

## **Chapter 4**

### **The UNIDROIT Principles of International Commercial Contracts**

#### **Introduction**

In February 1994 the Working Group of the UNIDROIT in which the most eminent legal experts of the 56 Member States of the UNIDROIT participated \*) completed its work of drafting a Model Law for International Commercial Contracts.

As this Model Law is the result of harmonization of contract law between Common Law countries and Civil Law countries, I am convinced that Indonesia need not to “re-invent the wheel” by attempting another comparative study on national Contract Laws and principles in order to arrive at a universally recognized set of principles for our Contract Law and Law of Obligations, but instead could benefit from the excellent work done by the UNIDROIT.

In fact there was already such a (limited) comparative law project conducted by the National Law Reform Agency (Badan Pembinaan Hukum Nasional – BPHN) in 1994, conducted by a team of Indonesian and foreign lawyers, which team I chaired, which involved a comparison between Indonesian Law Obligations, American Law, Dutch Law and Australian Law.

Nevertheless my personal view is that the UNIDROIT Principles of International Commercial Contracts would be a better example, and would give higher, universal recognition to the new Law of Obligations, including Law of Contract, as the experts involved in the UNIDROIT Working Group already represented a very large proportion of the legal systems in the world, and consisted of the most eminent, experienced and internationally recognized experts, not only in

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\*) Michael Joachim Bonell : An International Restatement of Contract Law, 2<sup>nd</sup>. ed., Transnational Publishers, Inc. Irvington-on-Hudson, New York, 1997, p. 19-30.

their own law, but also in the field of International Private Law and Comparative Law.

It is therefore, that for the sake of clarity the UNIDROIT Principles of International Commercial Contracts (UPICCS) are discussed in this study, because as we can see in Chapter 5, the Indonesian Academic Draft for a Bill of the Law of Obligations (which include the Law of Contract) has not yet adopted a number of very important principles of the UNIDROIT Model Law such as for instance, the principle of Balance between the Parties and of Protection of the Weaker Party, Fair Interpretation of Standard Contracts, Matters of non-performance in changes of circumstances or other unsurmountable difficulties to perform, Relief of responsibility in certain, specifically named circumstances and the like, which are very important principles for parties of Developing Countries, where the overall situation is not yet as stable and settled as in Industrially Developed Countries.

### **The Principles of Commercial Contracts in UNIDROIT**

In broad lines, UPICCS consists of seven Chapters, namely Chapter I : General Stipulations; Chapter II, Drawing up of Contracts; Chapter III, Validity of Contract; Chapter IV, Interpretation of Contract; Chapter V, Contents of Contract; Chapter VI, Performance of Contract, and Chapter VII, Non Performance. The Seven Chapters are further detailed in 109 Articles. UPICCS uses the method of "Restatement" as used by the ALI (American Law Institute), that is by including the "black letter law", its comments.

It must be remembered that the principles are an effort to harmonize disparate interests: those of developed and developing countries, of liberal and socialistic countries, of common law and civil law, that are applied to harmonize contract law trans-nationally. Considering the many regulations, and without ignoring other stipulations, the writer will put forward several principles that can be related to the renewal of contract law.

## **1. The Principle of Freedom to Enter into Contract**

### **a. The Freedom to Decide on the Contents of the Contract**

The first pillar of Contract Law is the freedom to enter into contract. The principle to enter into contract has also been formulated by UPICCs by providing a "reorientation to a new paradigm" in line with the existing social-economic disparities of today. The principle of freedom to enter into contract is simply formulated in UPICCs in article 1.1, with the statement that : " *the parties are free to enter into contract and decide on its contents*". To this are given 3 comments, namely: (1) The freedom to enter into contract as a basic principle in international commerce; (2) economic sectors that do not offer competition are an exception; and (3) party autonomy is provided with compulsory regulations.

There is an effort here to place the principle of freedom to enter into contract proportionally in various social situations.

**Firstly**, the principle of freedom to enter into contract is of top interest in international trade. It is the right of each businessman to freely decide on whom he wishes to offer his goods or services to, and from whom he wishes to receive supplies. Also, the opportunity to freely determine on the conditions of each transaction, forms a cornerstone of an open international economic system, that is market oriented and competitive.

**Secondly**, There are a number of exceptions in the principle of freedom to enter into contract. There are economic sectors that are the authority of the state to decide on behalf of public interest, which form exceptions to free and open competition. In this case, for example, certain goods or services may be requested from a designated supplier only, which is usually a public body, and who may or may not be allowed, under certain obligations, to enter into

contract with whoever so requests, but is limited only to available supply of the goods or services.

**Thirdly**, “party autonomy with mandatory rules”. Related to the freedom to decide on the contents of the contract, in the first instance UPICCs has provided stipulations that may not be ignored by the parties (for example Article 1.5 on the “exclusion or modification by parties”). Furthermore, there are public and private regulations that are mandatory as enacted by the state (such as Anti-Trust Law, The Law on the Control of Foreign Exchange and Price, and laws that give certain obligations or prohibit conditions in the contract that are considered not fair in general, that are meant to protect the consumer. etc). These can validate the regulation contained in the Principles (which is specifically regulated in Article 1.4 on “Mandatory Rules”).

**b. The Freedom to Determine the Form of Contract**

As a manifestation of the freedom to enter into contract, UPICCs stipulates the principle of simplicity in forming a contract. In principle, a contract need not be written. Article 1.2. states that *“in UPICCs there is no obligation that a contract must be in written form or must be proven in writing. The existence of a contract may be proven through different means, including through witnesses”*. This stipulation means that (1) As a rule a Contract is not subject to formal conditions; (2) Exceptions are possible based on the law enforced; (3) conditions of form of contract that are agreed by the parties, are also possible.

In principle, UPICCs does not prescribe anything regarding the form of a contract. Although this principle refers to the written contract, but it may be extended to other conditions of contract. The condition also covers modifications and termination of contract by agreement of both parties. This is an important principle in the context of international commercial relations, as, considering modern communications systems, transactions are made very rapidly and not based on paper documents. The first sentence in this principle

takes into consideration the fact that some legal systems consider formal conditions as a substantive issue, while others stress only the evidence. The second sentence is meant to clarify that according to the principle of freedom to use any form, this also includes the validity of oral evidence in court procedure.

UPICCs gives allowance for certain national laws that prescribe specified forms of contracts. An example is the contract on the rights of land in Indonesian law. In this case, the freedom to form a contract is modified by the law in force as Indonesian law prescribes that contracts concerning land (especially with foreigners) should be in writing. National or international law may make an exception of certain conditions, such as on the form related to the entire contract as well as to the individual conditions (for instance agreements on arbitration or jurisdiction clauses). In fact, the parties may agree on a special form for the closure, modifications or termination of their contract.

### **c. A Contract is Binding as Law**

UPICCs states the principle that a contract that is made on the basis of agreement by both parties is binding. Article 1.3. states that "*A Contract that is legally valid is binding to the parties. A contract may only be modified or terminated according to the conditions laid down by agreement or as stipulated in these principles.*" This formulation contains several principles, namely (1) the Principle of *Pacta Sunt Servanda*; (2) Modifications; (3) and the Effect of Contract on a third, unrelated party.

**Firstly**, this Principle lays down the basic principle in contract law, namely that of *pacta sunt servanda*. The binding nature of a contractual agreement clearly indicates that an agreement has been clearly entered into by the parties, and that such agreement will not be marred by any illegalities. Additional stipulations on closure of a legal contract may be found in national or international regulations that are valid and mandatory.

**Secondly**, a reasonable result of the principle of *pacta sunt servada* is that a contract may be modified or terminated at any time by agreement of the parties. Modification or termination without agreement is contrary to this exception and is acceptable only when it is in accordance with the conditions of contract or when this is clearly regulated in the Principles.

**Thirdly**, Whilst as a rule, a contract affects only those parties entering the contract, in certain instances, however, it may occur that it will also affect a third party. Therefore, a vendor, who on the basis of domestic law, may have the contractual obligation to protect the physical integrity of a certain good, is so obliged not only towards the buyer but also towards others with him at the place of sale. Similarly, a consignee of a cargo company has the right to sue the carrier for non-performance, when the carrier is bound to the contract through the sender. Based on the principle that bind the parties, this article does not ignore the effects to a third party, that may arise from the contract, based on the law in force. Also, these principles do not ignore the effects of cancellation or termination of contract on the right of third parties.

#### **d. Mandatory Rules as Exceptions**

UPICCs allows for mandatory rules that arise from domestic law, as well as from international law that may hamper the freedom of entering into contract. Article 1.4 states that “*in these principles there is no stipulation that must limit the implementation of mandatory rules, that arise from national, international or supra-national regulations, that are applied according to the regulations in the relevant civil code*”. There are four basic principles in this formulation. These are: (1) Mandatory Rules that are in force; (2) Mandatory rules that are in force only when the Principles are included in the Contract; (3) Mandatory Rules may be enforced when the Principles are the law that regulate contracts, and (4) Reference is made to the relevant international civil law pertaining to each case.

**Firstly**, By mentioning the special nature of these principles, nevertheless, it should not be interpreted that they ignore mandatory rules, arising from national, international or supra-national laws. In other words, mandatory rules that are the law in the countries as an implementation of international conventions, or adopted by supra-national organizations, may not be ignored by these principles.

