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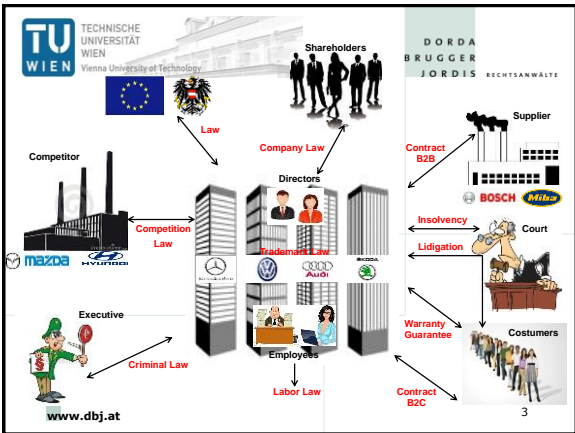

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Second Lesson

Contract Law, General Terms of Business

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Overview

- Definition of a Contract
- Sources of Contract Law
- Freedom of Contract
- Formation of a Contract
- Breach of Contract, Remedies

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What is a Contract?

- "A contract is an *agreement* giving rise to *obligations* which are *enforced* or *recognized by law*."
- No general contract, but different types contracts
- Intention to be bound by an agreement
- Enforceability of a contract
- Gentlemen's agreement versus (written, oral or conclusive) contracts

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Sources of Contract Law I

- Law of contract is governed by **national laws and statutes**
- Civil Law countries (Continental Europe): Civil Codes
 - Austrian Civil Code („Allgemeines bürgerliches Gesetzbuch = ABGB")
 - Germany: Bürgerliches Gesetzbuch – BGB
 - France: Code Civil
 - Italy: Codice civile
 - Switzerland: Zivilgesetzbuch - ZGB

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Sources of Contract Law II

- Common Law Countries (UK, USA, Canada, Australia, New Zealand) : no Civil Codes. Contract Law is mainly governed by Case Law
- Certain statutes governing Contract Law in UK:
 - Sale of Goods Act 1979, Sale and Supply of Goods Act 1994
 - Unfair Terms in Consumer Contracts Regulations 1999
 - The Consumer Protection (Distance Selling) Regulations 2000
- USA: Uniform Commercial Code (US)
- USA: Restatement Second of Contracts (US)

Sources of Contract Law III

- EU legislation has an impact on contract law in the member states
- Differences in laws of member states act as a restriction on intra-Community trade because contracting parties are generally unsure of legal rules which prevail in other member states
- Harmonization of laws of member states through directives
 - EC Directive on Unfair Terms in Consumer Contracts (93/13/EEC)
 - EC Directive on Consumer Rights (2011/83/EU)
 - EC Directive on E-Commerce (00/31/EC)
- Long-Term Goal: European Contract Law

Sources of International Contract Law

- UN Convention on Contracts for the International Sale of Goods (CISG)
- UNIDROIT-Principles of International Commercial Contracts
- INCOTERMS (not binding unless agreed)

Freedom of Contract

- Parties can choose **whether** they want to enter into a contract.
- Parties can choose **with whom** they want to enter into a contract .
- Parties can freely determine the **contents** of their contract.
- Parties can choose the **form** of their contract (e.g. oral or written).
- Parties can consentaneously choose to put their contract **to an end**.

Formation of Contract

"Meeting of the mind"

- **Valid offer**
 - Present intent to be legally bound on acceptance
 - Essential terms must be definite and certain
 - Communication to the intended offeree
- **Acceptance:** Must made only by the person to whom addressed or their lawful agent
 - **USA:** Agreement supported by consideration
- Defenses such as lack of legal capacity, illegal subject matter/purpose, mistake of material facts, duress, fraud.

Formation of a Contract

- Expression of **mutual consent by the parties**
- Mutual consent may be expressed by both parties **simultaneously** or **by acceptance of a prior offer**
- An offer is binding and **cannot be revoked** once it is received by the offeree
- An offer must clearly express the offeror's intention to enter into a contract
- An offer must be addressed to particular person
- An offer should explicitly mention a period during which the offeror regards himself as bound by the offer and the time in which the offer must be **accepted by the offeree**

Formation of a Contract

- Acceptance of an offer means that the **offeree agrees with the offer in all its terms** = contract!
- The contract, once concluded, is **binding** on both parties and enforceable. It cannot be redrafted or amended unilaterally (without the consent of the other party) but only unanimously (by mutual agreement).

