HANDOUT OF

BUSINESS AND PRIVATE LAW

2022-23 EDITION

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BASIC FOUNDATIONS OF CONTRACT LAW

Contract Law is based on the autonomy of the parties: they can decide the terms of the contract itself.

- A contract is a legally enforceable agreement (*promise*) between parties that binds the behavior of the said parties. The terms of the contract are also decided between the parties.
- In 19th century, in England, America, France, and Germany a universal definition of a contract was given: a contract is the will of the parties

TORT LAW

Tort law is the law of delicts → law that is based on CIVIL fault.

- If there is negligence, it can be seen as the cause of delict

It tells us how two people who are not in a contract relate to each other.

- Aim: provide relief (usually monetary) to the injured party
- It must make the victim be in the original position → suing cannot make a person richer.
- Everything that is not contract law is this (general civil law)

CONTRACT LAW

Contract law is used mostly for business interactions and is reliant on the principle that **a contract is based on the** will of the parties.

- Must be mutual obligations (both sides perform obligations of about equal value)
- The Romans did not use these principles → They had laws for specific contracts, and operated case to case.

It tells us how people relate when they enter into a contract

- Suing can make up for the losses (recover expected profits, etc.), more than just the original situation occasionally

CIVIL LAW

Civil law in general relates to persons, things and the relationships between them.

In the 16th century the contract philosophy was started with Aristotle: transactions (sale and lease) were described as voluntary commutative justice.

- The contracts must be voluntary: the rational man must willingly choose to do something or not.
    - Causa: the reason to enter into a contract, can be both sued for gift giving and exchange

Scholars concluded that you can enter in two types of contacts:

1. Gratuitous contracts (enrich the other party at your own expense)
    1. Donor must intend to benefit the other party
    2. Gifts are acts of freedom (they can choose whatever gift to give away= but they cannot be revoked after delivery → promises of gifts

3. These types of contract are binding if they are intended by the promiser and the time of the promise to be binding
4. In the 16th century... since the receiver of the promise can be no poorer, the gratuitous contract (even if not kept) **cannot be enforced**
5. In the 17th century, promises of gifts should be binding as long as the promisor intended to transfer a right to the object

2. Exchange/Onerous contracts (exchange for goods of equivalent value)
    1. What Aristotle called **commutative justice**

a. i.e. sale, lease, barter contract

COMPARATIVE LAW PERTAINING TO GIFTS:

1. In the French Civil Code, the requirement of notarization was carried forward:
    - A gift must be finalized done before notaries to make sure the intention is clear → otherwise the gift is void.
    - AND the gift could not be taken back before the agreed date / before it served its purpose it was borrowed for
2. In the German Civil Code, a gift is something that enriches the other party upon agreement. Notarial confirmation is required as well.

The requirement for a contract to have *causa* or cause had passed into the French Civil Code.

- But there is an argument that you cannot have a contract with no *causa* → you always have a reason behind why you do a contract (you want something)

COMMON LAW

Common Law (typical to England) is based on writs (formal written orders issued with a judicial body).

- If a promise was broken there were two writs that could be consulted:
    1. Covenant: formal agreement or a promise (practically a contract), it required a **seal** or formality to be considered binding.
    2. Assumpsit: it required consideration

- Consideration was used when a court wanted to enforce a promise.
    1. The doctrine of consideration was used when the court asked if something should be enforced without a seal (i.e. exchange, gratuitous contracts, etc)
- **Seal:** imprint on paper utilizing wax → used to execute a legal document and guarantee its authenticity

- Then it was concluded that...
    1. Gratuitous contracts required a seal
    2. Contracts of exchange required consideration

- Causa of a contract: reason for each party entering into a contract was to receive performance/money of equivalent value BUT equal value is relative to the contracting parties (what they intend to give away)

DOCTRINE OF CONSIDERATION

There is consideration if I made you a promise that convinces you to give up your legal rights.

- When it seems sensible to enforce a promise → consideration
- Gratuitor's contracts don't have to have consideration (**one side gives up nothing**)
- So if one promises to keep an offer open but there is nothing given in return for it → no consideration, no contract (that is why there is paid deposit before signing contracts)

- In some cases we don't need consideration, we have unconscionability (fairness of contracts)
- Consideration is not required when the extra clause for the contract is fair or the circumstances enforcing the promise are fair

VOLUNTARY COMMITMENT

When is a commitment binding? Whether person A who mails the acceptance of the contract before it received the revocation from B can hold the B to the contract if 1, B receives his acceptance 2, if B does not receive it.

Common Law *It is always possible to revoke an offer before acceptance.*	Civil Law *An offeror is bound to the offeree as soon as the offer arrives at the offeree's address.*
English Law	French Law
Free revocation: it is always possible to revoke the offer before acceptance You need to revoke in front of the other party (in-person). **Mailbox rule:** the contract is complete, thus binding, as soon as the acceptance is put out of the offeree's possession (regardless of if it reaches the offeror). For the offer to have an **expiration date** there must be consideration.	No free revocation. An offer may be withdrawn freely as long as it has not reached the person it was addressed to. An offer is *always* binding after it **reaches** the other party. In French law, the offer is binding if you had relied upon the offer.
American Law	German Law
Free revocation: it is always possible to revoke the offer before acceptance You need to revoke in front of the other party. IF the offer you make can **induce reliance,** then you are bound to the contract. **Reasonable reliance**: the offer must be reasonably relied on and costs to be suffered by reliance	The party who was offered to conclude a contract with another party is bound by that offer unless he states that he is not bound. An offer is binding unless it expires. **An offer made in-person can only be accepted immediately.**

Adams v. Lindsell (ENGLISH LAW)

Circumstances: There was acceptance in the case of the offer (the plaintiff wrote letter of acceptance and sent it) but the acceptance letter was late and the product was sold to someone else when it did not arrive on time.

Court: The offer has been made to others but it hasn't been revoked before, so it's **binding**. Acceptance arrived later than expected but it is anyway binding for the **mailbox rule**. There is a contract therefore expectation damages can be awarded.

- If the contract was only binding when the acceptance letter was received then it is a cycle that could go on forever – waiting for a letter that they received it etc.

Mailbox rule*: the offer is considered accepted at the time that the acceptance is communicated. Parties can change the terms to not use the mailbox rule and determine between themselves when the contract is binding.*

Dickinson v. Dodds (ENGLISH LAW)

Circumstances: A letter of offer was sent to the plaintiff and the acceptance letter was also sent but then the defendant sold the property to someone else, claiming he has never seen the acceptance letter.

Court: The offer was nothing but an **offer**, (not accepted by both parties hence no concluded agreement). There was **no consideration** for undertaking the promise (additional time should have been needed to consider).

- The offeror never revoked the offer (**free revocation**) but the agreement was not binding because one side "internally changed his mind".
- For the contract to be binding, there should have been "an offer continuing up to the time of acceptance"

PRE-CONTRACTUAL LIABILITY

Liability before a final commitment is made is known as precontractual liability.

<table>
<tr><th colspan="2">Common Law
English and American Law</th><th>Civil Law</th></tr>
<tr><td colspan="2">Consideration</td><td>German Law</td></tr>
<tr><td colspan="2">Consideration parties must give up legal rights (I made you a promise that convinces you to give up your legal rights).
• If a person gives nothing back for his commitment there is no consideration.
• A naked pact/promise is not enforceable, there needs to be consideration to enforce a promise.
If there is consideration and you break the promise you are liable for expectation damage.

A gift/gratuitous contract is not enforceable → no consideration.</td><td>Culpa in contrahendo – fault in conclusion of the contract
- Def.: duty to negotiate in good faith, to prevent a party from concluding a contract to her detriment.
• A party awakens unfounded hope that the contract will be concluded and caused him to incur in expenses that would be of use if the contract had been concluded but they are not.

If you act in bad faith in the negotiation phase you are liable.

It is a fundamental element in tort law (strict liability = it is not necessary to prove fault).</td></tr>
<tr><td colspan="2">Promissory Estoppel</td><td>French Law</td></tr>
<tr><td colspan="2">The promisor is liable to the promisee who relies on the promise.

Originally doctrine of promissory estoppel was invoked as a substitute for consideration rendering a gratuitous promise enforceable as a contract.

Used only in American Law</td><td>A contract must be negotiated and performed in good faith.

(introduced in 2016)
All contracts must be negotiated, formed, and performed in good faith. This provision is a matter of public policy.
The commencement, continuation, and breaking off of pre-contractual negotiations are free from</td></tr>
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A promise without consideration can still have legal effect under 3 conditions:

1. The offeror should reasonably expect the promise to induce action or forbearance
2. The offer does induce such action or forbearance
3. Injustice can *only* be avoided by enforcing the promise

Promise → reliance to promise → reliance is reasonable

- You can ask for **reliance damage** (put the victim in the same state as if the promise had been kept)

No duty to negotiate in *good faith*

In American and English law there is no requirement to negotiate in good faith.

- According to American law if a promise to negotiate in good faith is made that promise is always automatically enforceable.

In English law a promise can be enforced if there is consideration.

control → but must satisfy the requirements of good faith.

However, it is important to underline that in France it could be contradictory: you can **walk away from the negotiations anytime** as long as it was *not in bad faith*.

3 cases where pre-contractual liability is awarded:

1. Disclosure of confidential information to a 3rd party
2. Negotiate without intention to conclude the contract (fraud)
3. Expectation to contract
    1. Allow to withdraw from negotiations under a reason (excuse)
    2. Reliance on the promise

Even when you do not have *culpa in contrahendo* (mandate to negotiate in good faith) in American Law, you still have the following doctrines to protect you (give you relief):

1. Sue for fraud (one of the party lies)
2. Unjust enrichment
3. Promissory estoppel

The following two cases differ, because in the 1st one, there was no contractual relationship although an offer was made, but in the 2nd one there was (and hence relief given). The difference is that in the 2nd case, the building company RELIED on the expectation that there would be a contract → incurred huge expenses to win the offer. In the 1st case, there was no reliance (not substantial).

Walford v. Miles (ENGLISH LAW)

Circumstances: There was an agreement between the seller and the first buyer (if the buyer gets a confirmed letter from the bank for a loan, the seller will stop negotiating with the 3rd party). The seller did not honor this agreement and sold to the 3rd party.

- The seller got sued by the buyer because he sold to a third buyer (if you sue him for breach of contract, seeing the promise to withdraw from other negotiations as a contract, you can obtain expectation damage).

Court: The seller won since "a bare agreement to negotiate has no legal content" → **not enforceable**.

- In English law there is no duty to negotiate in good faith. – "how is the court to police such agreements?"

- The plaintiff cannot enforce the promise and so there is **no contractual relationship** between the two parties. The defendant can walk away from the negotiations and no expectation damages are due.
- The seller has the right to walk away and does not need to be a proper reason to withdraw.