**Secondly**. In the case where these Principles are considered having been included in the contract on the basis of agreement by the parties, then the Principles will, in the first place, harmonize the mandatory rules that regulate contracts. For example, these principles will bind the parties only for as long they do not affect regulations that are in force, where the parties are not allowed to ignore these regulations through contract. Furthermore, mandatory rules on forum, and possibly also third countries, will also be enforced, on condition that they apply to any law regulating contract, and in the case of third country regulations, that there is a close relation between the countries and the contract being made.

**Thirdly**, however, in the case of a dispute being brought to arbitration, where these Principles apply as the applicable law regulating contracts, then these principles can still not ignore the application of mandatory rules where the application of complaint is separated from that where the law is enforced (*lois d'application necessaire*). Examples of mandatory rules, and the application of rules that may not be ignored by choosing other laws, may be found in the area regulating foreign exchange, Import-Export licensing, regulations on restrictive trade, etc.).

**Fourthly**, The court and arbitration differ widely on the manner of application of mandatory rules pertaining to international commercial contracts. For that reason, this chapter avoids to consider several issues related to this problem, especially on whether as a complement, mandatory rules on forum and of *lex contractus* of third parties must also be taken into consideration. And if so, in

how far and based on which criteria. These problems are solved in accordance with the rules of international private law, relevant to each case.

Therefore, UPICCs stipulation basically regulates those areas of contract law that are within the purview of party autonomy. This contains rules that not only regulate but that are also mandatory. Article 5.1. mentions that "*the parties may ignore the application of these principles or divert or modify the validity of each rule, except when otherwise determined in these Principles*". Therefore, there are three main elements related to the existence of UPICCs, namely: (1) the Principles are non-mandatory in nature; (2) Ignoring or changing these may be done openly or tacitly; (3) There are, however, mandatory rules in the Principles to be observed.

**Firstly**, Rules contained in the principles in general, are not mandatory, for instance, the parties may in each separate case ignore their application in total or in part or change the contents to adjust to the principles in accordance to the needs of the special kind of transaction involved.

**Secondly**, Ignoring or changing the principles by the parties may be done openly or tacitly. Ignoring and changes are made tacitly when the conditions to be made have been individually negotiated or become part of standard conditions that are included in their contract by the parties. When the parties clearly agree to apply only several chapters of the Principles,- (for example, only on the performance or non-performance of the contract, then the Principles of UNIDROIT are valid),- then it is understood that the Chapter involved will be enforced together with the general principles mentioned in Chapter 1.

**Thirdly**, There are several stipulations in the Principles that are compulsory in nature, for instance, the importance mentioned in the Principles, when the parties are not allowed to ignore or divert from the Principles according to their own will. Given the nature of the Principles, the non-adherence to this perception has no consequence. On the other hand, it needs to be noted that stipulations that are being used reflect the standard of behaviour and rules that



are compulsory in nature based on most national laws. The Stipulations that are compulsory in nature are usually so stated.

For example, Article 1.7 on good faith and fair dealing, with stipulation in Chapter 3 on substantive validity, except insofar as these stipulations are connected or contain errors and initial impossibility (see Article 3.19). Further Article 5.7 (2) on the determination of price, and Article 7.4.13 (2) on agreed compensation for non-performance of contract. An exception is when the compulsory nature of a stipulation tacitly follows the contents and purpose of that stipulation (See article 7.1.6).

**e. The International Nature and Purpose of UPICCs to be kept in mind at their Interpretation**

As stated in Chapter II, "*lex mercatoria*" is a law that is uniform or in harmony with the laws of each country. This is also the wish of UPICCS. Article 1.6 says that "*in the interpretation of these principles, attention must be given to the international nature and the purpose, including the needs to promote uniformity in their implementation.*" What then needs to be noted are: (a) the Interpretation of the Principles in reverse to the interpretation of contract; (b) Consider their international nature; (c) the Purpose of the Principles; and (d) that there are additional stipulations to the Principles.

**Firstly,** As in each legal text that is legislative or contractual in nature, the Principles may cause uncertainty regarding their exact meaning. The interpretation of these principles will differ from the contract that the parties apply. Even when the principles are understood to be binding to the parties only at the contractual level, for example, where their application is dependent on the individual contracts, then these principles still form a set of autonomous regulations that are valid, in order that they may be uniformly applied to a number of contracts of different kinds, and are in force in many parts of the world. As a consequence, these principles must be interpreted different to such terms as used in each contract. Rules on their interpretation is

regulated in Chapter 4 of the Principles. This Chapter is concerned with the manner how the Principles must be interpreted.

**Secondly**, The first criteria in the interpretation of the Principles, as regulated by this article, are their “international nature”. This means that the terms and concepts contained therein, must be interpreted autonomously, (for instance, in connection with the Principles themselves), and not refer to meanings as are traditionally understood in certain domestic laws. This approach becomes important, considering that the Principles are the results of comparative studies made by legal experts coming from various legal backgrounds and from diverse cultural environments. When they formulated each stipulation, these experts were forced to find a legal language that is sufficiently neutral, in order that they could reach the same understanding. Even in the exceptions where the terms or purpose have never been used in their traditional meaning.

**Thirdly**, by stating that in the interpretation of the Principles one must note their purpose, this article clarifies, that the Principles are not interpreted rigidly and to the letter, but must be seen in the framework of their purpose and in the rationale found in each stipulation, as is also found in the Principles as a whole. The Purpose of each stipulation can be known, both through the text itself and from the comments on the stipulations. As to the purpose of the Principles as a whole, this article clarifies that, the main purpose of the Principles is to provide a uniform framework for international commercial contracts, and firmly refers to the need to promote their uniform application. For example, by giving assurance that in practice, the Principles offer the widest possible interpretation and are uniformly applied in diverse countries. See further Article 1.7, which, although addressed to the parties, may also be included in the purpose of the Principles to investigate good faith and fair dealing in the context of contractual relations.

**Fourthly**, a number of issues that should have been included in the Principles are, however, not distinctly regulated. To determine whether or not issues are within the purview of the Principles, despite the fact that they are not being

clearly thus regulated, or whether they fall outside of it, it should first be determined whether or not these are clearly stated, either in the text and/or in the comments.

The need for uniformity in the application of the Principles means that whenever there is this gap, then a solution must be found, wherever possible, in the Principles themselves, before domestic law is used. The first step to a solution for unsolved questions is to apply an analogy on certain stipulations. Therefore, Article 6.1.6 on the Place of Performance, should also have regulated the problem of Compensation. Similarly, stipulations in Article 6.1.9 that relate to the problem of financial obligations expressed in a foreign currency other than the one where payment is made, should also include financial obligations that may be expressed in financial units, such as SDR (Special Drawing Rights), or ECU (European Currency Unit). When, however, a problem can not be solved by extension of the stipulation through analogue cases, then solution may be sought in the underlying general principles. Several of these basic principles are clearly stated in the Principles. Others, however, must be found in the special considerations, for instance, where regulations must first be analyzed to see whether the stipulations may be considered as a statement of a general principle, and may also be applied to the case other than that which it specifically regulates.

The parties are of course at liberty to agree on certain national laws that may be referred to, to complement the Principles. This stipulation may read as follows: *“This contract is ruled by the UNIDROIT Principles and complemented with laws from country “X”, or “This contract must be interpreted and implemented in accordance with the UNIDROIT Principles, while matters not clearly solved through these, may be solved in accordance to the laws of country X”.*

## **2. The Principle of Good Faith and Fair Dealing**

The second pillar of Contract Law is the principle of good faith and fair dealing. The two principles must become the basis of the entire contract, from the time of negotiation to its performance and termination of contract. Article 1.7 says that (1) in international commerce, each party must act according to the principle of good faith and fair dealing; and (2) that the parties may not ignore or limit this responsibility. According to the “restatement” of this article, there are three essential points in the principle of good faith and fair dealing. These are: (1) “good faith and fair dealing” as a basic, underlying concept of the Principles; (2) that in international trade, there is a specific interest in the principle of good faith and fair dealing; and (3) there is a mandatory element in the principle of good faith and fair dealing.

**Firstly**, there are a number of stipulations in the entire chapter, that differ from the Principles, that contain the direct or indirect application of the principle of good faith and fair dealing. This means that good faith and fair dealing is considered as one of the most basic ideas that underlie the Principles. To state in the general conditions that each party must act according to the principles of good faith and fair dealing, paragraph (1) of this article clarifies that, although there are no specific stipulations in the Principles, on the behaviour of the parties during the entire process of the contract, including during the process of negotiation, nevertheless, the parties must act in accordance with the principles of good faith and fair dealing.

**Secondly**, Reference made to the “principle of good faith and fair dealing in international trade”, is meant firstly to clarify, that in the context of the Principles, these two concepts are not applied similar to their usual application in national legal systems. In other words, domestic standards may be considered only as long as they are generally acceptable among different legal systems. Furthermore, implications of the formula thus used mean, that the principle of good faith and fair dealing must be interpreted in the framework of special conditions in international trade. Standard business practice may differ

from one trade sector to the other, and even within one sector may differ more or less, depending on the social and economic environment where the company does its business, the company's size, technical capabilities, etc.

It must be noted that when referring to the Principles and/or comments on good faith and fair dealing, such reference is related to "good faith and fair dealing in international trade" as specified in this article.

**Thirdly,** The responsibility of the parties to act according to the principles of good faith and fair dealing forms a basic nature, meaning that the parties may not by contract ignore or limit this principle (clause (2)). On the other hand, it does not prevent the parties to include in their contract, the responsibility to seek improved quality of behaviour.