There are

- defenses under the law such as
 - lack of legal capacity,
 - illegal subject matter/purpose,
 - mistake of material facts,
 - duress,
 - Fraud etc etc
 - or there may be a contractual clause providing for the termination of a contract (in particular: lease agreements, employment agreements)
- without such defense a contract is a binding instrument enforceable, i.e. one party to the contract cannot cancel the contract unilaterally without such defense.

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Formation of a Contract

- Acceptance of an offer means that the **offeree agrees with the offer in all its terms**
- An offer is only regarded as accepted if the acceptance does not contain any reservation or condition
- In cases where the **offeree sets reservations and/or conditions**, his reply (which in fact is not an acceptance) **is regarded as a new offer (counter-offer)** which becomes a valid agreement only upon acceptance by the other side.
- Specific requirements for offer and acceptance concluded online are set forth in specific laws and the Austrian E-Commerce Act
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Formation of a Contract

- Order confirmations** (Auftragsbestätigung) are very common in practice. In most cases an order confirmation is an acceptance of the offer. If an order confirmation goes beyond the conditions of the offer, the order confirmation is regarded as a new offer which the purchaser may accept by implication simply by accepting delivery of the goods subject to the order.

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Silence as Acceptance?

- **General rule:** A failure to respond to a certain offer is generally not regarded as an acceptance.
- Therefore the contract does not come into existence, if the offeree does not respond.
- Even if the offeror states in his offer that his offer can be accepted by silence, saying for example, "*if you don't reply within 7 days the contract will come into existence*", the offeree cannot be forced to respond. There are many reasons why the offeree might remain silent.
- **Exception:** Prior to the offer, the offeree himself has indicated an offer is to be taken as accepted, if he does not indicate the contrary by an ascertainable time.

Precontract - Vorvertrag

- A precontract is an agreement to conclude a contract (with the predefined content) in the future. A precontract binds the parties to conclude a certain contract at a later date. It gives each party the right only to demand the conclusion of the main contract, not to specific performance of the contract.
- A precontract is not just preliminary or unbinding!

Precontract

Example:

"A and B hereby agree that both A and B shall sign the attached purchase contract at the latest by year's end."

- Binding!
- Effect of precontract: Final contract (purchase contract) must be signed as anticipated (without amendments)
- If not signed in due time: Each party to the precontract may sue the other party before court for signature (not for specific performance under the final purchase contract).

- Why not just sign the final contract (purchase contract) today (providing for delivery and payment at a later date)?
- General rule: Any amendments to the precontract and/or the final contract need the mutual consent of all parties to the agreement.

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Form of the Contract

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Terms of a Contract

- The contents of a contract are known as its terms.
- The terms of a contract define the rights and liabilities of the parties. They are of great practical importance.
- Terms of a contract can be **individually negotiated** between the parties (or by their lawyers) or included by way of standard terms.
- Commercial parties have their own **standard terms** of business (General Terms of Business - GTB, General Sales Conditions ...) and seek to incorporate them into the contracts they conclude.

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Precontractual Agreements

- Head of terms (not binding; but "Punktation" is binding under ABGB differing from Germany's BGB)
- Letter of Intent
- Letter of Commitment
- NDA (binding)

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Standard Terms - GTB

"Always read the small print before you sign on the dotted line"

- Standard terms (General Terms and Conditions of Trade – GTCT) become part of the contract only if the parties consent to those terms being incorporated into the individual contract.
- Standard terms must be explicitly referred to by the parties before the contract is concluded. Availability of GTB text on the website is sufficient (Supreme Court)
- If the other one rejects GTB and refers to his own GTB – **"Battle of Forms"**

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Standard Terms - GTB

- Conditions of unusual content in standard terms are **invalid** if those provisions are detrimental to the interests of the other party **and** if this party could not have expected such provisions.
- Only if the party is explicitly made aware of such conditions, will they be considered valid.
- Conditions in standard terms for **consumers** are also void if they are unclear.

