

# **A Comparison of the Contract Sections of the New Hungarian Civil Code with English Law and the Proposed Common European Sales Law**

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## **Introduction**

2014 is a year to celebrate in Hungary and the European Union. First, because it marks the tenth anniversary of Hungary's accession to the EU; and secondly because it has seen the introduction of the new Hungarian Civil Code, a project to which so many of our Hungarian colleagues contributed so much. At the same time it is a fascinating period for contract lawyers and those interested in European private law generally, because we have the possibility of a European measure of general application, the proposed Common European Sales Law (CESL).<sup>1</sup> The proposal is limited in scope: it applies only to sales, the supply of digital content and related services; and, if the amendments proposed by the European Parliament<sup>2</sup> are accepted, it will be limited to distance contracts and possibly even to internet contracts. Nonetheless, if the CESL succeeds it may be just the first in a series of measures that, ultimately, could cover increasing numbers of cross-border contracts. The model proposed is of an 'Optional Instrument' that the parties would be free to use or not to use. So it will leave the law of the Member States for domestic transactions entirely untouched – and allow parties to cross-border contracts to use a national law, or where applicable the United Nations Convention on the International Sale of Goods (CISG), instead.

## **I How do Approaches Differ?**

This makes it appropriate to reflect on the relationship between the Member States' 'domestic' laws and the CESL, and to consider the differences between them. Our laws of contract are different not only in the terminology and the concepts that they employ, but also in the results

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\* Hugh Beale, Professor of Law, Warwick School of Law, Honorary QC, Honorary Member of the Hungarian Academy of Sciences and a Fellow of the British Academy.

<sup>1</sup> Proposal for a Regulation on a Common European Sales Law, 11 October 2011 COM(2011) 635 final.

<sup>2</sup> See <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&mode=XML&reference=A7-2013-0301&language=EN>.

they produce. I have suggested before that at least some of these differences are more than the result simply of historical tradition.<sup>3</sup> They reflect different assumptions about the transactions to which each law is likely to apply and, in particular, the differences between the cases that lawmakers (whether legislators, judges or academic proponents of ‘received doctrine’) envisage coming before each system’s courts. They also reflect differing assumptions about the markets in which the transactions are made; differences in philosophy; and different views of the role that the law and the courts should play. In this paper I aim to explore how the CESL, the contract sections of the new Hungarian Code and English law compare in a number of ways, and to consider the relationship between the two national systems and the CESL. For the most part I will discuss only business-to-business (B2B) contracts and I will ignore business-to-consumer (B2C) contracts. This is partly for reasons of space but mainly because of the harmonizing effect of the consumer *acquis* that is implemented in each of the three systems. This does not result in uniformity, certainly, but as far as B2C contracts are concerned it does reduce the differences between the systems very significantly.

## II Key Issues and Dimensions

In terms of results (and in fact also in terms of terminology and concepts) the three laws have a great deal in common. In many situations the legal outcome will be substantially the same whichever law is applicable. But there are a number of key issues on which there are substantial differences. Moreover, the laws seem to differ in a number of key dimensions. I have selected four to discuss. These are: (1) assumptions about the relevant market; (2) individualism – the extent to which parties are free to pursue their own goals at the expense of the other party and, conversely, are expected to look after their own interests; (3) the amount of discretion left to judges through leaving them to apply general standards rather than detailed rules; and (4) the extent to which the judge is expected to interpret the contract, and so fashion the parties’ obligations, to the particular context of the transaction.

My aim is not to criticize any of the laws, nor even to evaluate them in terms of criteria such as justice or efficiency, but, taking each dimension in turn, merely to see what position each law appears to occupy along the relevant spectrum. This is a speculative venture, in the sense that in order to work out the underlying assumptions, we often have to carry out ‘reverse engineering’ – in other words, to work backwards from the relevant provisions. This is because the policies and assumptions are not always stated. This is certainly true in a case-law system like English law, as not all judges articulate their reasons and different judges may give different reasons for

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<sup>3</sup> See H. Beale, ‘The Impact of the decisions of the European courts on decisions made by the national courts in English law’ in G. Máthé and others (eds) *Panel Meeting of the 5<sup>th</sup> European Jurists’ Forum* (Magyar Jogász Egylet 2009, Budapest) 209, and a revised version, ‘The Impact of the decisions of the European courts on English contract law: the limits of voluntary harmonisation’ (2010) 18 *European Review of Private Law*, 501; and also H. Beale, ‘Characteristics of Contract Laws and the European Optional Instrument’ in H. Eidenmüller (ed), *Regulatory Competition in Contract Law and Dispute Resolution* (CH Beck 2013, Munich) 315.

the same rule. But it is also true for the CESL, where the Group of Experts and the EU Commission sometimes gave their reasons but at other times did not.<sup>4</sup> In the case of the Hungarian Civil Code (HCC) the relevant documents may exist but I have not managed to find them in English.<sup>5</sup> So I hope I will be forgiven for guessing; and I hope that readers will be willing to tell me where I go wrong, as undoubtedly I will have done. In the case of the HCC there is the additional complication that I do not know how the provisions are supposed to be or are likely to be applied.<sup>6</sup>

### III Good Faith and Fair Dealing

A good example of the difficulties in knowing how a provision is to be interpreted and applied comes right at the start of the HCC § 1:3 provides:

*[Principle of good faith and fair dealing]*

(1) In exercising rights and in fulfilling obligations the requirements of good faith and fair dealing shall be observed.