### **3. The Principle of Recognizing Local Usage in Business Transactions**

As stated by Wirjono Prodjodikoro in the Draft Law that he proposed, that one of the principles that must be noted in drafting the new Contract Law is the principle of Usage and Custom. It appears that UPICCs has also included the principle in application of local usage. Article 1.8 that regulates Usage and Practices states that (1) The parties are bound by each usage that they have agreed upon and by each practice that is in force among them; and (2) that the parties are bound by usage that is widely known or routinely in use in international commerce by parties engaged in a particular trade, except when such usage is unreasonable.

This stipulation contains six important main elements , namely: (a) Practices and usage in the context of the Principles; (b) Practices in use among or between the parties; (c) Usage that has been agreed upon; (d) Other usage in force; (e) the Application of unreasonable usage; and (f) usage that ignores the Principles.

**Firstly**, this article lays down the principle that the parties are, in general, bound by practices and usage that meet such conditions as regulated in this article. Further, these same conditions must be met in practice, and usage to be applied to each case and for such purpose as clearly mentioned in the Principles.

**Secondly**, a practice that is in use between the parties in a certain contract is automatically binding, except when the parties specifically mention to ignore such use. Whether or not a practice is “in use” between the parties will naturally depend on the situation in each case. However, a behaviour that was found only once in a previous transaction between the parties is not deemed sufficient.

**Thirdly**, by stating that the parties are bound by the usage that they have agreed upon, clause (1) of article 1.8. merely validates the general principle regarding entering into contract as regulated in article 1.1. In fact, the parties may negotiate all conditions of contract, or in specific matters refer to sources other than usage.

The parties may formulate the application of each usage, including such usage normally used in the commercial sector, but that is not yet used by either of the parties, or usage related to other kinds of contracts. This makes it possible, however, for the parties to agree on what is wrongly interpreted as “usage”, as for example to apply the term “usage” to a set of regulations drawn up by a trade association, but which, in fact, only partially decides on general behaviour.

**Fourthly**, clause (2) determines the criteria by which to identify usage that may be applicable when no special agreement has been made by the parties. In fact, usage must “be known in general and routinely experienced in the related trade”, and forms a condition for the application of usage at international, national or local level. The next qualification that refers to “international

commerce" is to avoid usage that is in use, and limited to domestic transactions, to be requested to be applied to transactions with foreign parties.

Only usage that is purely local or national in nature, may be applied without special reference to it by the parties. Therefore, usage that is in force in the exchange of certain commodities, or in trade exhibitions, or in harbours, is applicable when such usage is routinely followed by foreign parties. Another exception is related to the problem of a merchant who is bound in a number of contracts in a foreign country, and is thus bound by such usage as are usually applied in that country in similar contracts.

**Fifthly**, a usage may be well known to business people in general within a given trade sector, but its application in a special case may be unreasonable. The reason for this may be found in certain situations where one or both parties take actions that in themselves or by their nature are not normal in such transactions. In this case, usage can not be applied.

**Sixthly**, Once the manner of transaction and usage are in force in the case under consideration, then they ignore opposing stipulations included in the Principles. The reason for this is because they are binding to the parties as implicit conditions in their totality. It is as though they replace those conditions that are specifically formulated by the parties, but by the same token, in their application they ignore the Principles. Exceptions are made only for stipulations that are specially mentioned as mandatory.

#### **4. The Principle of Agreement through Offer and Acceptance and through Behaviour**

In principle, agreement is reached through offer and acceptance. The Contract Law of the Civil Code does not regulate these principles. On the contrary, the UPICCs formulators considered the practical elements in the process to a contract, because in this process will arise the contractual rights and

responsibilities towards the making of the contract, that are based on the principles of good faith and fair dealing. Article 2.1 of UPICCs states that “ *A contract may be made either through offer and acceptance or through the behaviour of the parties that show that there exists an agreement*”. In short, there are two main elements here, and these are: (1) offer and acceptance; or (2) there is the behaviour showing that there exists an agreement between the parties.

The basis for the UPICCs Principle is that an agreement between the parties is sufficient to make a contract. The concept of offer and acceptance is traditionally used to determine “whether and when” the parties have come to an agreement. The combination of the concept of “offer and acceptance” on the one hand, and that of “behaviour” on the other, seems to indicate that the drafters have tried to combine the Common Law concept with the Continental Law concept of agreement. As explained in this article and Chapter, the UNIDROIT Principles used this concept as its main tool of analysis.

In commercial transaction practice, contracts that entail complex transactions are often formed only after long negotiations, without a specified sequence of offer and acceptance. In such a case, it may be difficult to determine the actual time that the contractual agreement has been reached. According to this article, a contract may be made although the actual time of agreement may not be determined, as long as the behaviour of the parties indicate sufficiently that an agreement has been reached. In order to determine whether there is sufficient evidence as to the wishes of the parties to be tied to a contract, their behaviour must be interpreted in accordance to the criteria set out in Article 4.1. etc.

In practice there often arise disputes as to when an offer has actually been made. In this case UPICCs has tried to define on what is meant by an “offer”. Article 2.2 states that “A request to enter into a contract becomes an offer when that offer sufficiently determines and shows that there is a wish of the offering party to be tied to a contract when there is acceptance”. Through this definition, the term “offer” is differentiated from “other communication”, where



one party in the negotiation may take the initiative to draw up a contract. This article therefore prescribes two conditions, namely that the request must include (1) an agreement to close a contract only when there is acceptance, and (2) show the wish of the offering party to be tied when there is acceptance.

Therefore, the basic elements are: (1) that there must be certainty of an offer, and (2) there is a wish to be tied. Whenever a contract is made only through offer and acceptance, further conditions must have been shown with due certainty in the offer itself. Whether or not the offer complies with these conditions may be determined from the general conditions. More detailed conditions may be mentioned, such as: (a) description of goods and services and when these will be delivered or handed over; and (b) the price of the said goods and services.

As regards the time and place of performance, this may be left undecided in the offer, without causing the offer to become less deciding. Thus, this will all depend on: (a) whether or not the offering party has seriously made an offer, (b) whether the party to whom the offer is addressed wishes to enter into a firm contract, and (c) whether conditions not mentioned in the contract may be determined through interpretation of the language of the agreement, or is not according to Article 4.1.etc, or refer to Article 4.8 or 5.2. This uncertainty may, however, be solved by referring to preceding practices or custom among the parties (vide Article 1.8), or refer to other special regulations found in other articles, as in Article 5.6 on Determining the Quality of Performance, 5.7 (On Pricing), 6.1.1 (on Time of Performance, 6.1.6 (on Place of Performance), and 6.1.10 (on Currencies not explicitly mentioned).

The second criteria to determine whether or not a party has made an offer that leads to a contract, or whether he is merely opening negotiations, can be seen from whether the party wishes to be tied when there is acceptance. This desire is rarely stated explicitly, and must therefore be interpreted in each separate case. The making of an offer (for example by firmly mentioning that this is "an offer", or merely an "expression of a wish" becomes the first indication of the

possibility of a wish, although it is not yet determining. Even more important, however, is the contents and the addressee of the request. For most people, a detailed and specified request addressed to one person or persons in particular, is usually meant as an offer, as compared to a request addressed to the general public.

A request may contain all main conditions of a contract but still does not tie the party giving the offer, despite it being accepted, if the request causes the closing of contract to be dependent on several small points that are left open in the said request.

An offer may also be withdrawn by the party making the offer. Article 2.3 states that (1) an offer becomes effective only when it reaches the party addressed to; and (2) an offer, even in the case when it can not be withdrawn, may still be withdrawn if the withdrawal reaches the addressee **before or at the time of offer**. When is an offer effective? Clause (1) of this article that is literally taken from Article 15 CISG, determines that an offer becomes effective at the time it reaches the addressee.

The exact point in time when an offer becomes effective is important, as it pinpoints the moment when the addressee may accept the offer, so that it will tie the offering party to the proposed contract.

However, there may be other reasons why an offer in practice may be important to be withdrawn. For, until such moment, the offering party is free to change his mind and decide not to enter into a contract, or replace his first offer with a second one, regardless whether the first offer will be withdrawn or not. The only condition here is that the party to whom the offer is addressed, must be informed that the offering party wishes to make changes, even before, or at the time that the addressee is informed of the first offer. Clause (2) of this article differentiates between "withdrawal" and "revocation" of an offer, as follows: before an offer becomes effective, that offer may be revoked, while the problem

whether or not it may or may not be withdrawn arises only after that time (see Article 2.4).

Article 2.4 clause (1) confirms that until a contract is made, an offer may be withdrawn if revocation is received by the person being offered, before it has become an acceptance. However, an offer may not be revoked (a) when the offer shows, both through confirmed time of receipt or through statement that the offer may not be revoked; or (b) when the party offered rightfully considers it as irrevocable and that he has acted according to the offer.

The question whether an offer may or may not be revoked, has traditionally been a most controversial problem related to the drawing up of contract. As long as there are no prospects of harmonizing the two disparate concepts in their basic approach, i.e. in the different legal systems, namely the approach of common law, where as a rule an offer may be revoked, and, conversely, the approach made by most civil law systems, then only one approach can be chosen as the main rule, and the other as exception.

