

## THE INVALIDITY IN THE PRINCIPLES OF EUROPEAN CONTRACT LAW – COMMON CORES AND ALTERNATE WAYS

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**Abstract:** The Principles of European Contract Law (PECL) has never been adopted as a binding legal authority in the European Union. While it remained a conclusion of a massive research project, the PECL certainly has an impact on the amendments to the legal framework for contracts throughout the Member States, and it serves as a unique *lex mercatoria* for European businesses. Furthermore, the PECL provides a starting point for any research that aims to identify common cores in the European contract law heritage. Chapter IV of PECL is dedicated to the validity of contracts, thus, this chapter serves as the base for the document's approach to the invalidity of contractual obligations. The invalidity of contracts remains a much-debated legal phenomenon in almost all jurisdictions and international business law. The presentation embraces the instances of invalidity (mistake, threat, fraud, inaccuracy in communication, excessive benefit, unfair advantage, unfair terms not individually negotiated), matters not covered by the PECL (illegality, immorality, or lack of capacity), the concept and the effect of avoidance, and the consequences of avoidance in light of the most recent amendments to the contract law framework in the Member States. The central question is whether the PECL's system on the invalidity of a contract may serve as a bridge between the different approaches of continental civil law legal systems and the common law legal systems. The presentation provides some examples of hot topics from the case law of selected municipal courts in Europe to identify the challenges courts face when deciding on the validity of contracts these days. Using these examples and combining them with some of the most recent legislative developments on invalidity across Europe, the presentation is searching for an answer to whether the common cores the PECL identified could help the spontaneous approximation of the laws of the Member States on contractual invalidity, or the Member States chose alternate ways to react to the practical challenges of the modern business environment.

**Keywords:** *PECL, invalidity, contract law, European legal heritage, harmonization of laws*

The question of the validity of contracts has been a long-time phenomenon not only in jurisprudence but in everyday legal practice as well. In the European Union, despite several attempts, even a partial harmonization of the general rules of contract law seems to be an idea. While the European Commission has been committed to the establishment of a European contract law that may provide for common cores and harmonized concepts in the topic of general contract law, no attempt was found

worthy of adoption by the Member States. Till now, the probably most interesting and influential attempt in the process of harmonizing contract laws in the European Union is the Principles of European Contract Law (hereinafter PECL) (Lando, 2003), which was intended to be much more than just a snapshot on the common cores and legal heritage of the Member States concerning contract law and the law of obligations: it was meant to offer a normative text, a draft for a future legislation in the EU. The PECL never earned the status of a binding legal authority, therefore, it remained an interesting outcome of a very thorough research project. Despite this troubled history of the PECL, it still often served as a reference point to national lawmakers across the European Union when introducing revisions to their existing contract law regimes. Therefore, the impact of the PECL is far more overreaching than what we may envisage given this latent and yet spontaneous harmonization of contract laws in the Member States the document could achieve. We do not say it is equal to the original intention behind the making of the PECL, however, it is still much more than what one could foresee based on the current non-legal status of the document.

As contract law relies on the concept of enforceability everywhere in the world, the PECL also had to pay particular attention to the classic crack on the shield: the grounds for invalidity. Chapter IV of the PECL is dedicated entirely to the question of validity (and invalidity) making it a key topic with utmost importance to any lawmaker. As with other chapters of the PECL, Chapter IV is incomplete as it does not cover the classic grounds of nullity, instead, it only deals with the grounds of voidability. The former category merges those instances when a serious mistake undermines the enforceability of the contract, and that mistake jeopardizes not only the interest of the parties or one of the parties but the public interest and the entire society. These grounds of nullity mainly cover three scenarios in most legal systems in the European Union: illegality, immorality, and lack of capacity. Illegality typically resembles the attitude of the lawmaker in a society that may be connected to the national culture or national political ambitions and public policies. (Keirse, 2011, p. 39) Therefore, it is easy to understand why a document that aims to harmonize contract laws in various legal systems should not cover the grounds of illegality as a threat to the enforceability of contracts. Immorality is even more rooted in the national culture and is also in constant motion. The morality of a society can hardly be seen as a constant phenomenon and as a beacon that applies to more than one nation. Also, immorality is a troubled legal category that is in lack of an exact definition, instead, it is formed by judicial practice. Finally, lack of capacity is an issue connected to the law of persons, an area of private law that also relies on national legal culture. The PECL was intended to provide for the second branch in the harmonisation of private laws in the EU that targeted business-to-business transactions as opposed to the first branch of the harmonization attempts: consumer contracts. Illegality, immorality, and lack of capacity (the grounds for nullity) are typically associated with consumer contracts (either contract between consumers or between a business and a consumer). In the business-to-business (B2B) world of contract law, voidability is more often referenced the dispute settlement proceedings,