(2) The requirements of good faith and fair dealing shall be considered breached where a party's exercise of rights is contradictory to his previous actions which the other party had reason to rely on.

Obviously any English lawyer is going to have difficulty in applying a concept that is largely unknown to English law,<sup>7</sup> but even those systems that recognize the concept of good faith appear to apply it rather differently. In German law, for example, § 242 BGB seems largely to have been used to enable the judges to create new doctrines to fill gaps in the Civil Code: 'there is something in this rich case law that reminds one of English case law techniques [...]':<sup>8</sup> The CESL, by contrast, contains a separate article (Article 4) authorizing judges to develop rules to solve issues that are within the scope of application of the CESL but which are not expressly settled by it.<sup>9</sup>

The CESL also imposes a general duty of good faith.<sup>10</sup> On the face of it, the CESL provision seems very similar to § 1:3:

<sup>4</sup> The reasons that were recorded will be explained in the Comments to the CESL that currently I am preparing on behalf of the Expert Group. I hope these will be made available publicly, e.g. on the Commission's website.

<sup>5</sup> For a while I was unsure if there was even an English translation of the HCC available. I am very grateful to my colleagues Tamas Tercsak and Sarolta Szabo (a student at ELTE who in 2013-2014 spent an 'Erasmus' year at Warwick) for locating translations for me.

<sup>6</sup> My colleague Dr Tekla Papp, who has spent some weeks at Warwick during 2014, was able to give me some guidance on the likely meaning of some provisions and on how the provisions of the former Code were applied. However, she had to return to Szeged before I completed this paper, so there were questions that I have not asked her. In any event, the mistakes are my own and, of course, my responsibility.

<sup>7</sup> A useful survey of the extent to which English law recognises good faith can be found in H. Beale (eds) *Chitty on Contracts* (31st edn, Sweet & Maxwell 2012, London) paras 1-039-1-053 (-S. Whittaker).

<sup>8</sup> B. Markesinis, H. Unberath and A. Johnston, *German Law of Contract* (2nd edn, Hart 2006, Oxford) 122.

<sup>9</sup> CESL Art 4(2).

<sup>10</sup> In the CESL a distinction is made between 'obligations' (of which the creditor can require performance) and 'duties' (which give rise only to remedies indicated in the relevant provision, e.g. to a claim for damages).

*Article 2 Good faith and fair dealing*

- (1) Each party has a duty to act in accordance with good faith and fair dealing.
- (2) Breach of this duty may preclude the party in breach from exercising or relying on a right, remedy or defence which that party would otherwise have, or may make the party liable for any loss thereby caused to the other party.
- (3) The parties may not exclude the application of this Article or derogate from or vary its effects.

However, Article 2 is intended to have a limited role. Recital 31 states:

The principle of good faith and fair dealing should provide guidance on the way parties have to cooperate. As some rules constitute specific manifestations of the general principle of good faith and fair dealing, they should take precedent over the general principle. The general principle should therefore not be used as a tool to amend the specific rights and obligations of parties as set out in the specific rules [...]

Under the CESL the principal role of good faith and fair dealing may be a limited one, namely to prevent a party acting inconsistently. It may also be employed to prevent an abuse of right. The HCC provision seems to have a wider purpose. Inconsistent behaviour is explicitly prevented by § 1:3(2) and there is a separate provision prohibiting any abuse of rights.<sup>11</sup> That suggests that § 1:3 is to apply more broadly. Later I will argue that one or other of these provisions seems to be regarded as a general restriction.

## IV A Fully Developed Market?

The first 'dimension' I would like to discuss is the extent to which each law assumes that most of the transactions to which it will apply take place in a well-developed market. The English law on remedies for breach of contract, for example, seems to assume that there is almost always a ready market in which a buyer can obtain substitute goods if the seller delivers non-conforming goods or does not deliver at all. Thus specific performance is almost never awarded in a sale of goods case.<sup>12</sup> Instead the buyer is expected to terminate the contract, go into the market to obtain replacement goods and claim any extra costs in an action for damages.<sup>13</sup> The CESL, in contrast, allows the buyer to require performance unless to require performance would be disproportionate.

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<sup>11</sup> § 1:5 para (1) HCC.