Clause (1) of this article, which has been literally taken over from Article 16 CISG states that until the moment that the contract is made, then an offer, as a rule that may not be revoked. However, the same clause mentions that a revocation of an offer is subject to the condition that revocation reaches the party offered, before the latter has confirmed receipt. This happens only when the party offered states orally that he has received the offer, or when the party offered indicates to its agreement by performing an action without informing the offering party, on the rights of the offering party to revoke his offer at any time until the contract is signed (vide Article 2.6(3)). However, if the offer is received through written confirmation, then the contract is closed at the time that the acceptance is received by the offering party (see Article 2.6 (2)), when the right of the offering party to revoke his offer has ended faster, that is when the offered party has stated his acceptance. This manner of negotiation may result in disadvantages to the offering party, who may not know whether he still is, or

is no longer in a position to revoke his offer. Yet, the party offered is justified to shorten the time for the offer to be revoked.

Clause (2) defines that there are two important exceptions to the general rule on revocation of offer: these are (1) if the offer indicates that it is irrevocable, and (2) if it was reasonable for the offeree to rely on the offer as being irrevocable.

Article 2.4 clause (1) confirms that until a contract is concluded the offer may be revoked if the revocation is received by the offeree or the person being offered, before he has dispatched an acceptance. However, an offer may not be revoked (a) when the offer shows, both through confirmed time of receipt or through statement that the offer may not be revoked; or (b) when the party offered rightfully considers it as irrevocable and he has acted accordingly to the offer.

The question whether an offer may or may not be revoked, has traditionally been a most controversial problem related to the closing of contract. As long as there are no prospects of harmonizing the two disparate concepts in their basic approach, i.e. in the different legal systems, namely the approach of offer, and acceptance, and, conversely, the approach made by most civil law systems, based on agreement, then only one approach can be chosen as the main rule, and the other is an exception.

Actions (of acceptance) made by the party being offered (offeree) may be in the form of preparations for production, buying or renting goods or equipment, laying out of expenses etc., as long as these actions are considered normal in the related trade, or are normally expected, or are known by the offering party.

An offer is not always accepted, but an offer may be rejected. Article 2.5 mentions that "An offer is terminated when rejection is received by the offering party". Rejection may be firmly mentioned or made in silence, but rejection is one of the reasons for the termination of offer. An offer is often rejected through

a response that shows acceptance but with additions, limitations or other restrictions (see article 2.11(1)).

In the case where there is no firm rejection, then statements or behaviour of the party offered must at all times convince the offering party that the party offered has no intention to accept the offer. An answer that merely asks for alternatives (for instance "can you reduce the price" or "can you send the goods earlier"), are usually not sufficient evidence of rejection.

It must be remembered that rejection will cause the offer to be terminated, disregarding the fact whether or not the offer may or may not be revoked, as mentioned in Article 2.4.

Regulations on the manner of acceptance are found in Article 2.6, that (1) A statement made or the behaviour indicated by the party offered that show acceptance to the offer, is considered an acceptance. Silence or inaction do not by themselves mean acceptance; (2) Acceptance to an offer becomes effective when indications of acceptance reach the offering party. (3) If, however, when based on an offer or as a result of existing practice among the parties or by custom, the offeree shows acceptance through an action, despite not informing the offering party, then acceptance becomes effective upon performance of the action.

In order to show that there is acceptance, the party offered must, by one or other means, show "acceptance" to the offer. A mere information that the offer has been received, or to say that the offer is attractive, does not suffice. Furthermore, acceptance must be made without condition, meaning that acceptance may not be made conditional to further actions to be taken by the offering party (for example "our receipt depends on your final acceptance"), nor by the party offered (for example "we herewith accept the conditions set out in your memorandum and will endeavour to submit the contract to our Board for their agreement within two weeks"). Finally, the contents of acceptance should

not include variations on conditions offered, or at least not alter these materially.

It is also ruled that, offer does not specify a special manner of acceptance. Indication of acceptance may be made through firm statement as well as through the implicit behaviour of the accepting party. Clause (1) of article 2.6. does not provide details on the form of behaviour, but it may be assumed that the behaviour is found in its performance, such as in advance payment on price, shipment of goods, or commencing work at appointed place.

By stating that "silence or inaction do not by themselves indicate acceptance", clause (1) explains that as a rule silence or inaction do not indicate that the offered party has accepted the offer. The situation becomes different if both parties have agreed that silence means acceptance, or when there is a certain way or custom that rules it thus. But if this has never happened, it is sufficient for the offering party to state in his offer that the offer is considered accepted when there is no response to the offer. While he takes the initiative to propose the signing of contract, the offered party is at liberty to accept or reject the offer, and may easily disregard the offer.

According to clause (2) acceptance becomes effective upon indication that acceptance has reached the accepting party (vide Article 1.9 (2)). On the definition on "reach" see Article 1.9(3). The use of the principle "receipt" is given priority to the principle of "sending", because the onus of sending is on the party offered rather than the offering party. This is because it is the former who decides on the means of communications, and who knows whether the means of communication chosen bears certain risks or delays, and who can assure that receipt reaches the addressee.

As a general rule, acceptance that is indicated merely through behaviour becomes effective only when information on the matter is received by the offering party. But it must be noted that special notification by the offered party becomes necessary only when his behaviour does not by itself explicitly indicate acceptance to the offering party within a reasonable time frame. In all

other matters, for instance when behaviour includes payments or shipment of goods by air or other fast transportation, the same results may be reached through the bank or transportation company who will inform the offering party of the remittance of money or shipment of goods.

A general exception to this general rule of clause (2) of article 2.6. may be found in the case mentioned in clause (3), namely that “ on the bases of offer or as a result of general practice among the parties, or by custom, the offeree can show acceptance through action, without informing the offeror party”.

In this case, acceptance becomes effective when the action is performed, without regard to whether or not the offering party has been properly informed.

Article 2.7 specifies the time of receipt. An offer must be received when the offering party has asked for confirmation, or in the case when there are no indications of time, through adequate time given, considering the situation, including the speed of communication used. A verbal offer must be received immediately, unless the situation shows otherwise.

With respect to the period of time that an offer must be received, this clause, which is in line with the second part of clause (2) of Article 18 CISG, differentiates between verbal and written offer. A verbal offer must be received immediately unless the situation shows differently. While, on a written offer, everything depends on whether the offer specifically mentions time of receipt. If affirmative, then the offer must be received within that time frame, while in any other matter, indications that there is acceptance must be received by the offering party “in adequate time period considering the situation, including communication facilities used by the offering party”.

It is very important to note that the regulations as mentioned in this article are also valid in circumstances, where according to Article 2.6(3), the offered party can show acceptance through action without informing the offering party: in this case this becomes a performance that must be made within a specific ensuing time period.

To determine the exact commencement of time frame set by the offering party, including calculation of holidays within that time frame, can be seen in Article 2.8; while in the case of delayed receipt or delayed sending, see Article 2.9.c.

### **5. The Principle on Prohibition to Negotiate in Bad Faith**

An important Principle regulated by UPICCs is regarding the extent of the principle on good faith that is in force as from time of negotiation. Article 2.15 regulates the prohibition to negotiate in bad faith, by determining that : (1) A person is free to negotiate and is not responsible for the failure of reaching an agreement; (2) However, a person in negotiation or who ceases negotiations in bad faith is responsible for the losses suffered by the other party. (3) It is bad faith, especially for someone to negotiate or continue to negotiate, when in fact he has no intention to reach an agreement with the other party.

Basically there are three important points to this rule, namely (1) the freedom to negotiate; (2) Responsibility for negotiations made in bad faith; and (3) The responsibility for the failure of negotiation in bad faith. A “restatement” of these three principles is explained by UPICCs, as follows :

**Firstly**, the parties are not only at liberty to decide when and with whom to make negotiations towards a contract, but also when, in what manner, and the time taken for the process of negotiation. These follow the principles of freedom to enter into contract, as mentioned in Article 1.1, and forms the basis to guarantee healthy competition among international commercial enterprises.

**Secondly**, it is the right of each party to freely make negotiations and to decide on the conditions of negotiations, which is not without limits, as this must not contravene with the principle of good faith and fair dealing, as regulated in Article 1.7. An example of negotiation in bad faith as explained in clause (3) of this article is when one party starts negotiations or continues to negotiate with no intention to make an agreement with the other party. Another example is



when one party, on purpose or by neglect, misleads the other party regarding, among others, the identity or conditions of contract put forward, by providing clearly misleading facts and through the withholding of facts that should have been given, on the identity of the parties and/or the contract. On the subject of responsibility to guard confidentiality, see Article 2.16.

The responsibility of the party who negotiates in bad faith is limited to the losses that he has incurred upon the other party (clause (2)). In other words, the affected party may ask for compensation of expenditures made during negotiations, and may also be indemnified for lost opportunity to enter into contract with a third party (this is called interest on trust or negative interest). However, in general he should not be asked to compensate for expected profit of the failed contract (known as interest on hope or positive interest).

**Thirdly**, the right to stop negotiations is also subject to the principle of good faith and fair dealing. When an offer has been made, then that offer may be revoked only within a time limit as specified in article 2.4. Even before reaching this stage, or when in the process of negotiations that do not follow the usual sequence of offer and acceptance, then one of these parties is no longer free to suddenly cease negotiations without due justification. If no agreement can be reached on this matter, then it will depend on the circumstances of the case. Specifically until the other party, who, resulting from the behaviour of the first party, puts forward sufficient reasons that may become the basis for further negotiations, including all other matters related to the contract on which agreement has been reached by both parties.