therefore, it seemed the right decision to focus on this angle of validity in a document that was entrusted to launch a harmonization process in the European Union. Two and a half decades have passed since the publication of the PECL, and business ethics, and contracting practices changed a lot. In the globalized world economy, it is a genuine question to see whether the intended provisions of the PECL on validity can still reflect those common cores in the contract laws of the Member States of the European Union, or the Member States stepped into alternate paths when deliberating on contractual issues connected to the invalidity of the agreements. This short paper intends to disclose some debates connected to the problem of validity in the Member States from the angle of the PECL.

### **1. AN OPPOSITION OF CIVIL LAW AND COMMON LAW CONCERNING MISTAKE**

Civil law and common law legal systems exist right next to each other in the European Union. While the United Kingdom left the European Union factually on 1 January 2021, it still left some legal systems that were heavily influenced by English common law (Ireland and Malta are notable examples). The vast majority of the Member States follow civil law traditions, however, our globalized world most certainly left an impact on some of these civil law systems pushing them a bit closer to mixed systems that merge common law legal institutions and civil law concepts in their contract laws. (Hesselink, 2021, p. 228) On the concept of invalidity, there is a big gap between common law and civil law. Civil law legal systems typically recognize mistake as a ground for invalidity even if the mistake to fact or law was not accountable to the other party. The civil law concept of mistake is equal to misapprehension. Civil law systems also list fraud or threat (including undue influence) as classic grounds for invalidity and typically categorize these instances as scenarios of voidability in contract law. Common law legal systems, however, barely recognize unilateral mistake as a ground for challenging the enforceability of the contract, instead, they rely on the concept of misrepresentation as a classic ground of voidability. Misrepresentation remains the core concept in common law, and very often it is even more restrictive given that it exclusively refers to a common (shared) mistake of the parties. The ideology behind this restrictive approach to the mistake is that the law should protect the reasonable reliance of the other party who believes an agreement did come into existence. (Smits, 2021, pp. 159–176) Declaring a contract invalid merely based on a unilateral mistake of one of the contracting parties would jeopardize this mission of contract law in common law legal systems.

It is not that hard to see a relationship between the concept of misapprehension/misrepresentation and the interpretation theories in contract law. The impact of the interpretation theories on invalidity concepts is remarkable in the two legal systems. Civil law systems typically follow the subjective interpretation approach when looking for the true and enforceable meaning of the contract. The subjective interpretation theory dictates looking at what was in the minds of the parties at the time they made the contract. This approach equally protects the parties

and provides for the possibility to challenge the enforceability of the agreement even if just one party was at a mistake. The invalidity concept of misapprehension, therefore, can be deducted from the subjective interpretation theory. (Kötz and Weir, 1997, p. 147) Common law, however, mainly relies on the objective interpretation approach when it instructs judges to look only at circumstances as they would seem to an impartial bystander. This latter concept is a bit more compatible with serving public policies as it keeps some distance from the parties when a dispute on the interpretation of the agreement is at the centre of the discussion. Therefore, it is not surprising common law legal systems do not want to give recognition to unilateral mistakes of one party to the agreement as it is typically hidden from society or from that impartial bystander. The PECL follows a mixed concept of interpretation. It merges the subjective and the objective concepts prioritizing the subjective approach when stipulating *'a contract is to be interpreted according to the common intention of the parties even if this differs from the literal meaning of the words'*. [Art. 5:101(1) PECL] The objective approach is reflected in the PECL as follows: the party's statements and other conduct are to be interpreted *'according to the meaning that reasonable persons of the same kind as the parties would give it in the same circumstances'*. [Art. 5:101(3) PECL] The PECL, therefore, can safely take the more open concept of mistake as a ground for invalidity too: it recognizes the civil law misapprehension as well as the common law misrepresentation.