<sup>12</sup> Specific performance is not awarded if damages would be an 'adequate remedy' [see H. Beale (ed) *Chitty on Contracts* (31st edn, Sweet & Maxwell 2012, London) paras 27-005-27-018 (- G Treitel)]; and in sales cases damages are treated as adequate unless the goods are unique [e.g. *Falcke v Gray* (1859) 3 Drew 651] or completely unobtainable [e.g. *Sky Petroleum Ltd v VSP Petroleum Ltd* (1974) 1 WLR 576]. In one case damages were considered adequate even though it would take 9 months for the buyer to obtain replacement goods: *Société des Industries Metallurgiques SA v Bronx Engineering Co Ltd* [1975] 1 Lloyd's Rep 465.

<sup>13</sup> See Sale of Goods Act 1979, § 51.

Article 110 provides

*Requiring performance of seller's obligations*

- (1) The buyer is entitled to require performance of the seller's obligations.
- (2) The performance which may be required includes the remedying free of charge of a performance which is not in conformity with the contract.
- (3) Performance cannot be required where:
  - (a) performance would be impossible or has become unlawful; or
  - (b) the burden or expense of performance would be disproportionate to the benefit that the buyer would obtain.

Likewise the expectation of the CESL seems to be that a seller whose buyer no longer wants the goods will normally find another buyer for the goods. Article 132 provides:

*Requiring performance of buyer's obligations*

- (1) The seller is entitled to recover payment of the price when it is due, and to require performance of any other obligation undertaken by the buyer.
- (2) Where the buyer has not yet taken over the goods or the digital content and it is clear that the buyer will be unwilling to receive performance, the seller may nonetheless require the buyer to take delivery, and may recover the price, unless the seller could have made a reasonable substitute transaction without significant effort or expense.

In contrast, § 6:138 HCC seems to anticipate a wide role for specific performance against either party:

*[Right of requiring performance]*

In the event of non-performance, the aggrieved party shall be entitled to require performance of the obligation.

I assume that this right is not wholly unqualified, and possibly a creditor who seeks to enforce the contract when the cost to the debtor would be out of proportion to the benefit to the creditor would be held to be acting contrary to good faith and fair dealing (§ 1:3) or to be abusing his rights (§ 1:5). However, it may also be that for a buyer to demand specific performance would be contrary to good faith or amount to an abuse of rights only in an extreme case. In any event the provisions seems to leave a good deal to the discretion of the judge – another of my ‘dimensions’ (see below). As to the seller’s claim against the buyer who no longer wants the goods, I am not clear that there is any limit on the seller’s right to require performance. This is because there is a such a limit in contracts for ‘Works’ (which I take to mean what in English law we refer to as ‘services’), where the customer has the right to withdraw from the contract on payment on damages to the contractor.<sup>14</sup> I see no equivalent for contracts of sale.

So the HCC may be drafted on the assumption that disappointed creditors may find it hard to make a substitute contract and therefore should be able to require performance more frequently than the CESL, and certainly than English law, allows.

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<sup>14</sup> HCC § 6:249, seemingly equivalent to *Kündigung*, § 314 (1) BGB.

## V A Market that is Price-competitive

English law also seems to assume that buyers and sellers will know, or will readily be able to find out, the ‘going price’ for goods and services. It is very easy in England to find lists of current market prices for most goods of substantial value, whether the goods are new or second hand; and also valuation services are readily available. This may be why we have no general provisions on contracts at unfair prices. Even in a consumer contract, the adequacy of the price is excluded from review, as it is under the Directive on Unfair Terms in Consumer Contracts.<sup>15</sup> The only possibility of relief is if there has been unconscionable dealing, which seems to require that one of the parties is suffering from an identifiable bargaining weakness such as lack of education or extreme poverty<sup>16</sup> – the kind of situation which under the HCC, I assume, would fall under the prohibition on usury.<sup>17</sup>

The CESL also assumes that consumers do not need to be protected against high prices per se.<sup>18</sup> Given that most cross-border contracts will be over the internet, where price comparison is the one thing that is relatively easy for the shopper, that seems a justifiable assumption.

In contrast, the HCC retains a provision on *laesio enormis*, albeit in more limited form than under the former code.<sup>19</sup> § 6:98 now provides:

*[Gross disparity in value]*

(1) If, at the time of the conclusion of the contract, the difference between the value of a service and the consideration due – without either party having the intention of making a gratuitous grant – is grossly unfair, the injured party shall be allowed to avoid the contract. The contract shall not be avoided by the party who knew or could be expected to have known the gross disparity in value, or if he assumed the risk thereof.

(2) The parties may exclude the right of avoidance provided for in Subsection (1), with the exception of contracts that involve a consumer and a business party.

Presumably the drafters felt that in Hungary there is not yet sufficient information on prices that it would be safe to get rid of the *laesio enormis* provision. This demonstrates that there is still a role for domestic sales law alongside the optional CESL, to provide rules that are better suited to domestic conditions.

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<sup>15</sup> Council Directive 1993/13/EC [1993] OJ L095.