## **6. The Principle to Guard Confidentiality**

During negotiation, company secrets may almost certainly be disclosed and, therefore, will be known to both parties. As a result, it is possible to misuse such confidential information to one's own advantage. Article 2.16 regulates the responsibility to guard confidentiality. When information is provided in

confidence by one of the parties during negotiation, then the other party has the responsibility not to divulge this information or misuse this to his interest, whether or not the contract will or will not be signed later. When necessary, such violation may be penalized or compensated on the basis of profit gained by that party. Three points may be deduced from this regulation, namely: (1) that the parties are basically not responsible to guard confidentiality; (2) there are information that is confidential by nature; and (3) that losses may be compensated.

**Firstly**, only when there is no responsibility to announce, then parties in the negotiation do not have the responsibility to treat exchanged information as confidential. In other words, when one party is at liberty to decide which data in the negotiated transactions may be disclosed, then such information, according to this regulation, is not confidential. Meaning, that it is information that the other party may disclose to a third party or may use for himself, even though the contract may fail.

**Secondly**, one of the parties has an interest that certain information provided by the other party should not be divulged or used for other purposes, except that for which it was provided. As long as that party clearly states that the information provided is confidential, then the situation is clear, namely that by receiving the information the other party is implicitly aware to treat the information as confidential.

A problem may arise when the prohibition to disclose information is considered too long, which may contravene existing laws that prohibit business practices that are hampering by nature. In fact, without such statement the party receiving the information may be burdened by the confidentiality. Because, facing the nature of the information or professional qualifications of the parties, that responsibility will be opposed to the general principle of good faith and fair dealing, when the party receiving the information discloses the information or uses such information for his personal interest when negotiations are cancelled.

**Thirdly**, Violation on the principle of confidentiality includes the regulation on first responsibility on losses. The amount of loss to be compensated may vary, depending on whether the parties have made a special agreement on whether or not to disclose information. Even when the adversely affected party does not suffer any losses, he has the right to ask for compensation from the party violating this agreement. This is to be taken from the gains the latter has received as a result of disclosing such information to a third party, or has misused it for his own advantage. When necessary, even when the information has not yet been disclosed or is only partially disclosed, then the disadvantaged party may ask for an injunction based on existing laws.

#### **7. The Principle of Protecting the Weak in Contracts with Standard Conditions**

As mentioned above, standard contracts form a source of "lex mercatoria". The practice of using standard conditions is common in the business world, including in Indonesia.

Article 2.19 determines that: (1) When one or both parties use standard conditions in a contract, then general conditions on the drawing up of a contract are in force, and are subject to Article 1.10-1.11. (2) Standard conditions are prepared specifications for general, as well as repeated use by one of the parties, but clearly without having held prior negotiation with the other party. This Article is the first of four articles (2.19-2.22), that regulate special situations where one or both parties use standard conditions in drawing up a contract.

"Standard conditions" must be seen as specifications of contract that are prepared for general and repeated use by one of the parties and are in fact used without prior negotiation with the other party (clause (2)). The determining factor in this case is not its formal appearance (for example that the standard conditions are contained in a separate document or in the contract document

itself; whether they are printed or stored in a computer, etc), it is also not the question of who has prepared these standard conditions (the party itself, the trade association, or professional association). Also, the question is not the contents (whether the conditions contain a set of complete rules covering almost all aspects relevant to the contract, or contain only one or two specifications on exceptions on responsibility or arbitration). What is important here is the fact that the standard conditions are clearly decided by one party only, without prior negotiation with the other party. These latter were previously only concerned with standard conditions that the other party must accept in its totality, while other conditions in the same contract may be negotiated.

In practice, general conditions in the drawing up of a contract are in force without regard whether one or both parties use standard conditions or not (clause (1)). This determines, that general conditions that are proposed by one party are binding to the other party only when accepted, depending on the case whether both parties have agreed only to those conditions that are explicitly mentioned or also include those that are implicitly understood. On the other hand, standard conditions that are contained in a separate document must be clearly mentioned by the party who wishes to use those conditions. The tacit use of such conditions may, however, be recognized when this has been the practice among the parties or is a common custom. See Article 1.8.

Article 2.20 regulates that whenever there are unusual "conditions", by specifying : (1) that no condition contained in the general conditions that are by nature unacceptable to the other party will become effective, unless that condition is explicitly accepted by the other party; and (2) in order to determine whether a condition contains that nature it must be seen from its contents, language and presentation.

The elements of this specification may be divided into four categories, namely that: (1) Unusual conditions in general conditions are not effective; (2) Conditions may be "unusual" in its contents; (3) Conditions that are "unusual"

in their language and presentation; and (4) Explicit acceptance of “unusual” conditions. Below follow comments on the four categories.

**Firstly**, a party that accepts general conditions as given by the other party, is in principle bound by them, regardless whether or not the party is aware of all the details, or has, or has not clearly understood the consequences of the conditions. There is, however, an important Exception to this rule, namely that, however much these general conditions have been accepted in their totality, nevertheless, the related party is not bound to the conditions when their contents, language or appearance are of a nature that is reasonably unacceptable to him. The reason for this exception is to avoid a party from using standard conditions in order by misusing his advantaged position to surreptitiously force the conditions on the other party, who would have rarely accepted such conditions, if he was aware of them. For other articles that aim to protect the economically weak and less experienced, see Articles 3.10 and 4.6.

**Secondly**, a condition that is included in the standard conditions may be found to be unusual because of its contents. This happens when the contents in such condition is normally not found in standard conditions in similar instances. To determine whether or not a condition is normal, one must study, on the one hand, conditions that are normally in use in this particular commercial sector, and negotiations that are normally in use between the parties. For this reason, a condition that, for example, excludes or limits contractual responsibilities on the part of the proposing party, may or may not be considered “unusual” and thus become ineffective in that particular case, where its effectiveness depends on whether such conditions are considered normal in that particular trade sector, and whether it is consistent with what is normal practice among the parties in the negotiation.

**Thirdly**, another reason for a condition contained in the general conditions to be considered unusual by the party involved, may be on account of its written language, which may not be clear, contain misprints, as for instance, in the

case of minutes of meetings. In order to determine whether or not this has happened, consideration need not be given to the formulation and presentation normally used in the typing of standard conditions, but more to on the professional expertise and experience of the party involved. Then, particular words may be both clear and unclear at the same time, depending on whether the related party has the same profession as the party using the standard conditions.

Language may also play an important role in international trade. When standard conditions are formulated in a foreign language, then several conditions may be considered unusual to the related party, despite the fact that they are clearly expressed in the conditions themselves, as the related party does not normally expect having to accept the consequences of such conditions.

**Fourthly**, the risks that are expected to be taken by the related party who is to be bound to unusual conditions will disappear, as long as they are openly discussed, and when the other party notifies the related party on these conditions and he then accepts the conditions. This Article specifies that then the parties will no longer base their agreement on the "unusual" nature of the condition, but on the fact that both parties have clearly agreed on the condition.

In practice there are often conflicts between "standard conditions" and non-standard conditions" that have been agreed upon. Article 2.21 determines that "in the case of conflict between standard conditions and non-standard conditions, then it is the latter that is valid".

Standard conditions are defined as specifications that have been prepared by one party and incorporated in the contract without prior discussion by the parties (see Article 2.19(2)). It is logical that when the parties specially negotiate and agree on specifications in a given contract, then these specifications will set aside such standard conditions that oppose these, when these conditions better reflect the wishes of the parties in the case.

Specifications that are separately agreed upon, may appear in the same document as the standard conditions, but may also be included in a separate document. In the first instance, it will be more difficult to differentiate between the conditions that are standard and which are not, and to determine the position of hierarchy of the different documents. In this case, the parties will often clearly include specification of contract, and which documents form part of the contract, as well as their individual value.

A special problem may arise when changes on standard conditions are only agreed upon orally, without crossing out specifications that oppose the standard conditions, whereas, those conditions specifically regulate the exclusive nature of any written notes that are signed by the parties, or where additions or changes in contents must be made in writing. On this case see Article 2.17 and 2.18.

Article 2.22 regulates the case when there are conflicting forms, meaning when both parties put forward forms or standard conditions. When both parties use standard forms and have agreed on exceptions on standard conditions, then a contract may be made on conditions agreed, whose contents are as per normal, except when one party has shown, or later without undue delay informs the other party, that he has no wish to be bound to the contract.

There are three situations that are regulated here, these are: (1) when both parties use separate standard conditions; (2) "the conflict of forms" is linked to the general regulations on offer and acceptance; and (3) when the doctrine of "knock-out" is used.

**Firstly**, it often happens in commercial transactions, when both the offering party as well as the accepting party, each refer to their own standard conditions. In the case when there is no clear acceptance on the offering party of conditions put forward by the accepting party, then the question arises as to what is the contract based upon, and which standard conditions are in effect.

**Secondly**, Whenever general conditions of offer and acceptance are applied, then there is no contract, when the acceptance by the offered party, -as exception mentioned in Article 2.11(2),- is accompanied by a counter-offer, or when both parties have started acting on the agreement without stating any objections to the other's standard conditions. In this case it is considered that a contract has been made, based on conditions that were sent last or last referred to, which is known as the last-shot doctrine.

**Thirdly**, the last-shot doctrine may be correctly applied when the parties clearly show that the use of their standard conditions are a requisite to the contract. On the other hand, when the parties, as often happens in practice, refer to their standard conditions almost automatically, for example, through the exchange of printed orders, and information on order forms with conditions printed on its back, then neither may be aware of any discrepancies existing between their conditions. In this case, then there are no reasons to allow the parties to dispute the contract. Or, when action has been taken, to force the validation of the last shot conditions.