The preconditions to mistake as to fact or law are clearly defined in the provisions of the PECL. The existence of the contract is by far the most important requirement to even analyse the effects of a potential mistake. When the meeting of the parties' minds is completely missing, it results in a non-existent contract rather than an invalid one. In practice, however, it is a truly thin dividing line between the non-existence of a contract and the invalidity of a contract based on a mistake. The decisive factor is the importance of the subject of the mistake. If the mistake refers to an important but non-essential part of the agreement, it should be categorized as a potential ground for invalidity. If the mistake is essential, therefore, the mistaken party would not have entered into an agreement at all, this is a defect in the meeting of the minds of the parties, therefore, the contract does not even exist. The second prerequisite to assessing the effect of a mistake is misapprehension. Civil law limits legally relevant mistakes to errors about the *'very substance of the thing or about the person with whom one contracted'*. (Smits, 2015, p. 163) Misapprehension does not require the conduct or the involvement of the other contracting party. It only refers to an important mistake in facts or law. The third precondition is the existence of a causal link. The contract would not have been concluded under the same conditions on a correct assessment of the facts. This causal link is vital when deciding on the invalidity of the contract. The mistake refers to an important element (or elements) of the contract, however, it is not fundamental that could have resulted in the party's lack of intent to make a contract in the first place. Finally, the fact the mistake refers to must bear apparent importance. The other party may not know the mistake but that the mistaken party regarded a certain quality as vital. This last condition clearly shows that PECL embraced the civil concept of mistake rather than the

misrepresentation concept of common law. The PECL does not necessarily require the mistake to be a common mistake. The classic situations that lead to the invalidity of the contract are as follows:

- the mistake was caused by information given by the other party;
- the other party knows or should have known of the mistake (contrary to fair dealing and good faith to leave the mistaken party in error);
- the other party made the same mistake (common or shared mistake).

In the first situation when the mistake is caused by incorrect information given by the other party, it does not necessarily mean the other party had any intention to mislead the mistaken party. The PECL does not go into details on the nature of the incorrect information, however, we can see some problems in the interpretation of the incorrect information in practice. Especially in the heavy and dynamic competition environment of the 21st century in the European Union, the so-called ‘sales talk’ is often at the centre of discussion whether it can be assessed as incorrect information given by the other party or not. (Kötz, 2017, p. 124) Such sales talks include the magnification of certain attributes of a product or a service without going into too many details. Examples would be ‘the best’, ‘unique’, ‘the most beautiful’, and alike that the future contracting party use to increase the demand for the product or the service. Sales talk, in the judicial practice of most Member States, does not result in rights that would arise from it. Courts typically conclude sales talk is too generic to induce mistake in the other party. While it can have an impact on the psyche of the other party, it is not specific enough to be assessed as a generator of a mistake. (Gordley, 2001, p. 247) More concrete statements are needed to induce mistake for the other party. In real-life scenarios, examples would be when the merchant states the product is fit for a certain use and has a certain quality that is missing. These statements, however, are rarely referred to as situations leading to the voidability of the contract. Parties are more interested to use these more concrete statements as measurements of the conformity of the performance to the contract. Therefore, it is mostly assessed as an instance of the breach rather than a situation of invalidity. The misled party may rely on the concept of the breach and apply the remedies of the breach (e.g. claim for performance, damages, or termination) that may not be available in case of an invalid contract.