<sup>16</sup> See generally H. Beale (ed) *Chitty on Contracts* (31st edn, Sweet & Maxwell 2012, London) chapter 7 section 3 (- H. Beale).

<sup>17</sup> § 6:97 HCC, cf § 138(2) BGB.

<sup>18</sup> However, one of the purposes of the withdrawal rights in an off-premises contract is to enable the consumer to check the price being charged.

<sup>19</sup> Former § 201 did not contain the last sentence of para (1).

## VI Individualism vs Protectionism

I have argued elsewhere that, at least compared to many of its continental rivals, for B2B contracts at least English law takes a very individualist stance.<sup>20</sup> Here I will merely point to some of its most individualistic features. Thus there are very limited controls over unfair terms: for the most part, the Unfair Contract Terms Act 1977, despite its broad title, affects only exclusion and limitation of liability clauses.<sup>21</sup> Even those controls are limited to the domestic market: the Act does not apply to international supply contracts and to contracts that are governed by English law only because of the choice of the parties.<sup>22</sup> Likewise, English law gives limited relief for mistake. Basically, a mistake as to the substance of what is being contracted for, or the surrounding circumstances (i.e. a mistake in motives for the contract), will give rise to relief only if the mistake was induced by a positive misrepresentation by the other party<sup>23</sup> or, in very limited circumstances, where the mistake shared by the other party.<sup>24</sup> English law does not recognise ‘fraud by silence’<sup>25</sup> and does not impose any duty to disclose relevant facts, save in limited cases such as contracts of insurance, partnerships and joint ventures.<sup>26</sup> Lastly, we have no general duty of good faith, whether in the making or the performance of contracts.

In contrast, the HCC and the CESL both contain quite a number of protective rules, even for B2B contracts. Thus § 6:90 HCC provides

*[Mistake]*

(1) A person acting under a misapprehension regarding any material circumstance at the time a contract is concluded shall be entitled to contest his contract statement if his mistake had been caused or could have been recognized by the other party. The mistake shall be considered to impact a material circumstance if the party, but for the mistake, would not have concluded the contract or would have done so only on fundamentally different contract terms.

[...]

<sup>20</sup> H. Beale, ‘The Impact of the decisions of the European courts on decisions made by the national courts in English law’ in G. Máthé and others (eds), *Panel Meeting of the 5<sup>th</sup> European Jurists’ Forum* (Magyar Jogász Egyeslet 2009, Budapest) 209.

<sup>21</sup> The Act also applies to a term in a B2B contract, if the contract is made on one party’s written standard terms and the term defines what that party has to do in broad terms: then the party cannot rely on the term to render a performance that is substantially different from what the other party reasonably expected, unless the term is reasonable: see § 3(2)(b). The same provision covers cancellation clauses.

<sup>22</sup> Unfair Contract Terms Act 1977, ss 26 and 27.

<sup>23</sup> The misrepresentee will be entitled to damages if the misrepresentation was fraudulent [*Derry v Peek* (1889) LR 14 App Cas 437] or careless [Misrepresentation Act 1967, § 2(1)]. Avoidance may be available [the court has a discretion whether to allow it, Misrepresentation Act 1967, § 2(2)] for a wholly innocent misrepresentation [*Redgrave v Hurd* (1881-1882) LR 20 ChD 1].

<sup>24</sup> See *Bell v Lever Bros* [1932] AC 161 and *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd* [2002] EWCA Civ 1407, which in effect limits the doctrine of common mistake to cases of initial impossibility [see at (76)].

<sup>25</sup> *Smith v Hughes* (1871) LR 6 QB 597.

<sup>26</sup> See generally, H. Beale, *Mistake and Non-disclosure of Facts: Models for English Contract Law* (Oxford University Press 2012, Oxford).

(3) The contract may not be avoided by a party who knew or could be expected to have known the mistake, or if he assumed the risk of the mistake.

The words underlined distinguish the rule clearly from, for example, German law, where a party may obtain relief under § 119(2) BGB even though the other party had no idea that the first party was mistaken (though in such a case the avoiding party may have to pay compensation for any reliance losses suffered by the other party, § 122 BGB).

In that respect CESL Article 48 is similar, but relief is expressly qualified further. The equivalent condition is that the non-mistaken party

(iii) knew or could be expected to have known of the mistake and caused the contract to be concluded in mistake by not pointing out the relevant information, provided that good faith and fair dealing would have required a party aware of the mistake to point it out.

Article 49, Fraud, gives a list of factors that should be taken into account in deciding whether good faith required disclosure:

(3) In determining whether good faith and fair dealing require a party to disclose particular information, regard should be had to all the circumstances, including:

- (a) whether the party had special expertise;
- (b) the cost to the party of acquiring the relevant information;
- (c) the ease with which the other party could have acquired the information by other means;
- (d) the nature of the information;
- (e) the apparent importance of the information to the other party; and
- (f) in contracts between traders good commercial practice in the situation concerned.