William Lacey v. Davis (ENGLISH LAW)

Circumstances: Owner of a premises (which suffered war damage) obtained 3 bids from builders. They calculated cost of reconstruction, and undertook **considerable amount of work** to prepare their estimates (which helped the owner negotiate with the War Damage Commission and increased the amount the owner received.)

- Then the owner sold the property without having the builders rebuild it.

Court: The work fell outside the work that the builders perform gratuitously (without charge tendering for a building contract), and the work was used for **some purpose** → increased the amount the owner received from the War Commission.

- Normally the law would imply a promise to pay for the services, but *no such promise was implied* (they did it with the expectation they would earn the contract + profits).
- The owner is liable for **the services paid (without expectation damages).**
    - Reasonable price.
- Unjustifiable enrichment → implied obligation to pay for the services.

In both upcoming 2 cases, there was reliance on the promise. In the 1st case, there was consideration on both sides but one side negotiated in bad faith → reliance damage. In the 2nd case, there was reliance on the promise one side made and then the promise was broken → promissory estoppel.

Channel Home Centers v. Grossman (AMERICAN LAW)

Issue: Can an owner's promise to negotiate in good faith and withdraw the lease premises from the marketplace bind the owner to the negotiation for a reasonable time?

Circumstances: A prospective tenant toured the premise, discussed the terms of the lease, and prepared a detail letter of intent.

- The owner acted in bad faith and breached his promise to "withdraw the Store from the rental market and only negotiate with the tenant". But the owner rented the property to someone else.
- The prospective tenant claims that the document is enforceable as a mutually binding obligation to negotiate in good faith.

Court: The owner's promise to withdraw the Store and only negotiate with the prospective tenant is **sufficiently definite to be enforced**, given that there was sufficient legal consideration and definite intentions on both sides.

- The promise is considered as a binding contract because both parties intended the proposition to be binding since they acted upon it. If there is consideration, the promise has the same effect of a contract so you can sue for breach of contract and get expectation damage.
- ***Promise to negotiate in good faith can only be enforceable when there is consideration (have they each given up a legal right?).***

Hoffman v. Red Owl Stores (AMERICAN LAW)

Circumstances: Red Owl Stores agreed to build a store in Chilton and stock it with merchandise for Hoffman.

- Hoffman was to invest $18k → so he sold his bakery, grocery story, invested in inventory (**actions that were in reliance on the promise made by Red Owl**). → substantial costs and disturbance suffered
- After seeing the store was operating at a profit, Red Owl wanted Hoffman to sell the store to them, promising a bigger soon shortly (never came).
- Then Red Owl claimed they need an extra $34k investment, and Hoffman terminated the negotiations.

Court: **Promissory estoppel** was invoked as a substitute for consideration → the act of reliance of Hoffman on the promise provided a substitute for consideration.

- Hoffman was substantially harmed by relying on the promise (the promise was reasonable expected to come true and it induced actions on the victim's part)
- Red Owl did not give up legal rights on their part → **no consideration**.
- Hence, promissory estoppel → **reliance damages were to be awarded.**

Cour de Cassation , 1972 (1) (FRENCH LAW)

Circumstances: Gerteis requested VL for further information before making its choice among several machines (no contract). The information was never transmitted to Gerteis.

- VL did not reply to the letter and signed a contract with another company (a *competitor* of Gerteis) → VL could no longer sell machinery in the area for a period of time.

Court: VL broke off negotiations without legitimate reason when they were far advanced. VL also deliberately withheld the esteem from Gerteis and broken off the negotiations "brutally".

- Gerteis made large expenditures and was left in a state of uncertainty → ***not*** negotiating in good faith.
- VL **is liable for delict (tort).** (delict - when one party commits a wrong against another)

Cour d'appel, 1969 (2) (FRENCH LAW)

Circumstances: Plaintiff installed mirrors in a model (and was paid for), but then their bid for another job was rejected without any information on competing firms and their offers.

Court: No culpa in contrahendo. There was no liability → the negotiation phase is designed to permit the eventual contracting parties to study and understand the risks of signing a contract.

- Duty to negotiate in good faith does not induce the expectation that the contract will be concluded
- The defendant had no obligation to accept that estimate if he found it too high or to communicate to A the offers of competitive firms.
- Important: the company was paid for installing the mirrors in the model apartment so it's a completely separate agreement- **compensation**

Cour d'appel, 1984 (3) (FRENCH LAW)

Circumstances: Actress signed a contract with movie company (contract was rescinded and the project was stopped and restarted)

- Her compensation was left blank in the 2nd contract
- She sent the contract back with compensation, *without* the filming dates
- She did not cash in her payment, and did not film in the dates specified → company sued her for breaking off negotiations and breaching contract.

Court: No contract had been formed because of the "absence of essential provisions" (filming dates + compensation both missing).

- No culpa in contrahendo before 2016 in the French Law.
- No wrongful breaking off of negotiations → free to walk away from negotiations in good faith AND she never signed the contract actually
- Suit rejected

Reichsgericht, 1934 (1) (GERMAN LAW)

Circumstances: The plaintiff claimed a payment and security for the delivery of newsprint to the defendant. After the promise, the plaintiff completed another delivery.

- Contract for the first delivery.
- A representative of the company promised security for debt, to secure the second delivery.
    - BUT… the promise of security was too indefinite and **not legally binding.**
- Suing because unable to get financial compensation for the services provided

Court: There is not a contract yet since the promise is not certain and detailed enough but the plaintiff believed a contract would arise and had useless expenses (negative interest).

- The representative is liable for *culpa in contrahendo* for the harm the other party suffered in reliance when the agreement was not reached.
- BUT: the company wrongfully created the image of security for the 2nd delivery to happen → company is in fault for the conclusion of the 2nd contract but not the earlier one

Bundesgerichtshof, 1989 (2) (GERMAN LAW)

Circumstances: The plaintiff tried to acquire a newspaper company composed of separate 3 newspapers. Before the contract was signed (final draft of the offer and everything was prepared and accepted by the plaintiff) two of the newspapers withdrew.

- The initial offer became ineffective, because later offers were sent → the contract was never concluded in writing.

Court: In principle, each party **must bear the costs incurred in the expectation that a contract will be concluded.** This risk that a contract will not come to be and that the expenses will be useless falls on each party.

- Duty to pay compensation only arises when a contract will certainly come to be, and then one party breaks off without **sufficient reason.**
- **No reliance damage awarded** because the offer was not sufficient to create trust in the plaintiff → it should have been shown that the conclusion of the contract was near CERTAIN and then damages could have been awarded

MISTAKE

Will an error in the contract void a contract?

Common Law	Civil Law
American Law	German Law
Bilateral mistakes at the time of contract as to a **basic assumption** can be made voidable. • Basic assumption → essential qualities A party may void a contract for mistake if: 1. A party would not have concluded the contract (or done so on substantially different terms) if not for the mistake. 2. AND the other party 1. The other party made the same mistake, or caused the mistake	A mistake is a ground for nullity **only if** it is about an *essential quality*. Can be *unilateral* or *bilateral* as long as it is about an *essential quality.*

(**bilateral mistake**), or knew of the mistake 2. The other party had not at the time of avoidance acted in **reliance on the contract** A party may **not** void a contract if: 1. Grossly negligent in committing the mistake 2. The **risk of mistake was assumed**	
English Law	**French Law**
Common Law requires mutual mistake (both parties must make the mistake) to avoid the contract. If it is a unilateral mistake *only if* not fraud but **grossly negligent behavior.** **Caveat Emptor** (risk falls onto the buyer)	A mistake is a ground for nullity **only if** it is about an *essential quality*. • A mistake is of such nature that one of the parties **would not have contracted** (or contracted on substantially different terms. • Acceptance of a risk about a specific quality rules out mistakes in relation to that quality Ground for nullity whether it bears on the act of performance of one party or the other. Can be *unilateral* or *bilateral* as long as it is about an *essential quality.*

There can be different types of mistakes:

1. Suitability of Purpose (Commercial Impossibility)
    1. If the purpose of contract cannot be fulfilled (generally) → contract is voided/useless
2. Quality
    1. IF a quality is important enough you would ask for a warranty (an express warranty would increase the price) → otherwise the risk is on the buyer rather than the seller

a. **Assumption of risk:** if the risk is **outside the ordinary (basic)** assumption, there can be a mistake
    1. You have to assume the risk you might be worse off after a contract → mutually assumed risk

a. **Evaluative mistake:** making a profit is **not** guaranteed, you cannot get out if you value it incorrectly
    2. i.e. market fluctuations can change the price over time

MISTAKE IN AUTHENTICITY

Leaf v. International Galleries (ENGLISH LAW)

Circumstances: Defendants sold a painting for 85 pounds, and a couple years later the plaintiff tried to resell the painting to find out it was **not** painted by the artist.

- The defendant believed it was.

Court*: This was a mutual mistake about the quality → not defrauded intentionally, but the **mistake does not avoid the contract***

- ***Caveat Emptor*** *→ common law doctrine that places burden on the buyers to reasonable examine before making a purchase.*
- *This is an innocent misinterpretation rather than a breach of contract.*

Smith v. Zimbalist (AMERICAN LAW)

Circumstances: A guy purchases two violins supposed to be from high-end creators with an **express warranty** for 8k. They turn out to be fake for 300$. Sues for breach of express warranty and mutual mistake.

Court*: The valuation mistake does not allow you to get out of the contract, BUT the high price (+express warranty) proves that the buyer acted with a purpose of transaction.*

- *The purpose was not fulfilled by the transaction → mistake → void of contract*
- *General purpose to collect art → can't collect cheap imitations.*

Firestone & Parson v. Union League Philadelphia (AMERICAN LAW)

Circumstances: Company bought a painting for 0.5M with an OPINION that it was done by artist X. Turned out it was done by Y, and worth only 50k. Parsons wanted to rescind the contract.

Court*:* ***Assumption of risk*** *of post-sale fluctuation is on the buyer and* ***cannot*** *be used to avoid the contract.*

- *The buyer was not given express warranty, but rather an expert opinion on the authenticity of the piece.*
- *Thus, this was not a mutual mistake → unilateral.*
- *No avoidance of the contract*

Cour de Cassation 1970 (1) (FRENCH LAW)

Circumstances: Chalom bought two chairs that claimed to be Louis XV pieces from a couple at an auction. After scraping it turned out to be another type of chair that had been reconstructed.

Court*: The sale was made invalid, even though the object preserved certain unique qualities.*

- *BUT* ***auction gives automatic express warranty*** *and transfers risk onto the seller.*
- *NOT fraud → no intention.*

Cour de cassation 1987 (2) (FRENCH LAW)

Circumstances: Vincent sold a painting at a public auction attributed to Fragonard. After Vincent's death the painting was truly recognized as Fragonard's and the heirs sued to have the sale annulled on the ground that there was an error in authenticity.

