

Comparative Private Law

Dr. Anna Plisecka

Judicial Control of Contracts

Judicial Control of Contracts

- I. Abuse of Circumstances and Excessive Benefit: Qualified *laesio enormis*

- II. Immoral and Illegal Contracts

Laesio Enormis

- The *laesio enormis* rule has its origins in ancient Roman law
- The seller of land could rescind the contract if the sale price was less than half of the just price
- The seller could return the price and request the sold land back or request the payment of the difference

Abuse of Circumstances and Excessive Benefit

It is discussed, whether

→ the contract should be void only because of the disproportion

→ the contract should be void only if the disproportion is the consequence of the abuse of circumstances by the stronger party

Abuse of Circumstances and Excessive Benefit

- In Civil Law: rules of public policy or usury
- In Common Law: doctrine of undue influence
- Recent development: constitutionalisation of the law of contracts

German Law: Abuse of circumstances

§ 138 BGB

Transactions contrary to public policy; usury

(1) A transaction which is contrary to public policy is void.

(2) In particular, a transaction by which a person exploits the position of constraint in which another person finds himself, or the inexperience, lack of discernment or substantial weakness of will of that other person, in order, for his own benefit or that of a third party, to procure the promise of, or to obtain, a pecuniary advantage in return for the provision of a service which is markedly disproportionate to such provision, is void.

French Law

Code civil

Art. 1111: Violence exerted against the person who has contracted the obligation is a ground for annulment even though it was exerted by a third party different from the one for whose benefit the agreement was made.

Art. 1112: There is violence where it is of a nature to make an impression upon a reasonable person and where it can inspire him with a fear of exposing his person or his wealth to considerable and present harm. Regard shall be paid, on this question, to the age, the sex and the condition of the persons.

Art. 1113: Violence is a ground for annulment of a contract, where it is exerted not only against a contracting party, but also against the party's spouse, against his or her descendants or ascendants.

French Law

- Cass. soc. 5 July 1965: «intellectual violence»
- A (labour) contract which is disadvantageous for one party may be avoided on the ground of threat if that party's consent to enter into the agreement is not freely given because of his urgent need for money.

German and French Law: Abuse of circumstances

- Commonalities:
 - a situation, in which a contracting party feels obliged to and cannot decide freely to enter into a contract or not
 - exploitation of this singular situation by the other party (i.e. recognition and willingness to exploit the difficulties for her own benefit)
 - a contractual imbalance to the detriment of the party in difficulties
- Differences:
 - § 138 BGB requests an infringement of public policy (cf. par. 1), i.e. a behaviour that is contrary to good faith in general
 - according to the Cour de cassation, the disproportion of the reduction, is enough regarding the situation of constraint Maly was in (i.e. an appreciation of the individual case)

Common Law: Duress

- Situation where a person performs an act as a result of violence, threat or other pressure against the person
- Pressure exerted upon a person to coerce that person to perform an act that he or she would ordinarily not perform
- In the context of contract law it is a defense; the contract may be rescinded, since it is then voidable
- There may be physical duress or economic duress

Equity: Undue influence

- Situation, where one person takes advantage of a position of power over another person; therefore, no free will is possible.
- Equity will investigate the manner in which the intention to enter into the transaction was secured: «how the intention was produced» (Lord Eldon, Huguenin v Basely 1807).
- Two groups of undue influence:
 - (1) **Presumed undue influence**: the relationship falls in a class of relationships that as a matter of law will raise a presumption of undue influence → the burden of proof lies on the person who took advantage, to disprove undue influence.
 - (2) **Actual undue influence**: the facts of the case indicate, that there was a relationship between the parties that led to undue influence → the victim has to prove that the transaction was brought about by the exercise of undue influence.

Lord Brown-Wilkinson

“Class 1: actual undue influence.

In these cases it is necessary for the claimant to prove affirmatively that the wrongdoer exerted undue influence on the complainant to enter into the particular transaction which is impugned.