I do not know whether the right to avoid under HCC § 6:90 is intended to be similarly qualified by applying the provisions on good faith and fair dealing or abuse of rights. If it is not, then the HCC seems to give considerably more protection to the mistaken party than does the CESL. If the right to avoid is limited by good faith, then again rather more discretion seems to be left to the judge, as no guidance on the relevant factors is given.

On the other hand, the CESL imposes a duty of disclosure in B2B contracts. Art 23 provides

*Duty to disclose information about goods and related services*

(1) Before the conclusion of a contract for the sale of goods, supply of digital content or provision of related services by a trader to another trader, the supplier has a duty to disclose by any appropriate means to the other trader any information concerning the main characteristics of the goods, digital content or related services to be supplied which the supplier has or can be expected to have and which it would be contrary to good faith and fair dealing not to disclose to the other party.

(2) In determining whether paragraph 1 requires the supplier to disclose any information, regard is to be had to all the circumstances, including:

- (a) whether the supplier had special expertise;
- (b) the cost to the supplier of acquiring the relevant information;
- (c) the ease with which the other trader could have acquired the information by other means;
- (d) the nature of the information;

- (e) the likely importance of the information to the other trader; and
- (f) good commercial practice in the situation concerned.

I did not find any duty of disclosure in the HCC except in the case of the renewal of insurance contracts.<sup>27</sup>

## VII Unfair Terms

I have already said that English law has only very limited controls over unfair terms in B2B contracts. In contrast, both the HCC and the CESL impose general controls over non-negotiated terms. Whether the controls are identical depends on two points of interpretation.

The first is whether the HCC provision applies to the terms taken 'one at a time' or only when the term is part of a standard set. The CESL provision applies only to terms that are part of a set of terms that was not negotiated:

### *Article 86*

#### *Meaning of "unfair" in contracts between traders*

- (1) In a contract between traders, a contract term is unfair for the purposes of this Section only if:
  - (a) it forms part of not individually negotiated terms within the meaning of Article 7; and
  - (b) it is of such a nature that its use grossly deviates from good commercial practice, contrary to good faith and fair dealing.
- (2) When assessing the unfairness of a contract term for the purposes of this Section, regard is to be had to:
  - (a) the nature of what is to be provided under the contract;
  - (b) the circumstances prevailing during the conclusion of the contract;
  - (c) the other contract terms; and
  - (d) the terms of any other contract on which the contract depends.

Thus if one or more of the set of terms has been negotiated individually, none of the terms in the set can be challenged as unfair. The idea is that if a party was sufficiently knowledgeable and had enough bargaining power to negotiate one term, presumably it could have done the same with the other terms, had it wished to do so at the time.

The HCC provision, at least in the English version, is not quite clear on this point. § 6:102 provides:

### *[Unfair standard contract terms]*

- (1) A standard contract term shall be considered unfair if, contrary to the requirement of good faith and fair dealing, it causes a significant and unjustified imbalance in contractual rights and obligations, to the detriment of the party entering into a contract with the person imposing such contract term.

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<sup>27</sup> HCC § 6:452.

Read on its own, that refers to 'a standard term' and so it seems to allow a challenge 'term by term'. However, § 6:77 defines 'standard contract terms' as

Standard contract terms means contract terms which have been unilaterally drafted in advance by one of the parties for several transactions involving different parties, and which have not been individually negotiated by the parties.

In addition, § 6:103 on *Unfair contract terms in consumer contracts* provides that:

(1) As regards contracts which involve a consumer and a business party, the provisions relating to standard contract terms shall also apply ... to the contract terms which have been drafted in advance by the business party and which have not been individually negotiated.

Those provisions suggest that consumers may challenge terms one by one but traders may do so only where the term is part of a set – i.e. the same rule as under the CESL.

The other doubt is over the standard to be applied. The CESL tried to indicate that a term which would be unfair in a B2C contract would not necessarily be unfair in a B2B contract, by providing that a term in a B2B contract would only be unfair if its use would be a gross deviation from good commercial practice as well as being contrary to good faith and fair dealing.<sup>28</sup> The HCC refers only to good faith and fair dealing. However, whether this is intended to impose a stricter standard on traders than the CESL does, I do not know.

## VIII The Discretion Granted to Judges

The amount of discretion – or perhaps it would be better to use the French phrase and talk about the width of 'the power of appreciation' – also seems to vary between systems. English lawyers are scared that vague standards will lead to increased litigation, as each party may expect the standard to be applied in a way that would be in its favour, and thus think it has a good chance of winning – and will invest resources in litigation accordingly. In an extreme case, when each thinks it has a high chance of success, the two parties may in total spend as much or more than the amount at stake.<sup>29</sup> So traditionally there has been a preference for 'bright line rules' that make the law certain even if the rigidity of the rule may not produce a just result. The rules on termination for breach of contract are an example. The traditional approach was to categorize the terms of the contract into 'conditions' and 'warranties'.<sup>30</sup> Any term of importance would be categorized as a condition, and breach of condition gives the innocent party the immediate right to terminate the contract.<sup>31</sup>

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<sup>28</sup> Art 86(1)(b).