Court: *Refused to annul the sale, because both contracting parties* ***accepted the risk*** *as to the authenticity (quality) of the work.*

- *No warranty ("attributed to Fragonard") so the buyer is assuming the risk.*

Cour d'appel 1988 (3) (FRENCH LAW)

Circumstances: Buyer bought a used car and found it was originally sold in 1955, even though it was claimed to be 1954 Rolls Royce.

Court: *Did not annul the sale for error of year of fabrication: "if the year of fabrication proceeded to change substantial characteristics of the object" then the error could annul the contract.*

- *Could be argued that it is a collectors item → year of fabrication contributes to its value*

Reichsgericht, 1929 (GERMAN LAW)

Circumstances: A couple delivers two Chinese vases to store W. to be sold on commission. Defendant buys them and resells them in Holland at a large profit, and then resold again to Kensington Museum in London (390 vs. 200,000 Reichsmarks).

- The former owner and commission broker claimed that the contract was void due to error (believed vases were from the 19th century, when they were from Ming dynasty).
    - Claimed compensation for their value to the interested parties

Court: *The age of the object contributes to its rarity → it is characteristic of the object (a normal vase vs. an antique).*

- *There was an error in value (evaluative mistake) on the side of the firm → but at the time of the contract they should have taken into account the risk of the quality:* ***quality mistake with no warranty → evaluative mistake when comes to value***
- *BUT… the mental state of the couple was such that they could not take into account the assumption of risk → falls outside the bounds of the contract.*

Reichsgericht 1932 (GERMAN LAW)

Circumstances: Plaintiff buys oil painting from defendant which was an original according to an opinion of museum director. Plaintiff claims the work was *not* an original, and wanted to void the contract for mistake and demanded return of price with interest.

Court*: rejected his claim. The seller did not give any guarantee (no express warranty), so the risk falls onto the buyer.*

MISTAKE IN SUITABILITY FOR A PURPOSE

Griffith v. Brymer 1903 (ENGLISH LAW)

Circumstances: at 11am the plaintiff agreed to rent a flat from the defendant for one day to view the coronation of King Edward and paid 100 pounds. Parties were unaware that the king was to be operated on.

Court*: the contract was void. Commercial Impossibility → the flat no longer served the general purpose to view the coronation and* ***both parties did not know that it won't*** *(due to surgery)*

- *Very high price (not normal price), basic assumption to view the coronation →* ***failure of general purpose***
- *If the cancellation happened after the contract was signed then it was not a mistake: the mistake* ***had to be there at the time of the contract formation***

Amalgamated Inv. v. John Walker & Sons (ENGLISH LAW)

Circumstances: The plaintiffs agreed to purchase a free-hold of a warehouse (advertised to be suitable for redevelopment, and they asked whether it was designated for "special architectural or historic interest") for 1.7 M pounds. The following day the warehouse was added to the special architectural or historic interest list (**not mistake at the time of the contract**).

Court: *At the time of the contract, there was no mistake (building was not on the list at the time of the contract). Contract is not void for mistake*

- *But you could sue for* ***frustration of purpose****, namely any events that happened after the sign of the contract that make the contract useless for the wanted purpose (excuse for non-performance)*
- *Can't redevelop the building after being added to the list.*

Sherwood v. Walker (AMERICAN LAW)

Circumstances: Sale of a cow. Both seller and buyer believe that the cow is infertile (lowered the price significantly, that they agreed on). But the cow turned out to be with a calf.

Court: *The majority claimed that it was a **mutual mistake***

- *Mutual mistake in suitability of purpose: barren v. breeding cow (that price would get you only a barren cow). It is a substantially different creature - the contract is voidable.*
    - *If it is a barren cow, you can only use it for meat whereas if it is a breeding cow you can use it for future revenue.*
- *BUT it was not a mistake according to the minority because **maybe the buyer was not mistaken** (might be a good investment if it is a breeding cow)*
    - *HOWEVER, the dissenting judge stated that there was a mutual assumption of risk because parties were not sure the cow was barren. So, the contract is valid.*

Cour d'appel, 1989 (FRENCH CASE)

Circumstances: A couple bought real estate for a very high value, and found out after purchase that there was a highway to be built 50 meters away.

Court*: It was a mistake, because if you spend so much money you want to be away from the highway and enjoy the benefits of your purchase → **essential quality. Sale avoided for error.***

- *The highway was outside the risk you were to assume.*

MISTAKE IN VALUE

Kennedy v. The Panama (ENGLISH LAW)

Circumstances: Plaintiff was induced to buy shares of stock from the defendant (investment contract). The company is thought to have a contract with the government of New Zealand, turns out they didn't.

Court: *There was no mistake → the plaintiff still got the shares, the contract was still fulfilled. Even though the defendant misled the plaintiff, the mistake was **not a fundamental/essential mistake.** You said something that was untrue, but the defendant was not intentionally lying.*

- *If it is a unilateral mistake → must have a guilty mind (more than negligent), so the risk is on the other party.*
- *English Law has an emphasis on **Caveat Emptor** → buyers must be aware, and inspect the things they acquire.*

Bell v. Lever Brothers (ENGLISH LAW)

Circumstances: The Lever Brothers hired the defendants to be chairman for a subsidiary of the company, before the subsidiary merged with another company → after the merger they agreed to pay compensation (severance pay). Then they found out that they violated their duties, that would have terminated their contracts without compensation due to breach of duty.

Court*: It was not a mistake according to English Law (this was a unilateral mistake). The defendants knew they broke a law and shouldn't get paid, but it was a unilateral mistake on the part of the company.*

- *It was **not** an essential condition for the defendants that they broke the law (technically not lying → not fraud)*
- *If they argued that they didn't know they broke a law, and they ought to get paid → mutual mistake, and then the contract is annulled.*
- *Only **one of the two parties** thought this was essential hence **unilateral mistake.***

Cour d'appel, Riom, 1988 (FRENCH LAW)

Circumstances: A land was sold for which a building permit has been obtained. During construction, a shifting of earth was detected and less houses (22 < 32) were only allowed to be built.

Court: *The contract was not annulled for mistake → "The sale was concluded among companies where the professionals were quite aware of problems of land and of construction".*

- *Valuation mistake*

FAIRNESS

ORIGINS

- Traditionally, no one cared about fairness regarding prices in Roman Law.
- In the medieval times, relief was only given for very high price deviations from the market price.
    - Just price: the price determined by the market, at which goods are commonly traded (varies from day to day and from region to region)
    - No toleration of the price when "one party took advantage of the other's ignorance or necessity to sell it to him for more than the market price"
- Changed around the 14th century when natural lawyers came up with a legal system.
    - Both the buyer and the seller can get remedy if the contract was unfair
    - Exchange requires equality
    - But also: things might be of different value to different people due to their specific tastes and needs
- Now common agreement: an unfair transaction is where one person exploits certain weaknesses of another to obtain a striking disproportion in the value of performances exchanged

What if a contract is unfair? We do not give relief for the contract being solely unfair, but we give relief for other things, such as exploitation of the weaker party, extra contracts that you have never read but you have to sign it, etc.

1. Fairness of Performance Terms

- Terms you must be familiar with otherwise there is no contract
- **Essential terms**: how much you'll pay, or how much of value is the car you are buying, the qualities
- **Auxiliary terms**: terms that are not essential like the length of the warranty
    - Only allocates the risks and terms between the parties
    - You are not necessarily aware of them but they are binding terms (can be still fair)

ENGLISH LAW

As long as you get something of value and you pay something of value, it is okay

Cresswell v. Potter: English case

Circumstances: a married couple bought a house together, and when they divorced, she wanted to claim half of the house since she paid for it as well. However, the plaintiff apparently signed off her rights in the contract, but she claimed she did not read those through.

Ruling: She was unable to observe the terms of the contract when reading the terms of the release because she was

1, **poor, ignorant**, and

2, **did not have advice from the outside** → the two sides are not equal obviously and there was no evidence that the plaintiff had any independent advice from the outside
3, **sale being of considerable value** – half of a house is a lot to a low-income person

Being unfair is not enough, you have to emphasize the fact that she was poor & ignorant and had no access to outside consultation. All these 3 must be satisfied for the case to be considered unfair, and this was indeed the case here → **relief was given.**

AMERICAN LAW: If a contract or any clause of a contract is shown to have been unconscionable at the time the contract was made, the court may decide to refuse the contract

What is unconscionability? When a contract is unfair or oppressive, the court may find it unconscionable. Likely circumstances: unfair bargaining and unfair terms.

Unconscionability:

allows you to set aside the contract for unfairness

- *Substantive*: gross disparity, the price was simply too high (more than 2.5 times the current market value) OR unfair allocation of risks without compensation
- *Procedural:* the defendant is ignorant in this field (doesn't know the market value of the product buying) but the other side is an expert (bargaining inequality, exploitation, one side is too oppressive)
    - *Difference on bargaining power (a weaker party)*
    - *Surprise terms (that were not known before)*

Toker v. Westermann: American case

Circumstances: a company sold fridges under a retail installment contract. The defendant claimed the contract was very overpriced (due to the installments and the extra interests) and refused to pay the high price, he only wanted to pay the lower price.

Ruling: relief was given

- Counting on specifically substantive unconscionability, the price was too high due to gross distortion (almost 3x of the market price)
- But there is no procedural unconscionability because both sides knew what fridge was bought.
- But the substantive side was so strong that relief was given (the plaintiff had to seek welfare assistance during the repayment). But also, the plaintiff was too poor to own a refrigerator to begin with so he should not have done it.

Unfairness comes down to what the salesperson does to you. If it charges a too high of a price, does not provide you with information necessary, or exploits you in other ways then it is unfairness. If, for instance, a plumber makes an issue sound extremely urgent when it is actually not urgent, to a person who does not know a lot about the issue, can be interpreted as exploitation and can be sued for relief.

Carboni v. Arrospide: American case – broker and sick father

Circumstances: a person signed a note on behalf of his father for$ 4000. It was for **200% interest per year** and was due in 3 months. The parties intended the sum to be paid at once after 3 months. However, the broker kept giving cash to the son through the original note and it ballooned to 99k in the end. Testimony on the 2 sides differed, because the broker claimed that the money was to renovate a property (well-off situation), while the son claimed it was to fund the medical expenses of his sick father (desperate situation).

Ruling: Substantive unconscionability existed because the interest rate was 200%, so extremely above the market price of 20%. Procedural unconscionability also was present because the situation deprived the family of any other meaningful alternative and he did not have access to any other better deals. In the end, there was relief given.