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"Battle of forms"

- the parties of the contract use contradictory general terms of business and defense clauses in contracts
- the legal consequence in Austria is **dissent**
 - Only the rest of the contract is valid
 - the contradictory part is governed by flexible law (default rules of law)
- under USS, "mirror image rule" applies
 - new offer unless change does not materially alter offer
- under CISG, it is a rejection of the whole offer

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TYPICAL CONTRACT PROVISIONS

Duties and Obligations:

This section of a contract is a detailed description of the duties and obligations of the parties and the deadlines for performance. For example: If one party's obligation is to create a multimedia work, software, or content for a multimedia work, detailed specifications should be stated. What is the nature of the work? When should the work be performed?

Examples:

Seller hereby sells an Buyer herewith buys the car:

- Audi A6 3.0 TDI quattro
- Color green
- with a mileage of not exceeding 70,000 kilometers and extra equipment ...

Date of delivery: [...]

Purchase price: EUR [...], cash on delivery

Seller shall deliver the car together with [...]

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TYPICAL CONTRACT PROVISIONS

Representations and Warranties:

A warranty is a legal promise that certain facts are true. Typical representations or warranties in contracts concern such matters as ownership of the contract's subject matter (for example, real estate) and the right to sell or assign the subject matter. For example, in commercial contracts, warranties of ownership of intellectual property rights and non-infringement of third parties' intellectual property rights are common. For contracts involving the sale of goods, certain warranties are implied under state law unless specifically disclaimed by the parties.

Example:

The Seller (of the hotel) hereby warrants that

- the agreements with TUI and Thomas Cook will at least last for a further period of 12 months after the transfer of the hotel from Seller to Buyer,
- the hotel's logo "ÖtzHotSpotSpa" as used for commercials and on the internet has not been contested by any third party before the transfer of the hotel from Seller to Buyer
- [..] etc. [...]

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Termination Clauses:

If the contract is not for a definite term (e.g. employment for just one month, purchase contract) these clauses ensure that either one or both parties have the right to terminate the contract without cause or under certain circumstances. Generally, termination clauses describe breach of contract events that trigger the right to terminate the contract for cause immediately (e.g., nonpayment of debts). Termination clauses also state how termination can be communicated (orally or written), and whether the breaching party must be given an opportunity to cure the breach before the other party can terminate the contract.

Example:

"Notice of ordinary termination may be given at any time with 6 weeks notice for any reason or no reason, such notice is to be effective only on the next end of a calendar quarter.

Each party hereto further shall be entitled to extraordinarily terminate the contract with immediate effect - without notice - for a material reason. Material reason shall be: Failures to pay sums due under the agreement when they fall due and payable, and: [...]"

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Typical Contract Provisions

- **Merger Clauses** (also: "Entire Agreement clause"; "Integration clause"):

Merger clauses state that the written document reflects the entire understanding of the parties. The purpose of merger clauses is to ensure that evidence outside the written document will not be admissible in court to contradict or supplement the terms of the written agreement.

Example:

"This is the parties' entire agreement on this matter, superseding all previous negotiations or agreements."

Typical Contract Provisions

- **Remedy Clauses:**

These clauses state what rights the non-breaching party has if the other party breaches the contract. For example, in contracts for the sale of goods, remedy clauses are usually designed to limit the seller's liability for damages.

- **Choice of law Clauses:**

A choice of law clause states that the contract shall be construed under and governed by the laws of a specific country (its national law). If there is such a contract clause then the legal rules of Private International Law which specify that the contract shall be governed by the laws of another country will not apply.

Example: "This contract shall be governed by and construed under the laws of the Federal Republic of Germany."

But contracts cannot rule out the application of protective rules (e.g. under consumer protection or labor law).

Typical Contract Provisions

- **Jurisdiction Clauses (legal venue clause, forum clause):**

These clauses state which court shall have jurisdiction in a specific case. Then this court will be competent rather than the court which would have jurisdiction according to the legal rules otherwise determining the competent court.

Example: "The parties submit all their disputes arising out of or in connection with this Agreement to the exclusive jurisdiction of the Courts of Vienna."

Or: "Any and all disputes arising from, in the context of or otherwise in relation to this agreement shall be subject to the jurisdiction of the competent court having subject jurisdiction in Paris."

Typical Contract Provisions

▪ As an **alternative to jurisdiction: Arbitration Clauses**

An arbitration clause states that disputes arising under the contract must be settled through arbitration rather than through court litigation. Such clauses generally include the name of the organization that will conduct the arbitration (the American Arbitration Association, for example), the city in which the arbitration will be held, and the method for selecting arbitrators.