This is the reason why this article determines that, despite it being regulated in the general specifications on offer and acceptance, but when the parties have agreed on exceptions to standard conditions, it must be on those conditions that are considered normal (or known as the knock out doctrine).

However, one of the parties may always put aside the knock-out doctrine, by earlier expressing, or later, but without undue delay inform the other party, that he does not wish to be bound to a contract that is not based on his own standard conditions.

## **8. Principles Regarding Conditions for Validity of Contract**

On this matter, the writer will not discuss all considerations regarding conditions for the validity of contract according to UPICCs. What needs to be underlined here is that UPICCs does not regulate the validity of contract as



contained in Article 1320 of the Indonesian Civil Code. The reasons for this are confirmed in Article 3.1. that state that the Principles do not regulate the invalidity of contract that arise from :

(a) inability; (b) non possession of authority; and (3) immorality and illegality.

This article confirms that not all reasons for the invalidity of contract as found in several national legal systems are used in the context of the Principles. The reason for this exception is the complexity that arises from problem of status, agency and public policy and the extreme differences that exist on the manner how the issue is treated in domestic law. The result is that, issues such as *ultra vires*, that is the fact of an agency going beyond its authority, or whether a director has the authority to bind the company, and the contents of an immoral and illegal contract, are regulated further in the laws that are in force.

The validity of contract that is regulated by UPICCs is solely based on the aspect of agreement, because this principle basically regulates only the mechanism of agreement made by the parties as founded on the freedom to enter into contract. The following discussion will highlight only outstanding specifications that are not yet regulated in the Civil Code.

An issue that is important to discuss is article 3.3. of the Principles that regulates the situation of "initial impossibility". The article says that: (1) The mere fact that at the time of conclusion of the contract, the performance of the obligation assumed was impossible, does not affect the validity of the contract. And that (2) The mere fact that at the time of conclusion of the contract one party was not entitled to dispose of the assets involved in the contract, does not, by itself affect the validity of contract.

The contract is valid even when the assets involved in the contract were already destroyed at time of contract, with the consequence that the impossibility of execution from its onset is equal to the impossibility that will happen after the contract is made. The rights and responsibility of the parties arise from the inability of one party (or maybe of both parties) to perform that which according

to regulations is tantamount to non-performance. An example is when an obligor has known of the impossibility of performance even at forming of contract.

Clause (1) also eliminates the possibility of doubt, such as on the validity of contract to deliver prospective goods. If the initial impossibility is caused by legal prohibition (as an export or import embargo), then the validity of contract will depend on whether, based on such legal prohibition, the contract must be cancelled or whether it prohibits only its implementation. Clause (1) even deviates from regulations found in several civil legal systems that state that the object of the contract must be made possible. This clause also deviates from the same regulations that state that there is an "authority", who because of initial impossibility, .... While Article 3.2 clause (2) of this article regulates cases where one party has promised to move or deliver goods, while, at time of forming the contract, he has no right of delivery, title nor legal rights on the goods nor its division.

Several legal system further state, that a contract on buying and selling that has been made under such conditions is null and void. But, in the case of initial impossibility, and even for stronger reasons, clause (2) of this article considers such a contract valid. In fact, as often happens, one party may receive legal title, or authority to take out goods after the contract is made. If this does not occur, then the rules on non-performance will come into force. The authority not to take out goods must be differentiated from the inability to do so. The latter concerns the inability of a person to perform, that can affect all or at least several types of contracts that he has made, however, that is beyond the scope of the Principles. See Article 3.1 (a).

The Principles also determine the possibility of cancellation of contract when there are mistakes, either on facts or on the law (article 3.4), mistakes in expression or presentation (article 3.6), the opportunity to correct non-performance caused by mistakes (article 3.7); ...(article 3.8) and threats (article 3.9).

However, most important to discuss in full is the Principle regarding the cancellation of contract based on gross disparity among the parties, which is not found in the Indonesian Civil Code.

### **9. The Principle Regarding the Possible Cancellation of a Contract with Gross Disparity**

Basically, this Principle is an implementation of the Principle on Good Faith and Fair Dealing and the Principle of Balance and Justice. It is based on the fact that there are gross disparities in society. For this reason there is the need for a regulatory system that can protect the party that is in a disadvantaged position. Article 3.10 on Gross Disparity states that: (1) One of the parties may cancel the contract or individual conditions of the contract at time of signing, when the contract or conditions contain in it provide unreasonably excessive advantages to the other party.

Attention must be given to the following factors: (a) the fact that the other party dishonestly profits from the dependence, economic difficulties or other urgent needs, or through his extravagance; or through ignorance, inexperience or unprofessionality at bargaining; and (b) the nature of the contract. (2) Based on the request of the party that has the right to cancel, the court may adjust the contract or the condition in accordance with reasonable commercial standards and fair dealing. (3) The court may adjust the contract or the conditions, on request of the party receiving the cancellation, as long as the latter informs the other party of his exact request upon receiving the information, but before the other party has acted according to the contract or its conditions. Specifications in Article 3.13 (2) are in force accordingly.

This stipulation contains three factors, namely (1) excessive profit; (2) unjustified profits as a result of (a) unbalanced bargaining position, (b) the

nature and aims of contract, and (c) other factors; and (3) cancellation or adjustments.

Firstly, these stipulations allow one of the parties, in the case of gross disparity of responsibilities on the parties, which offers excessive and unjustifiable profits to one party. The matter of excessive profits must be present at time of making the contract. A contract, that does not appear to be dishonest when the contract comes in, but later shows itself to be so, may be adjusted or terminated based on the stipulation of hardship mentioned in Article 6, section 2. The term "excessive" profits means that, according to this article, a significant difference in value and price or other aspects that disturb the balance in the performance and counter-performance, is not sufficient reason for the cancellation or adjustment of contract. What is required is such gross imbalance as to shock the feelings of a reasonable person.

Secondly, regarding unjustified profits, these profits must not only be excessive in their nature, but must also be unjustified. Whether or not this stipulation is met will be seen after evaluation of all aspects relevant to the case. Clause (1) of this article specifically refers to two factors that need special attention.

The **first** factor is that one of the parties has received unfair profits from the dependence, economic difficulties or urgent needs of the other party, or on account of his extravagance, ignorance, inexperience or unprofessional conduct at bargaining (sub clause (a)).

Similar to the situation where one party is dependent on the other party, a superior bargaining position that is a result of market conditions alone, is not sufficient.

The **second** factor is the nature and purpose of the contract (sub clause (b)). There are situations where excessive profits are unjustified even when the party receiving such profits has not misused his superior bargaining position.

Whether such situation has or has not occurred often depends on the nature and purpose of contract. Therefore, a condition in the contract that is valid for a very short period that informs about faulty goods or services that have been sold or delivered, - despite this being justified as agent contribution, - may become substantial at the end of the transaction. Or where the value of the goods or services are not high, this may accrue to excessive profits when the contributions are insignificant, or conversely, when the value of the goods and services are excessively high. In this case, other factors must be considered, for instance, ethics in use in business and commerce.

**Thirdly**, cancellation of the entire contract or of several conditions in the contract are, according to this article, subject to the general conditions regulated in Article 3.14-3.18. However, according to clause (2) of the article, upon request of the rightful party to cancel, the court may adjust the contract in accordance with reasonable commercial standards in fair transaction. Similarly, according to clause (3) the party receiving notice of cancellation may also request adjustment, as long as he immediately informs the canceling party of this request upon receipt of the cancellation notice, and before the canceling party has acted in accordance with the said cancellation.

When the parties can not agree on the procedure to be taken, this must be considered by the court whether the contract should be cancelled or adjusted, or when adjusted, with what conditions. When, upon the notice or thereafter, the party who has the right to cancel asks for adjustment only, then his right to cancel is forfeited. See Article 3.13 (2).

Nevertheless, because the condition to cancel is a right, this means that the wronged party is not forced to cancel the contract. In fact, conversely it can be reconfirmed both explicitly or tacitly. Because, if this possibility is not regulated, there may arise uncertainties about the contract.

Article 3.12 regulates such enforcement by stating that when the party who has the right to cancel, either explicitly or implicitly confirms the contract after a

period of time when notice of cancellation is in process, the cancellation of contract must be disregarded.

This article stipulates that the party who has the right to cancel, may explicitly or tacitly confirm the contract. The tacit confirmation of contract may not be sufficient, for example when the party with the right to cancel the contract sues the other party for non-performance. A confirmation is acceptable only when the other party knows of the suit of when the court has given its verdict. A confirmation of contract may also happen when the party with the right to cancel proceeds to act upon the contract without using his right to cancel the contract.

Another case may be where the party with the right to cancel the contract loses such rights. Article 3.13 states that (1) When the party who has the right to cancel the contract does so on account of a mistake, but the other party states that he wishes to continue to perform and further acts upon the contract, and this is understood by the canceling party, then the contract is considered made in accordance with the understanding of the other party. The other party must then make a statement to that effect or .....; (2) Upon such statement or performance of contract, then the right to cancel the contract will be forfeited and each notice of cancellation prior to this will be invalid.

According to this article, the party at fault may avoid the cancellation of contract when the other party expresses his wish to perform or clearly acts according to the contract as understood by the party faulted. The other party's interest may be based on the profits that he gains from the contract, or even in its adjusted form.