- But maybe: a 200% interest rate was indeed a market price for someone in a low-income, desperate (stressed, medical expenses) situation since no one else wanted to give the loan.
- Inequality of bargaining power also present

GERMAN LAW

1. If a legal transaction violates good morals, then it is void.
2. If a legal transaction takes advantage of another person, if he is in a distressed situation, has inexperience or lack of judgment, or the price is disproportionate then the contract can be nulled.
    a. Usury: taking an interest or a loan
    b. Door to door sales: the consumer that enters into a contract has the right to cancel it within two weeks of the contract. He can cancel for any reason.

Reichsgericht: German case 1921

Circumstances: the defendant was leasing a property from the plaintiff, but after a while the defendant wanted to withdraw from the contract due to error and for fraud. However, the plaintiff wanted to reestablish the contract. Also, there was a clause saying that the owner can use the apartment even if it is leased + if the payment was late even by 1 day, then the tenant can be kicked out and lose the entire year of rent.
Ruling: Previous decision was in favor of the plaintiff. But the higher court found that the contract put significant burden on the defendant since the contract contains oppressive provisions, like extremely high rent. The defendant was inexperienced in business matters → ignorance, or not knowing what he was doing. But it was **the NATURE OF THE TERMS** that violates good morals, which annuls the contract.

- Disproportion: the price was too high
- Indiscretion: it was such a stupid contract to enter with such harsh conditions. But the landlord did not do anything to induce the tenant to enter into this agreement.

Bundesgerichtshof: German case 1961

Circumstances: A contract of a loan of 20k DM provided the lender with an agreed profit of 750DM per month. The profit was coming from a 45% interest rate annually. But the contract is only nulled when in addition to the striking disproportion in the interest rate, there are also unfair parts about the lender's character (procedural unconscionability).
Ruling:

- Disproportion existed because the market rate was 20% and he was promised 45% → nature of the terms play an important role. Easier to find disproportion in price so it was void by violating good morals.
- It was a 45% interest rate AND good security backing provided (real estate, etc.) -> could have obtained a loan at a normal bank
- Relief was given due to this careless chase for profit

FRENCH LAW

- If a seller receives less than 5/12ths of the value of a property then the sale can be set aside
- If a revocation of a contract is allowed → choice either to return the object and recover the price or keep the estate and pay the just price

- Fraud: lying simply
  Duress: one party influences and created a constraint on the other (creating fear, harm, etc.) – threat of legal action does not mean duress but in general, DURESS IS GROUND FOR NULLITY

Also duress: when one party exploits the other's state of dependence or desperateness

Cour de Cassation 1887: French case

Circumstances: ship was stuck in the sand, 18k was paid for rescuing the boat. If the rescue boat was not paid for, all profits would have been lost.
Ruling: Court found that the owner of the boat should only pay a lot less for the rescue. There was no duress since it was not physical → no relief. But the court lowered the price of the rescue since it was the exploitation of the owner's desperate situation to some extent .

- Is this duress? No, because the rescuer did not force or induce the owner of the ship to pay for the rescue. Duress is only when physical consequences are present, here only economic consequences were present. The captain only agreed to the rescue ship's price because he was scared about the lost profit.
- In English and American law, duress is not present!!

Cour d'appel, 1930: - insurance

Circumstances: L had to pay H for damages (60k) due to an accident which L was supposed to be responsible for. However, L wants the decision to be modified because in the contract signed by the parties, it was included that L should be discharged in case of an accident. For the limited liability, H received 1500 francs at the time of contracting
Ruling: it is evident that H took advantage of the **desperate state** (established by experts appointed by the court) of H. Both parties are bound to the contract because they signed it. This situation was very unfair, no one in their right mind would have entered into this bargain **so there must be fraud or duress**. H was exploited to give up its rights in a very desperate state, to create a situation where whether there is an accident or not, H wouldn't have had to pay.

- We are not supposed to care about fairness when looking at contracts, but we do, just under different names (fraud, duress, etc.)

Cour d'appel, 1953 – painting case

Circumstances: a vendor sold a painting for a much higher value than it was worth, and the buyer wanted compensation post the event for the overpayment. It seems like an evaluative mistake, but this should not be remedied by law since the buyer should have checked the quality of the painting to the best of his ability.
Ruling:

- However, it is an error in value -> mistake → mistake can be grounds for nulling a contract
- The buyer was not very good at evaluating the value of a painting so he was dependent on the merchant who exploited this (described himself as a man of honesty, an expert recognized by the government and a famous art critic)
- the disproportion is very huge, so it could be unfair under some specific circumstances. (50k versus 400k)

2. Fairness in Auxiliary Terms + Risk Compensation:

ENGLISH LAW: unfair contracts are not binding for consumers + a contract is unfair if it causes a significant imbalance in the parties' rights and obligations.

AMERICAN LAW

Weaver v. American Oil Co.: fairness in AUXILIARY TERMS

Circumstances: the representative of an oil company presented a contract to the defendant that included a **harmless provision** for the lease, which basically said that any harm that the oil company does should not be litigated in substance. Then litigation arose because the employee

of the oil company sprayed gasoline over the owner of the property which caused him to get injured. The contract would have actually forced the leaser to compensate the oil company for its own negligence.
Ruling: the oil company shifted the burden of getting injured onto the company that is leasing the land. This is **substantively unfair,** because actually the oil company should be held accountable for these actions. There was no proof that Weaver read the contract or the agent drew any attention to the harmless cause. Therefore, the court concluded that because **Weaver had no legal advice** and he did not understand the terms, the contract was null on **procedural unconscionability.**

- The oil company took advantage of Weaver's poor education, because he is taking high risks with no compensation – unfair **compensation.**
- Even if Weaver accepted the terms that are highly risky, he should have gone to get insurance for the risk he is taking, but the insurance should be refunded by the oil company. But they wanted to shift the risk without paying at all.
- The clause was in small font and contained no heading (hidden)

French law: any contract which deprives the debtor's essential obligation of the substance is deemed not to be written.

ISSUE: Can a company escape liability about essential obligations in case of breach of contract with a limited liability clause?

Cour de Cassation, 1996 – courier case

Circumstances: a company was hired to deliver envelopes consisting of a tender offer. The company **failed to deliver them within the time frame,** but a clause in the contract limited the liability to the price of carrying those envelopes.
Ruling: any contract which deprives a debtor's essential obligation to the substance of the service is deemed not to be written. Due to this, since the company was a special carriage **offering reliability and speed for its deliveries**, and due to cancelling the company's essential obligation, the clause deems not to be written

- This was a tender offer so the damage could be huge
- They have the essential obligation to deliver the mail within a certain number of days → but you also pay more for that extra service
- This is about risk compensation – the **company was financially compensated** for the risk they were taking (so the risk is on them). If they were not compensated, this wouldn't be the case.
- No compensation on the buyer side → they did not get a lower price for the risk they were taking

Cour de cassation, 2010 – software case

Circumstances: Oracle contracted to deliver the final version of a production software to a manufacturer. Oracle failed to deliver the software but its liability for damages was limited by the contract.
Ruling: The court found that Oracle's liability in this case was the essential obligation taken up, therefore any contract saying it should not be liable is deemed not to be written. HOWEVER, the manufacturer received fair compensation at the same time, specifically a discount rate, and a powerful spot in a committee → the contract should stand because the manufacturer received compensation for its "risk", so not all its essential obligation was forgone.

- The limited liability clause still stands here because the other party received fair compensation for it

Comparison between the 2 cases above: these 2 cases are not contradictory because the difference is in the risk compensation. The delivery company that was hired was paid more

because it was known for its fast speed, there was no compensation or liability when the company could not deliver. In the 2nd case, they gave a discount and other incentives as well.

- In both cases: the defendant tried to shift the risk to the other side

FRENCH LAW: Any contract which creates a significant imbalance in the rights and obligations of parties is deemed not to be written.

- This is again about risk allocation and risk compensation

Cour de cassation, 2018 – insurance case

Circumstances: An insurance company's insurance contract says that if the insured person makes false declarations, fails to disclose some information, etc. then it is not eligible for any compensation in case of an accident.
Ruling: **First**, this contract deprived the insured person of fair compensation in case of submitting inaccurate documents. This led to the insurer not performing the essential obligation laid out in the contract. Attaching "such excessive consequences" to false declarations is what makes the contract not be written. **Secondly,** the clause in the contract causes a "significant" disequilibrium in the rights and obligations of the two sides → deemed not to be written.

- Intentionally lying would mean losing your rights in normal law too
- But here, it was also exaggerating / misstating that would cause the insured people to lose their rights → and misstatement of facts (anything that is not 100% accurate) → imbalance of obligations (unfair)
- No insured person would have been willing to take this risk had they known

3. Fairness in Weird Terms:

Weird terms in a contract can be:

- Prohibiting women from wearing a hijab to work
- Sometimes regarding contract clauses limiting personal liberties → offensive morally → can object in court
- E.g. a woman was fired when she was asked to show her butt during a performance in a hospital → the court said that this was against personal liberties, no one should be asked to expose their body parts in front of the public

German law: A contract can be nulled when it disproportionately disadvantages one side in the contract. Disproportionate disadvantage can also be shown when the contract is unclear. But in general, it comes from 1, limiting essential ideas 2, not being in accordance with underlying ideas of the contract.

- In German law, if the clause is surprising, it can be nulled (e.g. have to be a specific age to rent an apartment)

Bundesgerichtshof, 2012

Circumstances: Parties entered into a contract about the use of a fitness center, specifically a 2-year long contract unless the user gives notice that it cannot use the center due to health reasons. The user did this, he gave notice to the fitness center with **a medical certificate**, but the center refused the termination of the contract because the certificate was "too unspecific".
Ruling: It is okay to prohibit users from terminating their contract for 2 years. However, there can be other reasons for the termination of the contract than illness (like pregnancy). Therefore, this clause severely disadvantaged one contracting side for the benefit of the other side. Nevertheless, the user provided documentation about his inability to exercise, so he medical certificate should not include further details about the nature of the illness (privacy concerns) + the doctor should be trusted.