Example:

"All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce (ICC) by one or more arbitrators appointed in accordance with the said Rules."

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Capacity to Enter into a Contract

- Capacity is the legal ability to enter into and be bound by the terms of a contract. General rule: every natural person has the capacity to enter into contracts.
- Minors (under the age of 18), mentally disordered and intoxicated persons possess no or a limited capacity to contract. They are protected by the law.

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Capacity to Enter into a Contract Minors

- General rule under Austrian Law: Contracts between minors and adults are not enforceable against the minor unless the contract is validated by the consent of the minor's guardian.
- Infants (under the age of 7) are not capable of entering into a contract. Exception: Contracts for everyday petty goods (such as children magazines, candy etc)
- **Minors** under the age of 14 possess a limited capacity to contract. Money and goods given to them to be used at their free disposal can be spent as they wish. But this should not endanger their ability to make their own living.
- **Minors** under the age of 18 also possess a limited capacity to contract. In addition, they can enter into contracts of employment and can spend their earnings as they wish. But this should not endanger their ability to make their own living.

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Validity of Contracts

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Illegality of a Contract

- If the **purpose** of a contract is illegal, it cannot be enforced. The contract is therefore void.
- Under Austrian and German law, money paid or property transferred under an illegal contract can be recovered.
- Under UK law the general rule is that money paid, property transferred or services rendered under an illegal contract cannot be recovered. But there are certain exceptions to this rule.

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Duress (Zwang)

- A contract is voidable if one party was placed under duress by the other party.
- The duress must be of a nature which actually influenced the contracting party in an unjustifiable way.
- Duress can be threatened or actual physical violence to the party.
- Duress can also be some other form of illegitimate pressure which has an influence on the contracting party's free will.
- The right to cancel the contract due to duress expires 3 years after conclusion of the contract.

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Fraud (List)

- A contract is voidable if one party has agreed to enter into the contract because he was deceived by the other party.
- The contract is voidable if the deceived party, knowing the real facts, would not have concluded the contract.
- The right to cancel the contract because of fraud expires 30 years after conclusion of the contract.

Error, Mistake (Irrtum)

- If a mistake occurs when entering into a contract, the party only has the right to cancel the contract
 - if the mistake refers to the subject-matter of the transaction itself (e.g. object of the sale, purchase price)
 - **and if** that the mistake was:
 - caused by the other party *or*
 - should have been obvious to the other party *or*
 - was clarified in due time.
- The right to cancel the contract because of mistake expires 3 years after conclusion of the contract.
- The right to withdraw due to mistake may neither be excluded nor restricted to the disadvantage of the consumer in the case of consumer transactions. However, a business (e.g. GmbH) may waive its right of cancellation due to error).

Breach of Contract

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Breach of Contract

1. Delay
2. Impossibility of Performance
3. Warranty

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Delay (Verzug)

- If the contract is not performed at the time or in the way stipulated.
- In the case of delay by the debtor the other party (creditor)
 - may either continue to **demand performance** of the party in delay **or**
 - **rescind the entire contract** after he has notified the party in delay of his intention to withdraw from the contract, if the performance is not forthcoming within a reasonable grace period.
- If the delay is caused by negligence, the negligent party becomes liable for damages caused by the delay.

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Delay (ctd.)

- EU Late Payments Directive applies to all contracts which involve the provision of goods or services to any business or public authority.
- You cannot assume that a contract will be excluded just because:
 - It is between two businesses; or
 - It is specifically negotiated; or
 - It also deals with other things (shares, real property etc.) as well as services or goods.
- The rules impose maximum payment terms (60 days in a B2B contract and 30 days in a B2P contract). They limit the scope for contracting out.
- Unless otherwise agreed, for **delay in making money payments** the debtor must pay interest at the rate of 4% between private individuals, but **9.2 points above basis rate (i.e. presently 8.58% per anno) in business life.**

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Impossibility of Performance

- Should performance by the debtor become impossible after the conclusion of the contract, then he will be released from his obligation to perform. In this case the other party is also not obliged to perform his obligation. The contract is void.
- If the impossibility to perform is the **fault of the debtor**, then he is liable in damages to the creditor.