Class 2: presumed undue influence.

In these cases the complainant only has to show, in the first instance, that there was a relationship of trust and confidence between the complainant and the wrongdoer of such a nature that it is fair to presume that the wrongdoer abused that relationship in procuring the complainant to enter into the impugned transaction.

In Class 2 cases therefore there is no need to produce evidence that actual undue influence was exerted in relation to the particular transaction impugned: once a confidential relationship has been proved, the burden then shifts to the wrongdoer to prove that the complainant entered into the impugned transaction freely, for example by showing that the complainant had independent advice.»

House of Lords: Royal Bank of Scotland v Etridge

Facts:

8 cases in which a wife charged her interest in her home in favour of a bank as security for her husband's indebtedness of a company through which he carried on business.

Later on, the wife asserted she signed the charge under undue influence of her husband.

The House of Lords had to decide, whether there had been undue influence (misuse of the influence one person has over another).

It then had to decide about the burden of proof – is there presumed undue influence between husband and wife?

Definition and conditions of undue influence according to Royal Bank of Scotland v Etridge

- (1) The complainant reposed trust and confidence in the other party or the party acquired ascendancy over the complainant.
- (2) The transaction is not readily explicable by the relationship of the parties.

Bundesverfassungsgericht (German Constitutional Court) on surety, 19 October 1993

- A bank had offered a businessman a loan of DM 100.000 on condition that the businessman's daughter would sign a contract as a surety.
- The daughter was 21 years old, uneducated, unemployed and had no property.
- A bank employee told the daughter: «Would you just sign this here, please? This won't make you enter into any important obligation; I need this for my files.»
- When four years later the father's business had financial difficulties, the bank claimed DM 160.000 (interests included) from the daughter because of surety contract.
- The Landgericht held the contract valid and ordered her to pay, the Oberlandesgericht found that the employee had violated his duty of information. The Bundesgerichtshof (Federal Court) did not accept this and held that every adult person is aware of the risks entailed by a surety.
- The daughter appealed to the Bundesverfassungsgericht claiming that the Bundesgerichtshof had violated her fundamental rights.

Bundesverfassungsgericht (German Constitutional Court) on surety, 19 October 1993

- The daughter claimed the violation
 - of her right of dignity (Article 1 German Constitution)
 - of her party autonomy (Article 2 German Constitution)
 - in combination with the principles of the social state (Article 20 and Article 28 of the German Constitution)
- The effects of constitutional law on contract law according to the German Constitutional Court:
 - Fundamental rights serve primarily to protect the citizens against the state but they also represent an objective scale of values, which apply throughout the legal systems.
 - The content of constitutional law flows into private law and effects the interpretation of existing civil statutes, especially the general clauses in the Civil Code, such as § 242 duty to good faith, § 137 nullity of contracts infringing good morals.
 - The application of these civil law rules must hence be in accordance with fundamental rights and constitutional law.
 - Courts that do not respect fundamental rights, when interpreting and applying the civil law, violate the constitution.

The Constitutional Court's decision

- In cases where a structural imbalance of bargaining power has led to a contract which is exceptionally onerous for the weaker party, the civil courts are obliged to intervene on the basis of the general clauses (§ 138 and § 242 of the Bürgerliches Gesetzbuch).
- This obligation is based on their duty to protect the basic right of party autonomy in conjunction with the principles of the social state.
- In this case, a contractual imbalance existed because the bank had failed to inform the daughter about the risk relating to the surety although the risk was very important with regard to her income and financial situation.

Immoral and Illegal Contracts

Illegality of contracts → infringement of public order

immorality of contracts → infringement of public policy

PECL

Art 15:101: Contracts contrary to Fundamental Principles

A contract is of no effect to the extent that it is contrary to principles recognized as fundamental in the laws of the Member States of the European Union.

What constitutes Illegality ?