The other party must clearly state that he will perform or clearly performs the contract in its correct adjusted form upon notice of the manner in which the faulted party understands the contract. As regards how the other party has received the information on faults to understand the conditions of the contract, depends on the circumstances of the case.

Clause (2) clearly states that as soon as there is a statement by the other party, or a clear implementation, then the right of the faulted party to cancel the contract is forfeited and every earlier notification on cancellation of contract becomes invalid. Conversely, the other party no longer has the right to adjust the contract when the faulted party has not only been given notification of cancellation but has also acted in accordance with such notification.

Acceptance of contract by the other party, however, does not preclude the faulted party from suing for damages according to Article 3.18, when he has suffered irreparable loss through adjustment of the contract.

#### **10. The Principle of “Contra Proferentem” in the Interpretation of Standard Contract**

The interpretation of contract is regulated in Chapter 4 that includes eight articles (article 4.1 to 4.8). However, in this paper only those that are not regulated in the Indonesian Civil Code will be discussed, in order that these may act as examples for the renewal of the Indonesian contract law. It is also because other stipulations are basically already regulated in positive law.

An important stipulation that has developed in “lex mercatoria” is the interpretation of standard contracts. Article 4.6 regulates “contra proferentem rule” which says that when conditions of contract as proposed by one party are not clear, then the interpretation made by the opposing party must be given priority.

One party is responsible for the formulation of a condition of contract, either because that party has prepared it himself, or has merely proposed it, perhaps, by using standard conditions that have been prepared by someone else. That party must then bear the risk of possible vagueness in the formulations used. That is the reason why this article says that, when conditions of contract, as

proposed by one party are vague, then priority of interpretation will be given to that of the opposing party. While the scope of validity of this regulation will depend on the circumstances in each case; and shortcomings in the conditions of the following contract will become agenda items in further negotiations of the parties,.....

Furthermore, differences of interpretation in the language of the contract, may cause disputes in international commercial contracts. Article 4.7 stipulates that when a contract is drawn in two or more language versions and both are in force, and when there are differences between the two versions, then interpretation must be made based on the language of the original contract.

International commercial contracts are often drawn in two or more language versions that can reconcile certain points. Sometimes parties clearly mention the version in force, for when all versions are equally in force then the problem arises as to how such differences must be resolved. This article, however, does not make hard and fast rules, but merely points out that preference should be given to the original version used in the contract, or, when the original is drawn up in different language version, to either one of the versions.

A situation when a different solution is preferred may arise when the parties base the contract on instruments that are widely and internationally used, such as INCOTERMS or UCP (The Uniform Customs and Practices on Documentary Credits). In the case when differences occur in other versions that are used by the parties, then the other version may be used, if this is clearer.

Article 4.8 stipulates that when the parties in the contract are in disagreement on a condition that is important to the rights and responsibilities of each, then a condition more appropriate to the circumstance must be proposed.

In order to decide on what is the more proper condition, attention must be given to the following factors, among others: (a) the wishes of the parties; (b) the



nature and purpose of contract; (c) good faith and fair dealing, and (d) properness.

Articles 4.1 – 4.7 is concerned with the interpretation of contract in its strictest sense, namely how to properly decide on the meaning of conditions of contract that are found to be vague. This article refers to problems related to the thinking process, i.e. *implicit conditions*. Implicit conditions or gaps will occur when, after the closure of contract, a problem occurs that has not been regulated in the contract, either because the parties did not want to regulate it or they did not expect this to happen. In several cases on implicit conditions or gaps in contract, the Principles offer ways to resolve the problem.

See, for example, Article 5.6 (Stipulation on the Quality of Performance), 5.7 (Stipulations on Price), 6.1.1 (Time of Performance), 6.1.4 (Request for Performance), 6.1.6 (Place of Performance), and 6.1.10 (Non specified currency). See also, in general Article 5.1 on implicit responsibilities. But, even when there are additions, or “stop-gap” conditions, or when general conditions are not applicable, or these regulations do not provide any correct solution to the situation as expected by the parties, or by the special nature of the contract, then this article may be validated.

Tacit conditions that are proposed, according to this Article, must be appropriate to the case concerned. To determine what is meant by “proper”, attention must first be given to the wish of the parties, which can be deduced, among other factors, from conditions that are specifically stated in the contract, or that are made before negotiations, or through the behaviour of each after the signing of contract.

In cases when the wishes of the parties can not be determined, then the condition proposed may be determined by the nature and purpose of contract, based on the principles of good faith and fair dealing and properness.

## **11. The Principle to Honour Contracts in Hardship**

An Article that is important in the Chapter on the Performance of Contract is the stipulation on the Situation of Hardship. This must be differentiated from "Force Majeur" which is regulated in the Chapter concerning Non-Performance. Regulations on Hardship are found in Article 6.2.1 to 6.2.3.

Article 6.2.1 stipulates that, when a performance of contract becomes heavier for one party, that party is, nonetheless, still bound to perform his promise and is subject to the stipulations on hardship. This stipulation identifies two main points, namely (1) the binding nature of a contract as a general rule; and (2) the change of relevant circumstances that is acceptable only in exceptional cases.

**Firstly**, the aim of this article is to clarify that, as a result of the validity of the general principles regarding the binding nature of a contract (see Article 1.3.), performance of contract must, as far as possible, be implemented, regardless of the weight of burden on the performing party. In other words, although one of the parties may suffer great losses rather than earn the expected profits, or when the performance of the contract becomes insignificant for that party, yet conditions of contract must in all circumstances be honoured.

**Secondly**, the principle of the binding nature of a contract is, however, not absolute. Whenever situations occur that cause fundamental changes in the balance of contract, then those are exceptional situations, which in the Principles is termed "hardship", as will be explained in the ensuing articles of this section.

The phenomenon of hardship is well known in several legal systems, but is hidden behind other concepts such as frustration of purpose, *Wegfall der Geschäftsgrundlage*, *imprevision*, *excessiva onerosita sopravvenuta*, etc. The term hardship is chosen because this term is widely known in international trade and is confirmed by its inclusion in several international clauses, which are termed as "hardship clauses".

Article 6.2.2 defines that hardship occurs when an event happens, whereby the balance of the contract changes fundamentally, either because the costs to perform the contract have risen, or because the value of the performance of contract has been reduced for the receiving party. Furthermore, (a) the occurrence of the event is known by the party damaged only after the closing of contract; or (b) the event could not be reasonably foreseen by the party damaged; (c) the event occurred beyond the control of the party damaged; and (d) the risks involved in the event have not been estimated by the party damaged. These stipulations regulate the following :

**a. Definition of Hardship**

Article 6.2.2. UPICCs defines the term “hardship” as a circumstance where an event has occurred that has caused fundamental changes to the contract, that meet the conditions regulated in sub clause (a) to (d). There are 3 (three) elements in “hardship”, namely: (1) a fundamental change has occurred in the balance of the contract, or (2) the costs of performing the contract rises, or (3) the value of the contract to one of the parties has been reduced.

**Firstly**, the general principle stipulates that, a change in circumstances does not effect (change) the responsibility of performance (see article 6.2.1). Then, the stipulation further mentions that hardship is applicable only when the change in the balance or equilibrium of the contract is fundamental in nature. A change in a case may be considered “fundamental”, depending on circumstances. When performance of contract can be precisely measured in financial value, then a change of 50% or more from the costs of the original value of the contract is considered a “fundamental” change.

**Secondly**, in practice, a fundamental change in the balance of contract is reflected in two different but connected ways. First, it is marked by a substantial increase in costs experienced by one party to meet his obligations.

This party is usually the only one who must fulfil non-monetary obligations. The increase in costs, may, for example happen as a result of a dramatic increase in raw materials that are important in the production of goods or the implementation of services, or because of new safety regulations that entail higher cost of production, or by an abnormal change in the exchange rate of foreign currency.

**Thirdly**, the manifestation of the second kind of hardship is marked by a substantial decrease in the value received by one of the parties, including when it has completely erased all value to the receiver. The performance may be monetary or non-monetary in nature. The substantial decrease of value or a total failure in the implementation of the contract may occur when a drastic change has occurred in the market (for instance as a result of a dramatic inflationary increase in cost, way above that agreed upon in the contract), or because of failure of implementation (for example as a result of a prohibition to build on the designated plot of land, or an embargo on received goods meant for re-export).

Of course the reduction in value in the performance must be measurable objectively: a mere personal opinion of the receiving party that there has been a reduction of value, is not relevant. As in all cases where there is failure to achieve the purpose of performance, this may be considered only when the purpose is known, or at least should be known by both parties.

**b. Additional Conditions on Hardship.**

There are 4 (four) additional "hardship" conditions justifiable by law, and these are : (1) that the event occurred or is known to have occurred only after the closing of contract, (2) the event is one that could not have been reasonably foreseen by the party damaged, (3) the event is beyond the control of the disadvantaged party, (4) the risk must not have been expected or assumed by the disadvantaged.

**Firstly**, according to sub-clause (a) of this article, the event that has caused hardship has occurred, or is known to the party damaged, only after the closure of contract. When this party has known about this at time of closure of contract, he should have made his calculations at the time of contract, and may, therefore, not use hardship as a reason.

**Secondly**, even when the change in the balance of contract happens after conclusion of the contract, sub-clause (b) of this article clarifies that this situation will not cause hardship when it should have been reasonably anticipated by the party damaged at the time of closure of contract.