Warranty (Gewährleistung)

- Also see the EC-Directive 1999/44/EC for Consumers
- A warranty is the obligation of the seller, that the goods being sold are as promised (no defects in terms of quantity and quality) at the time of delivery.
- Liability for breach of warranty is **imposed by the law** and **does not depend** on the **negligence** of the seller.
- Liability for breach of warranty also exists, if the contract does not contain expressed terms on warranty and also if there is no "Guaranty" expressed.
- In general parties are free to modify and even to exclude the warranty provisions of the law.
- In **business to consumer** contracts warranty provisions **can not be limited or excluded!** (Exception: purchase of second hand goods)

What are "defects"?

- performance does not comply with contractual commitment
- deciding factor: construction of the terms of contract
- defect of quality or in title
- If the defect is not covered by
 - contractual exclusion of warranties or
 - description of quality (e.g. "lower price because there are scratches")

What are "defects"?

- specifics of contract of manufacture/sale/Service
- At the time of delivery
- presumption of faulty delivery if defect occurs within first 6 months

Warranty

Primary Remedies:

- In case of breach of warranty, the buyer can request the seller to **repair** or to **replace** the defective good (transport borne by seller).
- The buyer can choose between reparation and replacement.

Secondary Remedies:

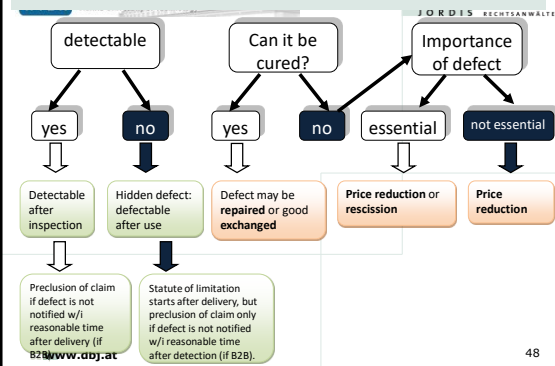
- Only if reparation and replacement are **impossible** or **disproportionally burdensome** for the seller, the buyer is entitled to an **appropriate reduction** of the price or to **rescind** the contract.

General:

- The buyer has a right to rescind the contract, if the seller does not repair or replace the good within a reasonable time.
- The buyer has **no right to rescind** the contract, if the **defect of the good is only minor**.

Additionally: Claim for damages (i.e. in excess of warranty claim), but only upon fault (= culpability)

Different kinds of defects



Warranty

Case (Supreme Court 29 Aug 2013, 8 Ob 106/12i):

- "Sporthotel" in Tyrol (near Achensee): "legionella case"
 - warranty claim
 - claim for damages

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Warranty

- A warranty claim must be raised within the following limited periods:
 - two years for moveable property
 - three years for immovable property.
- The period starts to run from delivery.
- The seller is only liable for the defects which already exist at the time of delivery (warranty is not guarantee).
- In business to business (B2B) transactions, the purchaser has the obligation to check if the good is defective within a reasonable time after the delivery and in case of detection of any effects to *immediately* inform the seller.

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Contract of Guaranty

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Product Liability Act

- Liability of manufacturer or importer for personal injury and property damage, which has occurred due to defective products, regardless of negligence or fault
- *Distinguish this from Warranty by Vendor!*
- Exclusion of liability possible (e.g. defect of product is due to legal provisions or administrative arrangement)

Product liability

EUROPE

- Directive 85/374/EC
- Austria: Produkthaftungsgesetz (PHG)
- Strict liability of **manufacturer** of parts for damages caused by defective product
- Product: Any movable corporeal good, even if part of immovable good
- Defect: product does not offer safety that can be expected according to 1. its presentation; 2. its typical use and; 3. time when it was put on the market
- Damage: bodily injury or damage of different good (not the defective product)
- Recovery: Consumers always, and businessman only if good not predominantly used in enterprise

United States of America

- Case law and Restatement (Second and Third) of torts
- Strict liability of manufacturer for:
 - Manufacturing defects
 - Design defects (affect whole line of production) → reasonable safety expectations of consumer not met
 - Inadequate warnings or instructions
 - Buell-Wilson v. Ford (2009): USD 55 Mio for paralyzed women whose SUV flipped over
 - Garrison v. Porsche (1983) car too powerful for college graduate
- Manufacturer, whole-seller, distributor
- Product: any good (IP rights, land...)