- transgression of the positive law (statutes, that expressly declare the contract illegal)
- other legislation, which shows the legislative intent or purpose to prohibit the contract or his object
- violation of common law concepts of public policy (ex.: sexual immorality, attempts to buy honors, interference with the course of justice)

German Law

§ 134: Statutory prohibition

A legal transaction that violates a statutory prohibition is void, unless the statute leads to a different conclusion.

§ 138: Legal transaction contrary to public policy; usury

A legal act that is contrary to public policy is void.

In particular, a legal transaction is void by which a person, by exploiting the predicament, inexperience, lack of sound judgment or considerable weakness of the will of another, caused himself or a third party, in exchange for an act of performance, to be promised or granted pecuniary advantages which are clearly disproportionate to the performance.

French Law

Art. 6 Code civil: Statutes relating to public policy and morals may not be derogated from by private agreements.

Article 1128: Only things which may be the subject matter of legal transactions between private individuals may be the object of agreements.

Article 1131: An obligation without cause or with a false cause, or with an unlawful cause, may not have any effect.

→ *public order* = rules protecting the political, social or economic order

→ *good morals (bonnes moeurs)* = basic principles of family life, social life and economic behaviour

→ sanction is linked to the concept of cause.

Swiss Law

Art 20 Code of Obligations

1 A contract is void if its terms are impossible, unlawful or immoral.

2 However, where the defect pertains only to certain terms of a contract, those terms alone are void unless there is cause to assume that the contract would not have been concluded without them.

Art. 27 Swiss Civil Code 1 No person may, wholly or in part, renounce his or her legal capacity or his or her capacity to act.

2 No person may surrender his or her freedom or restrict the use of it to a degree which violates the law or public morals.

Common Law

A contract may be void because of its illegal OBJECT or its illegal CONSIDERATION

Two maxims:

Ex turpi causa non oritur actio (no action arises from a bad cause)

Lord Mansfield: «No court will lend its aid to a man who founds his cause of action upon an immoral and illegal act.»

(b) *In pari delicto potior est conditio defendentis* (where there is equal fault, the defendant is in a stronger position)

Lord Mansfield: «Objection of illegality is always allowed to the defendant (in order to protect the public order, not in order to protect him)»

Consequences of illegality

an illegal contract is not enforceable

in general, if it is partially executed, the party which has been disadvantaged cannot ask for restitution

exceptions:

- the party repents and repudiates the contract (*locus penitentiae*)

- if one party is innocent, she may be entitled to restitution (cf. *in pari delicto*)

- the party which is protected by statutes, is also entitled to claim restitution

Queen's Bench: St. John Shipping Corp v. Joseph Rank Ltd.

Facts:

- The defendants chartered the plaintiff's ship to carry grain from the USA to the UK.
- The ship was overloaded in contravention of the Merchant Shipping Act 1932; the master was fined the maximum fine.
- The defendants paid part of the freight but withheld a sum equivalent to the extra freight earned by overloading.

Legal problem:

- (1) Does the Merchant Shipping Act mean to prohibit contracts?
- (2) Does the contract in question belong to the contracts that are prohibited by the Act?

Answers to the legal problems

- (1) «The relevant section of the Act of 1932, section 44, provides that the ship 'shall not be so loaded as to submerge' the appropriate loadline. It may be that a contract for the loading of the ship which necessarily has this effect would be unenforceable. (...) But an implied prohibition of contracts of loading does not necessarily extend to contracts for the carriage of goods by improperly loaded vessels. Of course, if the parties knowingly agree to ship goods by an overloaded vessel, such a contract would be illegal; but its illegality does not depend on whether it is impliedly prohibited by the statute, since (...) there is an intent to break the law.»
- (2) «In my judgement, contracts for the carriage of goods are not within the ambit of this statute at all. A court should not hold that any contract or class of contracts is prohibited by statute unless there is a clear implication (...) that the statute so intended. If a contract has as its whole object the doing of the very act which the statute prohibits, it can be argued that you can hardly make sense of a statute which forbids an act and yet permits to be made a contract to do it (...).»