- The business incentive would create a huge barrier to quit

- Alternative argument: one could also argue that this term was surprising, the average person would not expect the gym to require a medical certificate for terminating

EXCUSES FOR NON-PERFORMANCE

- If you breach your contract, you can get 1, expectation damage 2, or future performance
- Unless you have an excuse not to perform your contract (impossibility or change of circumstances)

1. Impossibility of Force Majeure

What is a force majeure? *Force majeure is a provision in a contract that frees both parties from the obligation if an extraordinary event directly prevents one or both parties from performing their contractual duties. IMPOSSIBILITY*

BEST PERFORMANCE V. LIABILITY BASED ON RESULTS

- A doctor or a lawyer is liable only if he is negligent. If he fails to perform his "contractual duty", he is still not liable.
    - The lawyer still won't be liable if he loses the case because 1, law does not allow lawyers (officers of the court) to promise to win (because if he promises to win → get a lot more money)
    - So they only have to perform according to the best of their ability
- However, a transport company promising to deliver your letter on time and fails to do so is liable even if he is not negligent sometimes (e.g. if the workers strike)

TERMINATION V. VOID

The contract is still valid but it is TERMINATED because performing it becomes impossible (different than being void) → restored to initial scenario

- In the case of void → the contract was never correct due to mistakes, duress
- In the case of termination → there was a correct contract but now it is cancelled

GENERAL IDEA OF NON-PERFORMANCE

- Only liable for mistakes that could have been prevented
- Not liable for circumstances that are out of the party's control (e.g. war)
- One cannot be obligated to keep an impossible promise but if the contractor was aware the promise was impossible at the time of signing the contract, he could be sued for losses
- The impossibility of performing a contract has to be ABSOLUTE (impossible for everyone, not just for the contractor)

Taylor v. Caldwell, 1863, English case

Circumstances: defendants agreed to let the plaintiffs use their Music Hall and gardens for 4 days for big concerts, for 100 pounds a day. In the meantime, the **Hall was destroyed by a fire** and damaged to the extent that the concerts could not be held. It was not the fault of either party.

Ruling: the parties must have from the start knew that the contract could not be fulfilled if this circumstance ceased to exist. Contracts are subject to an implied condition that parties should be excused if circumstances change out of the control of the two parties. Conclusion: **both**

parties are excused, the defendant from performing their promise to provide the gardens, the plaintiffs for paying the money and taking the garden.
Note:

- English law before the 19th century was not consistent as to when it excused a party and when it did not (e.g. excused a painter that died but did not excuse a lessee from paying rent during the Civil War)
- General agreement: a contract is valid as long as "matters remain in their present state" → this can excuse a party from performing even if the performance has not become impossible

GENERAL RULE: **if the task is impossible before signing the contract (initial impossibility) or after signing the contract (ex-ante impossibility) → you are released from the contract and** (not liable for expectation damage)**.** However, if you knew at the time of the contract that the task was impossible and you still signed it, then you are liable. IN ALL JURISDICTIONS

French law:

- there is force majeure when the event is beyond the control of the debtor and when the circumstance could have been foreseeable. If temporary → perform after it passes unless it is too late, if permanent → discharged from obligations.
- French law does not distinguish between a case when performance is excused by force majeure versus by impossibility
    - Force majeure: earthquake, war, etc.
    - Some contracts entail a duty to perform at its best (doctor – liable only if negligent) and others entail duty to actually achieve a specific result (delivery company - liable unless force majeure)

German law:

- Liability for an impossible performance depended on whether the party was responsible for said impossible performance
- If a party behaved like a reasonable person then any event which made the performance impossible for him must have been an accident
- Some contracts entail a duty to perform at its best (doctor – liable only if negligent) and others entail duty to actually achieve a specific result (delivery company - liable unless force majeure) – German law is very similar to the rest of our studied countries in this way

2. Change of Circumstances

FRENCH LAW: - In case there are unforeseeable change of circumstances + the party had not accepted the risk of those changes → renegotiate the contract or terminate the contract (if failure from negotiations)	**GERMAN LAW:** BASIS OF TRANSACTION - The party having to perform is bound to perform as required by good faith - If the circumstances of a transaction have substantially changed → adaptation of the contract + division of risks properly - Same if essential assumptions around the contract have changed - If adaptation is not possible, the disadvantaged party can request to withdraw from the contract
ENGLISH LAW: - Only frustration of purpose exists!	**AMERICAN LAW:** - Both hardship and frustration of purpose

HARDSHIP/IMPRACTICABILITY or FRUSTRATION

- Hardship: it becomes extremely expensive to perform the contract after the contract has been performed → economically unfair to perform
    - Similar to fairness, but again, the difference is that hardship arises after the formation of the contract
    - You could still perform the contract but it becomes more difficult
- Frustration: there is no point in performing because performing becomes totally useless
    - Similar to mistakes, the only difference is that mistake happened before the contract, frustration happened after
- Not every jurisdiction has these two types

CHANGED CIRCUMSTANCES HISTORY:

- All contracts are made subject to the condition that the circumstances will not change (of course, if a surgeon becomes blind before a surgery, he does not have to perform the surgery)
- Same for a promise: a promise is not binding in circumstances changed where the promisor did not intent to be bound
- However, some conditions for a contract were implicit, they did not have to be specifically stated

EVENT HAPPENING -> PERFORMANCE IMPOSSIBLE

- Event happening before entering into a contract but I was aware of it → mistake
    - if I got paid more for it → I am liable because I was aware of it
- Event after the contracting moment → impossibility and excuse for non-performance

Krell v. Henry, 1903, English case

Circumstances: the plaintiff sued the defendants because he rented a high-priced room along the coronation route of the new English king. In the meantime, the king fell seriously ill and the coronation was postponed. The plaintiff wanted the difference in prices back.
Ruling: Important procedure is to: 1, Define what is the **substance of the contract** 2, define whether the substance of the contract needs some **assumptions to continue existing** (in this case, the essential assumption for the higher price was that the coronation actually would take place). The outcome was that the judge regarded the coronation as an essential condition for the contract to take place, therefore now that it would not take place, both parties are excused from it.

- impossibility of performance does not only have to arise in the case of destruction or nonexistence of something

Tsakiroglou v. Noblee & Thorn: English case

Circumstances: sell 300 tons of groundnuts, the usual shipment was through the Suez canal. Following military operations, the Suez Canal was blocked for shipping, but the defendants could still have shipped around Africa → they did not ship any nuts in the end because the alternative route would have been much more expensive (twice as expensive as expected before) and longer (also double).
Ruling: did not perform the contract in the end. In English law, there is NO HARDSHIP, so the defendants cited **frustration of purpose** (it is the closest thing they have). The issue becomes whether the shipment of the nuts is still useful.

- One side: the other route was still practical and doable, and in the contract this route was not excluded from all possible routes. Therefore the change of circumstances fell short of the needed level.
- Bottom line: **the seller may incur a greater cost and a lower profit but the increase in expense is not so substantial as to cite frustration.**

Transatlantic Financing Corp. v. US: American case

Circumstances: Transatlantic Group contracted with the US to carry a ship of wheat from the US to Iran. In the meantime, the Egyptian government nationalized the Suez Canal, through which the shipment was supposed to be made. Then a regional war started and the Egyptian government closed down the canal. The company asked for compensation because now they must take a much longer and more expensive route, the US refused the additional compensation. The ship still changed course and reached Iran by taking the longer route.

Ruling: **Performance became much more expensive (15%) but they performed it anyways.**

- This is a situation that the company could have anticipated it before the contract, so **the additional risk should have been allocated before** the original contract was signed.
- The shipping company could have asked for more money initially, but they did not anticipate these circumstances although it was known (they have professionals estimating the risk)
- The company was paid for the risk, so they cannot ask for more when the probable risk matures and becomes reality
- The court cited hardship, the risk was on the shipping company

3 steps to evaluate performance based on a change of circumstances:

1. Contingency – something unexpected happening (YES)
2. Risk of the unexpected event was not allocated by the contract (NO)
3. The occurrence of the unexpected must have made the performance impractical
    a. The shipping company was not less suitable than the US to purchase insurance
    b. In fact, the shipping company is better at calculating the risk because they are in the industry

- Unless all these are found, excusing from the contract fails

Mineral Park v. Howard: American case

Circumstances: Defendants made a contract with the public authorities to build a bridge on the land of the plaintiff. The plaintiff granted them the right to use the land and build on the land and do whatever is necessary (take out gravel and earth). However, only 50k of the expected 100k cubic yards of earth and gravel was taken out of the plaintiff's land, because they were only the ones above water. Had the underwater ones been extracted, it would have costed the defendants much more**. The defendant did not want to perform the contract because it could not have made a profit, the plaintiff wanted to enforce it regardless.**

Ruling:

- hardship case, it became commercially impossible to perform from a f**inancial perspective**
- The cost would have been 10 times of the originally expected one, but performance would have been still possible just not advantageous or practical.
- The defendant was excused on the grounds that at the time of contracting, they were not binding themselves to take what was not there (look at it from a practical pov)
- Something is impractical when it can only be done at an **excessive or unreasonable cost**

NOTE:

- You can argue that this was a mistake but would have to prove that the mistake was about the substance of the contract (something completely different)
- Could also argue frustration of purpose → because now the performance became so expensive, the company could not have made a profit, so performing it was useless for them

Reichsgericht, 1923:

Circumstances: the plaintiff owned a real estate property for which he obtained a mortgage from the defendant to pay for it. The mortgage debt was due in 1920, which the plaintiff paid 19k with overdue interest and the required principle amount. The plaintiff wanted the mortgage to be

closed and finalized, however the defendant refused to do this because the debt should have been paid in currency of the previous German jurisdiction.
Ruling: the issue is whether the creditor can demand payment in German paper money at times of heavy inflation. In general, the debtor has seen its property's value skyrocket as much as the required amount in German paper currency. It is important to consider both the economic ability of the debtor and the increase in the property's value.

- Conclusion: **the bank can indeed require the mortgage to be paid in hard money.** Revalorization was allowed here but it should be allowed on a contract-to-contract basis.
- Revalorization: to set a new currency for an existing loan/mortgage

Bundesgericthshof, 1959:

Circumstances: A claim for an increase in the amount of fixed rent in a contract cannot be upheld on the ground that the continuous decline in purchasing power money has caused the collapse of the basis of the transaction.
Ruling:

- It is possible that during a long-term contractual relationship the balance between the performance and the payment has become upset so it is not fair anymore to keep the original terms of the contract → law in good faith requires proportional adaptations to the changed circumstances of the situation
- But not all modifications are justified, only the ones the ones that affect the interests of the parties to a great extent
- End line: risk has to be assumed before the contract and the promise has to be kept

Bundesgericthshof, 1973:

Circumstances: the annual salary of an executive at a company was a base salary and a specific percentage of profits. Then the person retired and claimed a higher pension on the ground that the general cost of living has increased substantially in recent years.
Ruling: the pension indeed should be adjusted to changed circumstances as the cost of living has increased by almost 50% in the period. Due to the increased inflation, the pension can no longer fulfill its intended function which was to provide a certain level of standard of living.

