
124 Art. 177(2) Feasibility Study provides a rule on how the value has to be assessed.
125 Above, text after note 78.
126 Art. 178 Feasibility Study.
127 Art. 179 Feasibility Study.
128 Art. 180 Feasibility Study.