<sup>29</sup> See G. Priest, 'Breach and Remedy for the Tender of Non-conforming Goods' (1978) 91 Harvard LR 960, esp. at 968.

<sup>30</sup> See, for example Sale of Goods Act 1979, ss 11 and 12-15 – though the Court of Appeal in *Cehave NV v Bremer Handels GmbH, The Hansa Nord* [1976] QB 44 held that an express term in a sale contract need not be either a condition or a warranty: it could be an 'innominate term', see (n 32).

<sup>31</sup> Subject now to Sale of Goods Act 1979, ss 15A and 30A, which in cases of non-conformity or short quantity prevent a buyer from rejecting in conditions that would amount to bad faith. The legislator and the courts [see (n 32)] seemed to be moving in opposite directions!

In the 1960s the Court of Appeal developed a more flexible approach, holding that there is an intermediate category ('innominate terms') when whether or not there is a right to terminate depends on the effect of the breach in the circumstances.<sup>32</sup> However, in the 1980s the House of Lords reverted to interpreting some terms as conditions even when exact compliance with the term did not seem very important. Thus a requirement on a buyer under an FOB contract to give the seller 15 days' notice of the ship on which the goods were to be loaded was treated as 'of the essence' (i.e. giving notice in time was a condition) even though the contract was silent as to the importance of the term and the seller could not show that the delay had any serious consequence.<sup>33</sup> The result was justified on the ground that the seller should be able to know immediately whether or not it had the right to terminate.<sup>34</sup>

The CESL is more nuanced on this point. In a B2B contract the creditor is entitled to terminate only if the debtor's non-performance was fundamental,<sup>35</sup> which is an open-textured standard. The CESL has sought certainty by frequently opting for fixed periods during which rights must be exercised, rather than laying down a 'reasonable time' limit; most of the provisions in question apply only to B2C contracts<sup>36</sup> but some fixed periods apply also between traders.<sup>37</sup>

In contrast, I have already pointed to a number of provisions in the HCC which seem to leave a good deal to the discretion (or appreciation) of the judge. The same seems to be true in the situation just discussed, when a creditor seeks to withdraw from the contract, or to terminate the contract,<sup>38</sup> for non-performance by the debtor. The test is simply whether the performance by the debtor is still of interest to the creditor. For example, § 6:140 provides that

*[Withdrawal, termination]*

(1) If in consequence of non-performance the obligee's interest in contractual performance has ceased, he may withdraw from the contract, or if restitution cannot be provided in kind, he may terminate the contract, unless this Act contains provisions to the contrary.

This might be construed either as a purely subjective test – i.e. does the creditor want to receive performance or not – or as an objective test, would the reasonable creditor wish to do so? If, as I suspect, the latter is the correct interpretation, it seems to leave more to the judge than the 'fundamental non-performance test' of the CESL.

<sup>32</sup> *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26.

<sup>33</sup> *Bunge Corp v Tradax Export SA* [1981] 1 WLR 711.

<sup>34</sup> [1981] 1 WLR 711, 715.

<sup>35</sup> CESL Art 114(1).

<sup>36</sup> E.g. CESL Art 111.

<sup>37</sup> Subject now to Sale of Goods Act 1979, ss 15A and 30A, which in cases of non-conformity or short quantity prevent a buyer from rejecting in conditions that would amount to bad faith. The legislator and the courts [see (n 33)] seemed to be moving in opposite directions!

E.g. CESL Art 121 (the buyer is expected to examine the goods 'within as short a period as is reasonable not exceeding fourteen days').

<sup>38</sup> In the English translation, 'withdrawal' seems to refer to the creditor ending the contract and making restitution (which seems to be equivalent to *Rücktritt* under § 346 BGB), whereas termination seems more like going over to damages (as under § 281 BGB). The CESL does not make this distinction.

## IX Contextual Material

The last question or dimension that I want to consider is the extent to which the judge is required to take into account not just the document, or the words used by the parties, but also the context of the transaction. Requiring a more ‘contextual’ approach does not necessarily result in the law being more protective, but it does mean that the court has to be more sensitive to the background to the contract, which may favour a party who did not ensure that the document reflected precisely what the party intended.

The issue has important cost implications, especially in complex transactions that may have been negotiated over an extended period and where a large sum may be at stake. This is because the degree to which the context has to be taken into account affects directly the amount of evidence that the court may have to consider and the length of any trial.