REMEDIES

1. Damages

GERMAN LAW

- Compensation must be given if it is proved that the loss would not have occurred had the contract been performed

AMERICAN LAW

- The injured party has a right for damages based on his expectation
- The expectation is measured by – the loss that the other party's failure or not performance has caused to him + consequential loss due to the breach of the contract

ENGLISH LAW

- Put the "victim" in the same condition had the contract been performed
- The victim must be compensation for losses and expectation damage as well

FRENCH LAW

- Loss that was occurred + gain that was deprived due to the unfulfilled expectations

2. Specific Performance

GERMAN LAW: unique in the sense that the obligation to perform the duty described in the contract is still there → the victim can claim the performance of the duty

- Specific performance can be requested anytime!!! (conditional on that the performance is still possible)
- But it depends on the injured person – he can also ask for damages if he sees it more fit
- Today's practice: grant an extra period in which performance must be made and if it is not, sue for damages

AMERICAN LAW:

- Specific performance will not be ordered if damages would be adequate for the damaged party
- To determine whether damages would be adequate: difficulty with finding a substitute performance OR difficulty proving w certainty that damages would be adequate

ENGLISH LAW:

- Specific performance is not ordered when financial damages are an adequate remedy (→ the claimant can go and contract with another person to perform from the damage paid)
- When the claimant cannot obtain a satisfactory substitute then specific performance is required
- The question is not only whether damages are an adequate remedy but also whether specific performance can do better
- Contracts involving personal service:
    - Equity in general cannot be the ground for specific performance
    - The court can always order the execution of the formal agreement → then the parties can agree on remedies

FRENCH LAW:

- A damaged side may: refuse to perform his own obligations, seek enforced performance, seek a reduction in price, terminate the contract, claim reparation

3. Excessive Cost of Performance:

Ruxley Electronics v. Construction Forsyth

Circumstances: the defendant contracted with two companies to build a swimming pool in his backyard for a specific price of 70k pounds. The contract explicitly said that the depth of the pool should be 7.6 feet but after the completion of the pool, it was noticed that the depth was only 6.9 feet.
Ruling: The court found that the decreased depth of the **pool has not decreased** the value of the pool → the **breach should have been fundamenta**l to claim performance in return. So the owner of the pool was only awarded 2.5k for general damages and not anything more. Then the owner appealed and was awarded more (21.2k) in damages against the company.

- The owner of the pool suffered a real loss that he is entitled to be compensated for but in some cases the loss cannot be fairly measured (only way is to estimate the cost of reinstatement or if someone else built that pool)
- So why doesn't the company just perform the specific performance that was required? Because there would have been an excessive cost at rebuilding the pool again → you pay damages and you are excused from performing the contract

AMERICAN LAW: If the breach of contract results in imperfect or unfinished construction then the damage can be based on → 1, reduction in the value of the property 2, reasonable cost of completing the performance

4. Recovery for non-economic harm: mental distress

Jarvis v. Swans Tour, English case:

Circumstances: defendants (a travel agency) have issued a brochure of winter sports holidays where one location was at a special resident host in Switzerland. The brochure stated that the price of the holiday included a party, tea, and a lot of other fancy things. The plaintiff spent a great amount and was looking forward to the holiday. However, when the plaintiff got there, the host did not speak in English, there was no entertainment at night and the cake was dry and bad quality. Basically, the circumstances were not as described in the brochure and it caused a great deal of distress to the plaintiff.

Ruling:

- The case is indeed about mental distress but that cannot be recovered in case of breach of contract in English law. On the other hand, the vacation has economic value and that can be recovered
- They sued for breach of contract but could only recover the economic losses (due to loss of vacation time → loss of income and loss of days of enjoyment)
- **Mental distress cannot be recovered in English law**

Deitsch v. Music Company, American:

American law: recovery for mental distress is excluded unless also physical harm occurred

Circumstances: the band did not show up last minute at the plaintiff's wedding when they already paid a deposit for the band. Due to this, the plaintiff had to arrange an alternative music solution in the middle of their wedding.

Ruling:

- The plaintiffs are **entitled to compensation due to the distress, inconvenience**, lost experience at their wedding, at their special night → they indeed got economic compensation of 750$ (more than just the refund of the cost they paid)
- In American law, you can recover mental distress but only if it is of a certain kind (the nature of the breach, under which circumstances you breached it) → compensation

Tribunal de commerce, 1932

Circumstances: the font size on a poster of the female actress was much smaller than the male actor's name when the contract defined that they have to have equal representation.

Ruling: The poster company did not perform their contractual duty as laid out in the contract, as numerous mistakes were made regarding the female actress → suffered **commercial disturbance and non-economic harm.**

- Damages must be compensated for, and a fine was also included until the poster was changed (French law).
- French rule – as long as you can prove there is damage, you can get compensation for it

5. Recovery for unforeseeable harm

Definition: *A person causing injury is not at fault if the reason for the injury was unforeseeable. The superseding cause breaks the chain of causation between the initial act of negligence and the injury.*

Issue: can expectation damage be limited due to unforeseeable harm? **You are only liable for what is foreseeable.**

- Standard rule: if you breach your contract → you are liable → you get expectation damage
- If the harm was unforeseeable: you can argue if the harm was foreseeable (the businessman told the driver exactly what an important contract he needs to sign and he needs to be there on time) or unforeseeable
- Disproportionality – was the compensation enough for the huge risk that the driver was taking (if the driver was late, then a contract worth 20m would be lost)
    - If the compensation was disproportionate → then the expectation damage can only be lower
- You get no expectation damage → because the driver was not compensated for the extra risk, if the driver was late, at most you can get back the taxi fare (but only if the driver was late compared to the commercial standard)

FRENCH LAW: A debtor is bound only to damages which were foreseen or could have been foreseen at the time of contracting, except when non-performance was due to intentional misconduct.

Cour de cassation, 1982 – roof case

Circumstances: the roofing and plumbing contractor accidentally lit on fire the building it was working with due to the use of blowtorch.
Ruling: The harm was unforeseeable in this case and since there was no willful misconduct or gross negligence, the contractor should not be accountable.

The difference in the two following cases is **foreseeability**. If the shipment is about something very valuable, if the shipping company loses it, then the person should not have given it to the delivery company to begin with. The risk is on the person making the shipment because you are **pushing a huge risk on the shipping company without fair compensation**. This can also be about fairness, because if I knew that I assume this risk then I would have asked for extra compensation. Since there is no extra compensation given, it is not fair for me to assume that risk.

Cour de cassation, 1913 – merchandise

Circumstances: A person checked in a 30kg bag into a train company carrying very valuable objects. The suitcase was lost, and then returned but without half of the valuable objects inside. The traveller sued for the value of the objects plus additional damages
Ruling: The train company argues they had no way of foreseeing what value of merchandise was carried in that suitcase. Nevertheless, **the court ruled that the entire amount of the stolen merchandise should be refunded** + additional damages (but less than the traveller initially wanted..

Cour de cassation, 1926 – merchandise

Circumstances: the plaintiff checked in a suitcase and declared its value to be 475 francs → it was lost after. The plaintiff sued for much more than the declared value.
Ruling: the damages can only be as high as what was foreseen at the time of contracting and since here that is only 475, the value of the damages can only be that much.

Introduction to Business Law

Main Topic: law governing companies in the European Union

- Corporations and other forms of business organizations
- Characteristics of a corporation
- The process of incorporation
- Legal capital (creditor protection)
- Equity financing
- Corporate governance – board structures, shareholder meetings, duties and liabilities

Corporations:

- One form of business organizations but it is used for large-scale businesses (allowing them to be listed on the stock market) and they dominate the EU economy
- Corporation is basically a public company or publicly limited company

Private v. public regulation:

- Public regulation:
  - Constitution – international treaties
  - Enactment of legislature – statues
  - Administrative regulation
  - Case law (opinions of judges in specific cases)
- Private regulation:
  - Includes rules not enacted by legislature, they are voluntarily adopted by the participants
  - Contracts, HARD LAW
    - bylaws, shareholder agreements, articles of association
    - Bylaws are rules made by the company to govern its members
    - These are mandatory to keep, if the principal is violated then the contract is breached, these contracts are enforced (e.g. fine, jail time)
  - SOFT LAW: best practices
    - Encouraged to be followed, but not mandatory - if not complying with these then you have to explain why you did not follow these → impact **company reputation in the market**
    - Corporate governance best practices
    - Stewardship Codes for investors - 1, to create the enterprise culture 2, these are **tailored to the company**, so the people who keep them are familiar with them
  - Some people argue that law only makes sense if there is enforcement and sanctioning if it is not followed → these people don't believe in company best practices
  - If you embrace a corporate governance code then comply and explain is automatically followed by it, it is not binding in general
- American laws that spread:
  - After the financial crisis, there was a breakdown of soft law (companies simply made wrong decision)
  - Dodd Frank Act: the most impactful Wall Street reform after the financial crisis attempting to restrict excessive risk-taking. It also tries to prevent consumers from being exploited
- Example: partner at a consulting firm working with a fashion company.
  - Partner salaries are both based on equity and salary.

    - The fashion company wants to appoint the partner as a Board member, can the partner sit in the Board as an independent director?
    - According to the code of corporate governance, this situation can potentially cause the partner lose its independence, because if the company stays a client, he is going to get a much higher salary (equity salary).
- Role of the Board of Directors:
    - Chairman: regulating the discussion and leading the Board
    - Committees: at least 3 committees, made up of people who have specific knowledge about the doings of that committee
- EU level v. state level:
    - Companies are creatures of national law which regulates their incorporation and functioning
    - Companies operated In any EU state must operate under the law of that specific nation state

National Company laws:

- Civil law countries – most of continental Europe, rules ex-ante
    - There is a specific code that has to be applied when deciding cases
- Common law countries – UK and the US, precedents play a more important role and establish a sense of flexibility, more ex-post

Sources of Company Laws at the EU level:

- EU law exists with the aim of manifesting the internal market (freedom of flow of goods and freedom of establishment)
- 1st goal: Harmonization Program – established different legislative tools
    - Regulation: has general applications, binding and applicable in all member states
    - Directive: binding in each member state, but the methods of implementation is left to the member states
    - Decision: binding only to the states it concerns
    - Recommendations and opinions are not binding in general, but can be voluntarily adopted by nation states
- 2nd goal: competition
- These two represent the core of EU company law (always trying to achieve harmonization and competition)

Types of Companies

Why does company law exist at all? Contracting is oriented at maximizing both parties' wealth while each of them adhere to some rules to create a cooperative ecosystem. The law defines default rules that save time for agents.

Sole Trader:

- When there is only one person employed in the company
- Advantages- simplified structure
    - Direct control over the entire decision-making
    - Lower costs because he does not need to pay anyone, there is little bureaucracy
    - No conflict of interest
    - Direct application of personal goals
    - Easier tax structure, potentially lower taxes
- Disadvantages:
    - Several disadvantages come along if the company wants to expand and increase the size of the company
    - Personal liability for business obligations – banks or employees or customers can go against personal wealth as well
    - Banks are aware of risks, so costs of external financing increase
    - Business development is hard to do, because specialized managers are needed and equity financing (e.g. consultants for market entry, investors)
- Maybe going for franchising when wanting to expand the business can be a good idea (others operating restaurants under your brand name with the same recipe, same operations, but simply you don't take care of the other restaurants) → might want to switch to another business structure

From Sole Trading to Incorporation:

- The corporation is a separate legal entity from the owner → reduces the problems arising when business development is considered (financing, skills)
- The company assets and personal assets are divided, the corporation does all the tasks
- The owner is another contractor to the firm who holds an equity interest in the company → will be paid after profits

COMMON STRUCTURE OF CORPORATE LAW IN DIFFERENT JURISDICTIONS

What is a corporation? It is a contract that parties put together to exercise jointly an enterprise with the goal of distributing profits.