**Thirdly**, based on sub-clause (c) of this article, hardship arises only when the events that cause hardship are beyond the control of the party damaged. Fourthly, based on sub-clause (d) there will be no hardship when the damaged party had anticipated/estimated the risks in a changed situation. The word "estimate" clarifies that the risk may not have been stated clearly, but follows the nature of the contract. One of the parties that enters into a speculative transaction is considered to have anticipated a measure of risk, although the risk has not been fully realized at time of signing the contract.

**c. Hardship is relevant only in Long-term Contracts in not yet performed implementation**

In line with its nature, hardship becomes relevant only when it is related to forthcoming performance.

When fundamental change in the balance of contract occurs after partial performance, then hardship becomes relevant only to unperformed actions.

Although this chapter does not specifically sets aside the possibility of hardship on other types of contract, hardship usually becomes relevant in long-term contracts, when performance by at least one party exceeds a certain time frame.

On the other hand, related to the definition of hardship and that of force majeure (see Article 7.1.7), according to these Principles, there may occur factual situations where a case may be considered both a hardship and a case of force majeure. When such a situation arises, then it depends on the damaged party to decide which legal action to take. When that party opts for force majeure, then legal action requires that the clause on non-performance be used. If, on the other hand, the party uses the reason of hardship, then in the first instance this is aimed at a re-negotiation in the conditions of contract, so that the contract is still valid although with changed conditions.

**d. Hardship as a Result of the Law Related to the Contract**

The definition of hardship in this Article is more general in nature. International commercial contracts often include more specific details in this regards. The parties may consider it more appropriate to adjust the contents of this article in the light of special situations in special transactions.

What are the legal consequences involved in this hardship, is explained in Article 6.2.3, that determines as follows: (1) At hardship, the party damaged may ask for re-negotiation. This request must be put forward immediately, pointing out the basis for such request.; (2) A request for re-negotiation does not by itself give the right to the party damaged to cease performance; (3) When no agreement has been reached in reasonable time, then either party may bring the matter to court. (4) When the court decides that there was hardship, the court may, when considered reasonable: (a) terminate the contract at a determined date or time period, or (b) change the contract to restore it to a balanced condition. Based on this decision, the restatement says as follows:

**(i) The Damaged Party has the Right to ask for Re-negotiation**

Because hardship contains a fundamental change in the balance of contract, clause (1) of article 6.2.3. provides in the first instance, the right to the disadvantaged party to request re-negotiation. The request, however, shall be made without undue delay.

A request for re-negotiation is not acceptable when the contract itself already contains a clause that allows automatic change in contract (for example, when there is a clause that allows automatic change in index given in changed situations).

Nevertheless, re-negotiation is allowed when the clause pertaining to change, as mentioned in the contract, does not describe the event that has actually caused the hardship.

**(ii) Request for Re-negotiation Without Undue Delay**

A request for re-negotiation must be made without undue delay from the time when hardship has occurred (clause (1)). The exact time when to request for re-negotiation will depend on each case: for instance, this time frame may be longer when the situation occurs in phases (see comments 3(b) of Article 6.2.2.).

The damaged party does not forfeit his right to ask for re-negotiation when he has neglected to act on this immediately. The delay may be due to allow a more in-depth study on the reasons, and whether or not hardship has occurred; and if it has, how it will affect the contract.

Clause (1) of article 6.2.3. also justifies the disadvantaged party the obligation to point out the reasons for re-negotiation, to allow the other

party to more accurately estimate whether such request for re-negotiation is or is not reasonable. A request that is not complete, is temporary considered unacceptable, except when the basis for hardship is so evident that it does not need to be specifically mentioned in the request. Clause (2) of this article determines that the party requesting re-negotiation is not by itself given the right to cease performance. This consideration is based on the special nature of hardship, and to avoid the misuse of law. The cessation of performance is justified only in exceptional circumstances.

**(iii) Re-negotiation must be made in Good Faith**

Although this article does not specifically mentions it, however, request for re-negotiation by the damaged party, as well as the behaviour of both parties during the process of re-negotiation are subject to the general principles of Good Faith (Article 1.7) and the Obligation to cooperate (Article 5.3). Therefore, the damaged party must in all honesty believe that there has been clear hardship and not request for re-negotiation only as a tactical maneuver. Also, when once request has been made, both parties must act in such a way that re-negotiation can be constructive, restrain from any disturbance and by providing all important information.

**(iv) Failure to Reach Agreement to be Brought Before the Court**

When both parties have, within a reasonable time frame, failed to reach agreement on the changes in the contract or to the changed situation, then clause (3) of this article provides the authority to the parties to bring the case before the court. This situation may arise either because the party who has not been affected, completely disregards the request



for re-negotiation, or because re-negotiations have not reached positive results, although both parties have approached the issue in good faith.

How long one party must wait before he can appropriately bring this problem before the court will depend on the complexity of the problem and the special situation in each case.

According to clause (4) of this article, when a court considers that hardship has occurred, it may resolve this in different ways. The first possibility is to terminate the contract. However, termination of contract in this case, depends on the non-performance of one party, where the outcome of this decision, as mentioned before, may be different from similar regulations generally applied (Article 7.3.1. *et seq*). Thus, clause (4) (a) determines that termination must be made "on the date and on the conditions" as determined by the court.

Another possibility is that the court makes changes to the contract in order to restore the balance of contract (clause (4) (b)). In this case, the court will decide on the fair sharing of losses between the parties. This action may, or may not cover changes in costs, depending on the nature of hardship. However, when changes cover costs, then the change does not necessarily mirror complete improvement resulting from the change in situation, for example the court will consider the extent of risks suffered by one party, and the extent to which the party receiving performance of contract actually benefits from its performance.

Clause (4) of this article clearly states that the court may terminate or change a contract only when deemed appropriate. Indeed, the situation may show that the solution does not lie in the termination or changes in contract, but must be found in the re-negotiation efforts by the parties themselves to reach agreement, or through improvements in the conditions of contract, that the parties themselves have determined.

## **12. The Principle of Acquittal of Obligation in Force Majeur Situations**

Non-performance happens when one party fails to perform his obligation in line with the contract, which includes defective or delayed performance. **The first form** is when “Non-performance” is defined as including all forms of performance, from a defective to the complete failure of performance. Therefore, it is non-performance when a developer builds one part of the construction according to the contract, but the other part is either defective or late in completion. **The second form** is taken to lay down the principles, where “non-performance” covers the “non-excused” and the “excused”.

Non-performance may be excused by reason of the behaviour of the other party in the contract (see Article 7.1.2), (Interference of a third party) and 7.1.3 (on the Continuation of Performance), and its further comments, or by reason of unexpected external events (Article 7.1.7 (on Force Majeur) and its comments). A party does not have the right to sue the other party for damages or special treatment on excused non-performance, but the party who has not received the results of performance has the legal rights to terminate the contract, on account of excused or non-excused non-performance. See Article 7.3.1 *et seq*, and its comments.

There is no general rule that regulates the accumulation of legal actions. It is assumed by this principle that all legal actions which are logically inconsistent may be accumulated. Therefore, in general it is regulated that when one party has succeeded to force performance, will have no right of damages, but, there is no reason why one of the parties may not terminate the contract on the basis of non-excused non-performance and at the same time sue for damages. See Article 7.2.5 (Change in legal action), 7.3.5 (The results of termination in general) and 7.4.1 (Rights on damages).

The following discussion will focus on the reason for the party acquitting non-performance because of force-majeur. Article 7.1.7 regulates the situation of

Force Majeur by stipulating that: (1) non-performance by one party may be excused when that party can prove that non-performance was caused by an obstacle beyond his control, and that it could not have been reasonably expected at time of closure of contract, or that he could not avoid or overcome the event or its effects. (2) When the obstacle is only of temporary nature, then the excuse must affect that period only within reason, with due consideration to the effects made by the obstacle upon the contract. (3) The party who fails to implement the contract has to notify the other party on the obstacle and its effects on his capabilities to perform. When the notice is not received by the other party in reasonable time, after the party who has failed to perform has known or should have known of the obstacle, then the latter will be responsible for damages as a result of non-receipt of notice.; (4) This Article does not, however, prevent any of the parties to use his rights to terminate the contract, refrain from implementing the contract, or ask for payments on interest on moneys due.

**a. The Meaning of Force Majeur**

This Article covers the foundation covered in the system of common law which is known as the doctrine of frustration and the impossibility of implementation of contract, which in civil law is known as the doctrine of force majeure. Otherwise known as "Unmoeglichkeit", etc, this stipulation is not identical with the two doctrines mentioned earlier. The term force majeure is chosen in this principle, because this term is better known in international trade practice, and in several international contracts is known as the force majeure clauses.

**b. The Effect of Force Majeur on Rights and Obligations**

This Article does not limit the rights of the parties, who have not received performance of contract, to terminate the contract, when non-performance is fundamental in nature. Whatever action has been taken, and where the

contract is acted on, form elements of excuse for the non-performing party to be acquitted from obligation on damages.

In several cases, obstacles may stand in the way of the entire performance of contract, at times this may be a delaying factor, in which case, according to this article he may be given additional time for performance. It should be noted that when additional time is given, which is longer (or shorter) than the delayed time given in crucial cases, this will result in the overall delay in the implementation of contract.

This Article should be read in conjunction with Chapter 6, section 2 of the Principles regulating hardship. See comment 6 on Article 6.2.2.

The definition of force majeure in clause (1) of this article is of a general nature. International commercial contracts often include more exact and more detailed specifications. In this case, both parties may decide the more correct stipulation and adapt the contents of this article to the special situation of the special transaction.