Traditionally, English law has adopted rules that seem deliberately calculated to reduce the amount of evidence that the court needs to consider.<sup>39</sup> Thus the so-called ‘parol evidence rule’<sup>40</sup> stipulated that if the contract was in writing, no extrinsic evidence could be adduced to add to, vary or contradict the written instrument.<sup>41</sup> The subjective intentions of the parties were normally irrelevant; what matters was the objective meaning of the words. The words of the contract were to be interpreted according to the normal or literal meaning of the words, unless either it was shown that the words had a technical or customary meaning that was different to the normal meaning, or that to give the words the normal meaning would lead to an absurd result.<sup>42</sup> Any statements made by one party during pre-contractual negotiations as to the meaning of the words used were to be ignored,<sup>43</sup> unless it could be shown that the parties had reached an agreement on a particular provision but by mistake it had been written out incorrectly. In that case the court had a discretion to ‘rectify’ the document to bring it into line with the prior agreement.<sup>44</sup> And terms would be implied into the agreement to fill any gaps in its provisions, only if that was absolutely necessary in order for the contract to be workable or represented the obvious intentions of the parties.<sup>45</sup>

Over the last few decades, however, English law has become much more ‘sensitive to context’. It is recognized that business people drafting contracts, and even their lawyers, seldom reach the draftsman’s ideal of enabling the judge to answer every conceivable question without having to raise her eyes from the document. Thus oral or other terms will quite readily be admitted to add to, vary

<sup>39</sup> For a fuller discussion see H. Beale, ‘Relational values in English contract law’ in D. Campbell, L. Mulcahy and S. Wheeler (eds), *Changing Concepts of Contract, Essays in Honour of Ian Macneil* (Palgrave Macmillan 2013) 138.

<sup>40</sup> See H. Beale (ed), *Chitty on Contracts* (31st edn, Sweet & Maxwell 2012, London) paras 12-096-12-112 (- A. Guest).

<sup>41</sup> See e.g. *Bank of Australia v Palmer* [1897] AC 540.

<sup>42</sup> See e.g. *Lovell & Christmas Ltd v Wall* (1911) 104 LT 85.

<sup>43</sup> *Prenn v Simmonds* [1971] 1 WLR 1381.

<sup>44</sup> On rectification see H. Beale (ed), *Chitty on Contracts* (31st edn, Sweet & Maxwell 2012, London) paras 5-110-5-145 (- H Beale).

<sup>45</sup> E.g. *Reigate v Union Manufacturing Co (Ramsbottom) Ltd* [1918] 1 KB 592 598; see H. Beale (ed), *Chitty on Contracts* (31st edn, Sweet & Maxwell 2012, London) para 13-004 (- A Guest)

or even contradict the written document,<sup>46</sup> unless there is a merger clause.<sup>47</sup> The objective approach still prevails, and courts still refuse to admit evidence of pre-contractual negotiations<sup>48</sup> – openly acknowledging that this is not because the evidence is not relevant, but to save the cost of what one judge called ‘threshing through the undergrowth’ of pre-contractual negotiations.<sup>49</sup> But it has long been acknowledged that in case of doubt, the ‘factual matrix of the contract’ must be taken into account.<sup>50</sup> What has perhaps changed, as the result of the speech of Lord Hoffman in the case of *Investors Compensation Scheme Ltd v West Bromwich Building Society*,<sup>51</sup> is that words only take their meaning from the context in which they are used, and that the question is always, in that context, how did the parties reasonably understand what was being agreed? In a recent case, the majority in the Court of Appeal held that the context should be looked at only if the literal meaning of the words would produce an absurd result.<sup>52</sup> The Supreme Court disagreed completely:

[T]he court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. ... If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense [...]<sup>53</sup>

The court may even interpret the contract as meaning something quite different to what the parties wrote, if it is evident that they used the wrong words or put them in the wrong order – not because the written document differed from the subjective agreement of the parties (a question English courts refuse to discuss except sometimes in the context of rectification) but because, in the context, the reasonable person would have interpreted the contract in the corrected sense.<sup>54</sup>

By a continuation of the same logic, Lord Hoffmann said that terms may be implied into a contract so that the contract reflects the reasonable understanding of the parties.<sup>55</sup> This has been more controversial,<sup>56</sup> but in a recent case in the High Court the judge relied on this dicta to hold that on the particular facts of the cases – a distributorship agreement – there should be

<sup>46</sup> E.g. *J Evans & Son (Portsmouth) Ltd v Andrea Merzario Ltd* [1976] 1 W.L.R. 1078. The court said simply that the document did not contain the whole of the agreement.

<sup>47</sup> A merger clause is now treated as raising a form of estoppel, which prevents either party from arguing that there were other terms, not contained in the document: see *Peekay Intermark Ltd v Australia & New Zealand Banking Group Ltd* [2006] EWCA Civ 386 at [54]-[60] (in that case, the clause was actually to the effect that neither party relied on any representation not included in the contract, but the reasoning applies to merger clauses also).

<sup>48</sup> See *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38.

<sup>49</sup> *Imntrepreneur Pub Co Ltd v East Crown Ltd* [2000] 2 Lloyd’s Rep 611, 614-615.

<sup>50</sup> *Prenn v Simmonds* [1971] 1 WLR 1381.

<sup>51</sup> [1998] 1 WLR 896, 913.