Corporate Model of Business Organization: pages 10-11 of the reading

- All jurisdictions have a similar corporate model
- Legal characteristics:
    - Legal personality
    - Limited liability
    - Transferable shared
    - Delegated management
    - Investor ownership
- Corporations facilitate capital formation and economic activity that otherwise would not be possible

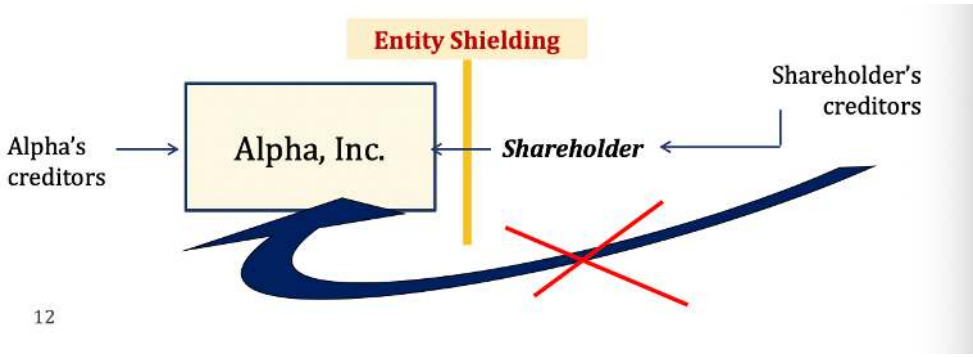
- Corporate law is really important because it provides a foundation for economic growth through accountability, investor protection and legitimacy to large-scale businesses
- Starting a corporation is "losing the control over everything" – you have to delegate some tasks, you cannot perform everything like as a sole trader (creation of the delegated management)

1. Legal Personality:

- An entity that differs from the person (natural or legal) that formed it
    - Can be an individual or another company, but the legal entity of the corporation is different from both
    - A clearly distinguishable separate entity
- Nexus of contracts – defines a corporation as a contract between multiple people
    - The company is going to be the center of the contracts, not the owner!

Entity shielding:

- : protects the creditors of the shareholders from claiming the company's assets (the shareholder's debt cannot cause the company to lose its assets)
- Entity shielding is the converse of limited liability
- So the creditor of the company cannot go against the shareholder's properties and vice versa → EXCEPT FOR the assets the owner has in the company specifically or the dividend



Priority rule: upon liquidation, the law grants the company's creditors priority in seizing assets as a guarantee. Then the shareholder's creditors can make their claims and only after that can shareholders divide between themselves what is left, so it follows in this order:

- Company's assets
- Shareholder's creditors
- Shareholders

Liquidation protection: shareholders cannot withdraw their share of the firm on their demand when the company is being liquidated but there are some exceptions (e.g. if the majority of shareholders force liquidation)

- This strengthens the priority rule
- However: individual shareholder can sometimes withdraw if they have good reasons
- Otherwise, they are "prisoners" of their own company and cannot sell their shares
- regulation needs to balance creditor protection v. not making shareholders prisoners

- When can you withdraw from a company? When major changes happen in the company, like moving the office abroad, entering a new industry

- And the withdrawal value is the value of the share before the major change happened

Preference rule: concurrent liability because companies are responsible for their own obligations, but the creditors can ask to be paid by the shareholders as well → so shareholders are liable for the responsibilities of the company kind of as well
  - Can also be that one of the founders are asked to pay, but that founder can go to other shareholders to ask for repayment
  - Protects the creditors and protects the reliability of the shareholders (that actually the debt will be repaid)

Benefits of Entity Shielding:
- Monitoring costs are an important factor to consider
- No need for creditors to monitor the shareholders → lower costs
- Individual shareholders cannot force the liquidation of the company (cannot withdraw shares at will)

NOTE to **increase capital** of the corporation:
- Increase the number of shares (US tends to do that)
- Increase the value of each share

Two additional rules of legal personality:
- **Authority Allocation**: allocates the power to buy and sell assets of behalf of the firm or other activities (delegated management, the board delegates tasks to managers)
  - Majority when Board decisions – faster decision-making
  - Unanimity – when everyone agrees to that decision, takes much more time
  - Delegated management is more complex than here of course
  - Board is liable for "wrong" choices they make
- **Coordination Issues**: there are high transaction costs when communicating between shareholders, creditors and stakeholders
  - Unanimity would be too costly when decision-making
  - It is in general expensive to have meetings, to wait with a decision, etc. → majority rule

Business Judgment Rule:
Example: imagine if you are a shareholder and you are not happy with a merger decision that the Board has made, since profits have been declining. What do you do as an unhappy shareholder? Can they go to court?
- Courts are not business-trained, they cannot evaluate the decision, especially that it is ex-post (more information is available)
- Also: as a shareholder you assume a level of risk, you could have sold your shares as well, and the Board acted in the best interest of the firm as well
- **Business judgement rule**: given the skills and the expertise the Board has, did they do their job properly?
- Judges evaluate the process – did the Board take every document into account? (if they left out an important document then it is their fault)
- Usually decisions are approved by the general shareholders meeting (In Italy), but there are delegated tasks
- In the US, the Board always decides

2. **Limited Liability** - company creditors can make claims only against assets owned by the company itself (OWNER SHIELDING)

- **Entity shielding (shareholder's creditors → company assets) + limited liability (company's creditors → shareholders' assets) = asset partitioning**

Benefits of Limited Liability

- No excessive risk-aversion by shareholders – shareholders are protected against claims from the company's creditors
    - Since the company's and my pocket are split, it is up to the shareholder to decide how much value to own in the company
- Decision-making is delegated to specialized managers (no need to be hands-on)
    - The management needs to take risks, ones that make sense, to run a successful business
    - Incentive-compatible system – management gets rewards if their risk is paid off
- It promotes investing in multiple businesses (only liable up until a certain amount)

NOTE: sometimes limited liability is disapplied under exception circumstances to protect the creditors. It is only the court that can lift this rule and make the owners' assets available to creditors (corporate veil)

3. **Transferable Shares:** the shares can be transferred from one owner to another

Benefits:

- Business is independent of owners' identity
- Liquidity of shareholders' interests
- Easy for shareholders to exit the business by selling shares → diversify, meet their interests (you can exit when it is the perfect time for you to do so)

TRANSFERABLE SHARES NOT EQUAL FREELY Tradeable SHARES

- Shares are freely tradeable in open corporations (=publicly listed corporations) which companies do to get liquidity and an increase in capital
- In private limited companies (closely held company) and unlisted corporations (privately owned, aka a joint stock company): transferable shares
    - Existing shareholders have to be preferred when choosing a seller compared to 3rd parties
    - If want to sell to a 3rd party, the other existing shareholders who are not selling must approve the sale according to clear guidelines (but limiting the right to transfer shares)

4. **Centralized Management:** control over the company's assets is transferred from principals (the owneCentralizrs) to agents (the board of directors)

- Decreases control costs but increases monitoring costs (especially for Minority Shareholders: shareholders owning the minority of shares)

Structures

- One- tier structure: US and UK
    - Taking care of everything within the board of directors
    - BOD also takes care of the audit structure → structure slightly overlaps in the management, so some people of the management is also within the BOD
    - Shareholders nominate the BOD
- Two-tier structure: German structure
    - A general shareholders meeting nominating the Board
    - And the shareholder meeting has a bit more power (difference)
- The structure here raises an **agency problem**, where two sides have different interest that they need to align
    - Minority v. majority shareholders can have conflicting interests

Business decisions are delegated to specialized and skillful managers:

- They legally represents the company (normally the Chairman)
- Can define business strategies
- Can direct the use of the firm's assets
  → make key decisions
- There can be a delegation within the Board - **from the Board of Directors to one or more directors**
  - If the whole board delegates a decision to directors, then they make the decision but the board **will still have the liability** but only if the execution meets certain conditions
  - If the Board delegates a decision to a committee / specialized managers, the committee comes up with a result and motivation for it → Board decides actually and motivates the decision and can also make a separate decision

Benefits of centralized management:

- No shareholder consent is required to make operational decisions
- No shareholder skill is required to operate the business, because the Board will make the decisions and take liability

→ lower cost of decision-making

5. Investor Ownership:

- Investors are not the legal owners of the firm

Specific Characteristics:

- Right to control the firm
  - Voting for the board
  - Voting to remove the board
- Right to receive the firm's profits
  - Residual claimants of the firm
  - Right to receive proportional profits according to how much they invested

OTHER FORMS OF BUSINESS ORGANIZATIONS

Private Limited Liability Company:

- : companies whose shares are not freely transferable as opposed to a public Limited Liability Company. The shares are tradeable, but the buyer must be approved by the owners of the company
- Corporations are generally used for large firms to access capital markets but a privately limited liability company is also good for medium and small firms with no access to capital markets
  - Low capital requirements
  - Cannot trade shares on normal regulated markets
- Corporations are highly regulated but private LTDs have simpler regulations and reduced requirements
  - Lower costs of running the business
  - Structure is less rigid – e.g. no auditor has to oversee the directors and the accounting processes
  - Members have more powers than normal shareholders (in a normal corporation, your power is correlated with how much of the company you own)
  - Members are managers often
  - The relevance of the members is higher in general
- But due to the simplicity and the lower requirements → constraints on business development (e.g. cannot expand above a certain size)

General Partnernships v. Copartnerships:

- No legal personality
- Unlimited liability (can claim the owners' assets)
    - In general, there is weak asset partitioning so the owner's creditors can go for the company assets and vice versa
- Members and managers are the same

In Italy, partnerships are:

- Assets and liabilities of the partners and the company are partially segregated
- The company's creditors may not claim the owner's assets UNLESS they failed at executing their claim from the partnership's assets
    - Basically: if the partnership's assets are not enough to pay off the debt, then there is the risk that the creditor can go against personal assets (unlimited liability)
- Owner's individual creditors cannot ask for the equity in the partnership until the partnership's term expires
    - BUT the personal creditors can object to extending the term (weaker entity shielding)

Limited Partnerships: contain characteristics of both a corporation and a partnership

- Limited partners: limited liability but have no managing authority
- General partners: full managing powers but have unlimited liability
    - they are liable together to the partnership's creditors

Summary of types of companies:

CORPORATIONS	PARTNERSHIPS	COMPANIES
- can solve optimize the sole trader's problems	- (Single partnerships) - Co-partnerships (1 kind of partner) - Limited partnerships (limited partners and general partners)	3 types: - corporations /joint stock companies (privately owned, not listed publicly) - limited liability companies - (partnerships limited by shares)
Characteristics: - legal personality (entity shielding) - limited liability (owner shielding, the company's creditor cannot claim the owner's assets) - transferable shares (I can transfer my shares when certain circumstances occur) - delegated management - investor ownership (dividends and the right to vote)	Characteristics: - no minimum investment required - no legal personality - no transferable shares (mutual trust amongst people is needed → can't sell shares unless partners approve)	

All for profit?