Another situation of mistake is when it is caused by non-disclosure by the other party. Civil law accepts silence as a cause of a legally relevant mistake, it does not require the active conduct of the other party. Modern contract law in the laws of the Member States now provides for some solutions to assess pre-contractual obligations. Some of them would categorize it as a form of tortious liability, while others have specific rules for this in contract law. (Gullifer and Vogenauer, 2014, p. 189) The party should reasonably expect to be informed about certain matters before agreeing. By this concept, Article 4:107(3) of the PECL describes the common grounds for this situation of mistake when determining the disclosure of information on:

- whether the party had special expertise;
- the cost to it of acquiring the relevant information;

- whether the other party could reasonably acquire the information for itself;
- the apparent importance of the information to the other party. [Art. 4:107(3) PECL]

The obvious question is when and what to disclose. In case the information can be easily acquired by one's own effort, it is typically not an obligation to the other party to disclose. There are, however, serious differences between societies valuing initiatives and education. In societies valuing initiatives, the law expects the citizens to be vigilant and active in gathering information on the expected performance in the contract. These legal systems tend to look at citizens as grown-ups and hold them accountable for recklessness in acquiring readily and easily available information. In the latter case, however, the legal system is more patriotic over citizens and expects less activity from a future contracting party to acquire even easily available information. (Hesselink, 2021, p. 73) In practice, this results in a gap in the assessment of the obligation of disclosure. Still, some common cores can be identified in the judicial practice of the Member States. There is no need to inform about future changes that may be acquired by the other party. Especially in the contract between businesses (professionals), one party does not have to disclose information on a likely surge in the market for the product that is the subject of the agreement. The costly acquiring of the information, however, may be relevant in several jurisdictions (e.g. France, Germany). (Mak, 2020, p. 202) It is not surprising some legal systems pay particular attention to the costs of acquiring certain information and decides on the obligation of disclosure based on the outcome of the cost efficiency analysis. Civil liability has been in transition from classic liability (sanction) to a cost and risk allocation system since the 1970s. (Gullifer and Vogenauer, 2014, p. 107) This cost efficiency analysis concept suits this trend and may be seen as a purely objective theory. Based on this concept, a hidden defect of the hardwood floor (woodworms affecting the floors) can only be recognized if the potential buyer invests in a costly and unreasonable opening of a section of the floors. Common law legal systems rarely respect the situation of non-disclosure as a ground for invalidity. In sales contracts, they apply the 'caveat emptor' (buyer beware) policy that shows the non-disclosure of information is not relevant in their theories on invalidity.

The only type of mistake recognized in common law legal systems is the common (shared) mistake. In this scenario, both parties may avoid the contract, therefore, it is a practical approach to the question of validity. Civil law legal systems also recognize common mistakes, however, they do not limit the scope of application of the concept of mistake to this scenario. In the infamous German match-fixing case, a football club purchased the game rights of a football player from another club. None of the parties (football clubs) were aware the player had accepted a bribe to lose a game before the parties made the contract. When the incident became known to the oversight bodies, the player lost his game rights and became practically useless to any football club. The buyer invoked the concept of common mistake and successfully made the court declare the contract void. The German court followed a

risk allocation on the wrong assumption and made the seller pay the consideration back to the buyer. (Sefton, 2005, p. 341)

## 2. FRAUD

In case the party's misapprehension is caused or self-induced by the other party's statement of silence, it is the instance of fraud that also leads to the invalidity of the contract. Fraud requires the intention and bad faith of the other party. In the previous instances of invalidity, non-disclosure might have been completely unintentional and, therefore, unaccountable to the party. Fraud, however, is pre-meditated. The party understands the consequences of giving incorrect information or non-disclosure, and he also knows whether the information is incorrect or it has relevance and importance to the other party. The most obvious difference between mistake and fraud is in the remedies. In case of a mistake, the mistaken party may avoid the contract, while fraud almost always leads to damages.