<sup>52</sup> *Rainy Sky SA v Kookmin Bank* [2010] EWCA Civ 582.

<sup>53</sup> [2011] UKSC 50 at [21].

<sup>54</sup> *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38.

<sup>55</sup> *Attorney-General of Belize v Belize Telecom Ltd* [2009] UKPC 10 at [21].

<sup>56</sup> P. Davies, ‘Recent Developments in the Law of Implied Terms’ [2012] Lloyd’s Maritime and Commercial Law Quarterly 140.

implied a term that the parties would perform the contract in good faith.<sup>57</sup> So the supplier was liable for giving misleading information to the distributor as to when certain products would be available to the distributor and for allowing competitors to sell the same products at cheaper prices in adjoining markets.

How does the CESL compare? Merger clauses are equally effective, and the provision on implied terms is probably not very different to English law.

*Article 68*

*Contract terms which may be implied*

(1) Where it is necessary to provide for a matter which is not explicitly regulated by the agreement of the parties, any usage or practice or any rule of the Common European Sales Law, an additional contract term may be implied, having regard in particular to:

- (a) the nature and purpose of the contract;
- (b) the circumstances in which the contract was concluded; and
- (c) good faith and fair dealing.

(2) Any contract term implied under paragraph 1 is, as far as possible, to be such as to give effect to what the parties would probably have agreed, had they provided for the matter.

[...]

On interpretation, the CESL refers first to the ‘common intention of the parties’,<sup>58</sup> but in the Expert Group it was recognised that this will very seldom be ascertainable and that the crux of Article 58 is the last paragraph, which refs to objective interpretation:

[...] the contract is to be interpreted according to the meaning which a reasonable person would give to it.

There is no explicit statement that the context must be taken into account, but its importance is evident from Article 59:

*Relevant matters*

In interpreting a contract, regard may be had, in particular, to:

- (a) the circumstances in which it was concluded, including the preliminary negotiations;
- (b) the conduct of the parties, even subsequent to the conclusion of the contract;
- (c) the interpretation which has already been given by the parties to expressions which are identical to or similar to those used in the contract;
- (d) usages which would be considered generally applicable by parties in the same situation;
- (e) practices which the parties have established between themselves;
- (f) the meaning commonly given to expressions in the branch of activity concerned;
- (g) the nature and purpose of the contract; and
- (h) good faith and fair dealing.

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<sup>57</sup> *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB).

<sup>58</sup> CESL Art 58(1).

So interpretation under the CESL is even more sensitive to context than in English law, particularly as evidence of pre-contractual negotiations and post-contractual conduct<sup>59</sup> are to be taken into account.

Unfortunately for me, I have to conclude my presentation on a note of uncertainty. In the HCC there seems to be only one general provision on interpretation of contracts. This is § 6:86(1):

*[Interpretation of contracts]*

(1) Contract terms and statements are to be interpreted in accordance with the contract as a whole.

I wonder if interpretation is considered to be something wholly for judges and not for the legislator. What the judges will make of it remains to be seen.

## Conclusions

What conclusions can we draw from this brief (and probably only partly accurate) survey of the three systems? The three laws show significant variations in each of the dimensions we have looked at.

Each seems to address a different market. The HCC, very sensibly and properly, addresses the domestic market in Hungary, and fashions rules that are particularly needed there. The CESL assumes a virtual marketplace in which information is easy to come by, if you make the effort to obtain it, and in which, if there is a non-performance by one party or the other, substitutes will normally, but not necessarily, be readily available. English law seems to address a highly developed market inhabited by sophisticated players with a lot of chips that they are prepared to gamble. I suspect that English law is really aimed at the international market and is much less good at catering for smaller businesses, which seldom appear as litigants.

There is substantial variation in the degree of protection offered by the three systems. English law is clearly much less protective, much more individualistic, than either the CESL or the HCC. That is illustrated by both the rules on mistake and disclosure of facts and also by the controls over unfair terms in B2B contracts. It is harder to compare the CESL and the HCC on these two issues but probably there is not much difference overall between the two.

The HCC seems to leave much more to the discretion or appreciation of the judge than does English law; and, at least to an outsider, even more than the CESL. The audience will be much better placed to gauge this than I am. However, the degree of discretion suggests to me that, like the CESL, the HCC is drafted with relatively 'small' (i.e. low value) disputes in mind. The degree of discretion conferred on the judge would not fit well, to the English legal mind, with high value, high-risk contracts between businesses that have large resources available to fund litigation. In those cases, certainty is at a premium.

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<sup>59</sup> Also excluded from consideration in English Law: *Whitworth Estates (Manchester) Ltd v James Miller & Partners Ltd* [1970] AC 583.

Lastly, there is the question of sensitivity to context. In their different ways, both the CESL and English law try to achieve this, though with some reservations still in English law. The Civil Code is largely silent on this point; no doubt the answer is to be found elsewhere. I look forward to finding it – on some future occasion!