While the prerequisites to fraud are almost identical in the laws of the Member States, the party's contribution to fraud remains an open question and results in divergent theories on fraud. Not all intentionally misleading and false statements lead to deceit as the party's (the victim's) contribution may levy the conduct of the fraudulent party. The addressed party's knowledge and expertise must be dully analysed when deciding on the relevance of that party's contribution. There is, however, an obvious problem concerning the addressed party's knowledge. Some Member States adopted the concept of the 'average consumer' that was originally created in European consumer law to filter the contribution of the addressed party. These legal systems (e.g. Belgium, Germany, Hungary) require a certain level of knowledge and expertise from the contracting parties and oblige them to recognize obvious instances of fraud. Other legal systems, however, only care about the special circumstances of the case that may derogate this expectation on the party's knowledge and expertise in busting the fraudulent fact and information. Regarding the latter concept, the special circumstances of the case may derogate the idea of an average consumer and judicial practice is more willing to levy the expectation toward the addressed party. A model case to illustrate this scenario is medical quackery. In an Italian case, the plaintiff's relative was suffering from terminal cancer. The medical doctors gave up on him and declared no cure was available for him. The plaintiff could not let his spouse pass away, therefore, she turned to the defendant who advertised his services using statements that might have been seen as quackery under normal circumstances. The defendant claimed he treated many people in this stage of cancer and brought them back to life, some of whom were recognized as famous persons known even to the plaintiff. The plaintiff, relying on the obviously misleading and false statements of the quack, paid money to the defendant and used his services. The patient died and medical science could easily prove the methods the defendant took to 'heal' the deceased were not scientifically approved and were the obvious practice of quackery. The Italian court concluded the special circumstances of the plaintiff (she was desperate of losing her husband which

affected her state of mind) justified her belief in the obvious case of quackery. (Smits, 2015, p. 171)

### **3. THREAT**

The threat is also treated differently in common law and civil law legal systems. In case of a threat, common law sees a defect of consent, while civil law deems it as a ground for invalidity. The PECL lists threat as a ground for invalidity following the civil law argument. The practical problem about with the threat is the difficulty in drawing a line between legally accepted pressure and unlawful harassment. If the party makes statements to get a better deal from the other party (e.g. in lack of a discount, I will buy the product from your competitor), however, the alleged threat is basically about proposed actions that he has a right to take, the threat should not be concluded. Unlawful harassment, however, is not always about threatening the other party to commit unlawfulness if she does not accept the proposed terms of the future contract. The case when the creditor threatened the debtor that he would file for bankruptcy unless the debtor accepts a low price on a new contract was found unlawful and labelled as a threat by a German court. (Sefton, 2005, p. 273) The court concluded the threat must be unrelated to the obligation of the other party, therefore, even lawful actions (like filing for bankruptcy) can be seen as a threat. This broad concept of threat shows a step toward the implementation of business ethics in the world of contract law placing the obligation of fair dealing and fair negotiation on the parties. In other legal systems, however, the threat remains an instance of a clearly unlawful action, therefore, lawful actions would never lead to the invalidity of the contract. (Keirse, 2011, p. 47)

Undue influence may be seen as a subcategory of threat. Undue influence requires a relationship of trust between the parties. This trust is used to strengthen bargaining power. The question is the level of use of this trust. Usury exists in the laws of the Member States, and in some, it is the only concept of undue influence. Usury, however, is a very serious form of exercising undue influence as it exploits the desperate situation of the other contracting party to gain unilateral and unfair advantages. Undue influence can be much less in some jurisdictions. The reason the PECL left it without discussion is that undue influence is in relationship to immorality that is not covered by the PECL.

### **4. PRACTICAL CONSIDERATIONS – INVALIDITY OR BREACH**

The grounds of invalidity as described in the PECL have not changed much in the laws of the Member States since the publication of the PECL. The gap between common law and civil law legal systems is still present and obvious, with respect to the concept of mistake, the instances of mistake, fraud, and threat (undue influence). Common law legal systems were not influenced by the PECL and did not move closer to the civil law approaches the PECL mostly incorporated. Judicial practice, however, shows the parties form the concepts of invalidity rather than the lawmaker or the courts. (Jansen and Zimmermann, 2018, p. 1248) Is it more beneficial to the



party to base his claim on invalidity rather than to claim remedies available for a breach? This remains the core question. We saw the difficulties in providing evidence for mistake or fraud, therefore, the concept on the burden of proof functions as a deterrence to parties and to make them move to the concept of the breach rather than base their claims on invalidity. It is also important to compare the available remedies to invalidity and breach. Invalidity typically results in the remedy of avoidance, while a classic remedy of the breach is damage. It is beyond debate, damages are far more attractive to the party than avoidance, especially if expectation damages can be claimed per the applicable laws. Invalidity cases are also more prominent in court litigation than in other dispute settlement processes. These conclusions prove legislation may seem constant, while the claims of the parties shape the approach to validity and they intend to channel most scenarios to the more open concept of the breach.

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