- Most of these companies share a common profit-making purpose
    - Want to earn profits and then distribute those profits through dividends
    - Debate that companies should benefit stakeholders as well (people who are impacted by the company), not just shareholders
- Some are non-profits though (foundations, associations)
    - Aimed to increase public benefit
    - Profits are not distributed amongst members but go into the activity of the company itself
    - Some companies even set up foundations within the corporations to tackle e.g. sustainability

The Process of Incorporation and Freedom of Establishment

HOW TO INCORPORATE A BUSINESS?

- Persons, either natural or legal, are free to incorporate a business according to a process subject to public control and publicity
- Articles of Incorporation: sets the first set of directors
  Bylaws: generally phrase how the next ones will be appointed, it is about company regulation anytime during the duration

Process

1. Shareholders negotiate the arrangements they want to wake and in writing, set up the company's constitutional documents
2. These documents need to be notarized (checked by a public official)
    a. If there are mistakes, aka breaches to the law, then the documents are changed
3. The documents are registered and made public
    a. The company comes into existence once the formation documents are registered
4. The company exists

What are formal requirements for?

- Making the parties aware of the significance of the declaration + encourage them to carefully consider the transaction → legal certainty
- Control by notary ensures compliance with the law
- Registration of the company makes the rules transparent and allows the public to access that information

EU law regarding Incorporation

Art. 14 Directive

Member states shall take measures to ensure compulsory disclosure by companies of the following documents: Constitutional Documents (bylaws), Amendments → to the benefit of third parties

- These documents need to be public to check the status of the company (e.g. so the suppliers know the state of the company)

Art. 3 Directive – Contents of Articles of Incorporation

The incorporation process of a company must give at least these pieces of information:

- type and name of company
- objects of the company (goal)
    - e.g. a company in the educational field
- amount of authorized capital
- any change in the authorized capital
    - if there will be an increase in the authorized capital, the document needs to state that
    - has to be the most updated possible because 3rd parties will rely on this since the amount of capital is an important characteristic of a company
- the rules governing the bodies responsible for representing the company (Board of directors basically)
    - information needed: number of directors, procedure for appointing them, required jurisdiction
    - Powers: administration, management, supervision, control, representing the company?
    - E.g. the Board of directors can purchase assets for the company with a joint signature above 1 million euros
- Duration of the company
    - Can be indefinite – lasts until the scope permits it
    - Can be definite

Art. 4 Directive – Contents of Bylaws

- The registered office
- The nominal value of shares subscribed and once a year, the numbers of them
- Special conditions limiting the transfer of shares
- Several classes of shares – information referred to each class of shares
    - General shares – unless states differently, each class is general shares
    - Privileged shares - TRADEOFF
        - Some give up some voting rights to get more dividends
        - Some give up dividends to get more voting rights
- Any provisions relating to conversion of different shares

Art. 2 Directive

All of the companies we studied (corporations, limited liability companies, and partnerships) need to follow the incorporation procedure

- The incorporation procedure helps third parties to be aware of what's going on in the company
- In order to share that information fairly, you need to put it in writing following certain rules

FREEDOM OF ESTABLISHMENT AND REGULATORY COMPETITION: THE CENTROS CASE

EU Minimal Capital Requirement: directive

- The minimum amount shareholders must contribute to the company's assets before it is permitted to start its operations → this is to guarantee some certainty to the company's creditors in exchange for limited liability
- **EU law: The members states shall require for incorporation to have a minimum capital of 25k**

- In Italy it is higher, so 50k
- Privately limited companies are not subject to this requirement

- Problem: what if a company chooses to be listed in one country with lower capital requirement?

Case: the Centros (EU Court of Justice) – Freedom of Establishment

- Centros was a company incorporated in the UK (where the minimum requirement is 1 pound)
- But they wanted to establish a Danish branch to operate in Denmark only
  - If a company wants to open a branch: they either create a sister company that is in their group, or they set up a branch
- Questions:
  - If they are Danish nationals, why would they start their business in the UK?
  - Why is there no business in the UK?
  - Is this a violation of freedom of establishment?
- Registration of the branch was refused because:
  - There is no business carried out in the UK, so the principal establishment would be in Denmark, not the UK
  - The company does not meet the Danish minimum capital requirement (200k) → to protect the Danish creditors against the risk od not being able to pay back
- Rule on freedom of establishment:
  - The company is already formed in an EU member state country → wants to enjoy the benefit if freedom of business & goods
  - **Article 49 prohibits restrictions on freedom of establishment on companies and also on branches**
- Court's Judgment:
  - The fact that the company was established in a member state that has more favorable legislation **does not necessarily mean abuse of Freedom of Establishment**
  - 4 conditions must be met when restricting freedom of establishment :
    - They must be applied in a non-discriminatory manner
    - They must be justified by imperative requirements
    - They must be suitable for securing the objective
    - They must not go beyond what is necessary to attain it
  - These conditions are not met: 1, the company had conducted some business in the UK, the Danish Court would not have refused 2, if the company had conducted some business in the UK, the Danish creditors would have been equally exposed to the risk 3, if shareholders had not been Danish, but UK nationals
  - Indeed **the Danish court was discriminating** since they differentiated between Danish nationals and UK nationals
- Consequences:
  - Forum shopping was allowed
  - Regulatory competition was supported → created an EU-**wide competition to reduce minimum capital requirements** to private limited liability companies
    - Although we are one Union, we still want companies to be listed in our country → competition should be encouraged

Legal Capital

Limited Liability:

- Incorporating a business through the procedure set out by the law creates a legal person that is distinct from its founders and grants the shareholders the beneficial limited liability
    - Entity shielding + owners shielding = asset partitioning (complete separation of assets)
    - Limited liability is an essential benefit for the investors, since they would not want to invest in the company if they could lose their personal assets due to debts of the Inc.
    - Transfer of risk from shareholder to the other parties who have financial claims against the corporation (the creditors of the company)
- Creditors are willing to grant limited liability to corporations, but in return they require the minimum capital regime as a guarantee
    - The law requires shareholders to show their "commitment" to the business through the minimum capital regime
    - If you look at the limited liability regime from the POV of the creditor, it is a risk (less chances for getting paid since you cannot ask for payment from the shareholders' assets, only the company)
- Essentially beneficial for shareholders but a risk for creditors

Protecting Creditors:

- Not any type of creditor can be protected from the issues generated by limited liability

1. Voluntary creditors – chose to enter into the business relationship with the business
    a. (banks, employees, suppliers)
    b. Can look at whether the company has enough assets to safely become their creditor (won't enter into a business relationship with a company that is insolvent – bank's decision)

   Involuntary creditors (product liability claimants)
    a. They did not choose to enter into a creditor relationship with the company
    b. E.g. a car manufacturer puts wrong brakes in a car and someone enters into an accident → seeking damages from the company
2. Adjusting creditors – capable of altering the terms at which relevant creditors provide credit to the company by taking into account the risk (e.g. the risk of default)
    a. Minimum legal protection is less important for them

   Non-adjusting creditors – they are not capable of altering the terms by taking into account the risk of insolvency (e.g. tort creditors)
    b. Minimum legal capital is more important for these types of creditors

- Not every voluntary creditor is an adjusting creditor and vice versa → some kind of legal protection is needed
- The guarantee/protection is the most important for the non-adjusting and involuntary creditors

EU Legal Capital Rules:

- Legal capital rules apply throughout the EU in order to pledge security for the company's creditors
    - These need to ensure that the rules ensure that shareholders contribute and maintain the amount of net assets of the company
    - A good amount of assets of the company reduces the risk of the corporation not paying back

- legal capital is a creditor-protecting buffer: the more equity, the more room for the business to operate less successfully but avoid becoming insolvent (TRADEOFF)
- Legal Capital system concerns:
    - Minimum capital
    - Capital formation
        - Restricted eligibility for non-cash contributions
        - Expert opinion about each candidate
    - Capital maintenance – maintain the amount of capital during the life cycle of the company
        - Restrictions on dividends
        - Capital cannot be distributed to shareholders unless a special procedure is followed
        - Recapitalize or liquidate: accumulate material capital losses
- Legal capital rules are harmonized rules over the EU, they apply all across Europe

TYPES of Legal Capital: share capital / corporate capital

- Legal capital is formed through shareholders' contributions in exchange for the shares they get
    - Overall equity investment made/assets contributed by the shareholders
- Authorized capital: FORMALLY SET AMOUNT
    - the bylaws authorize the company to have a certain amount of corporate capital
    - Set through the bylaws, written formally
    - Set by the shareholders for the company
    - This does not mean that that amount is actually invested into the company, it is just allowed
- Subscribed capital: COMMITTED AMOUNT
    - Then you need the shareholders to actually provide that amount of capital, they need to commit to send that amount of investment
    - Portion of the overall authorized capital (on paper, set by the bylaws) for which you have a binding commitment by the shareholders (they will actually give that investment)
    - This is an enforceable commitment by the shareholders
- Existing capital: ACTUALLY PAID AMOUNT
    - The amount of capital that has been paid to the company, the investment has actually been made

Par Value: amount of existing aggregate capital / number of shares issues after capital formation

- The bylaws also set the number of shares issued by the company
    - The certificate of the share states that you subscribed for a portion of the capital and you actually invested it
    - The certificate also gives certain rights to the shareholders (voting rights, dividends)
- The par value is the value of each share (proportion of the legal capital)
- A share cannot be issues for less than its par value but any excess payment compared to the par value is the SHARE PREMIUM

Example: Alpha Inc.'s corporate capital is set at 1m

- Usually the par value is $1 per each share (traditional) → but the bylaws can set any par value by manipulating the number of shares
- Each share shall be issued at a price NOT LOWER than its par value
- Share premium being 0 means that the shares are sold at the par value

Alpha Inc.'s Initial Balance Sheet (t_0)			
Current assets (cash)	100,000	Share capital	100,000
		Share premium	0
		Other Reserves	-
		Retained profits (losses)	-
		Current FY profits (losses)	-
		Liabilities	-
Total Assets	100,000	Total Liabilities & Net Equity	100,000

Inc.'s «Net Equity»

Par value of a share NOT EQUAL accounting value NOT EQUAL market value:

- Par value= legal capital / number of shares
  - Set by the bylaws in formal writing
- Accounting Value = net equity (legal capital + retained profits) / number of shares
  - Calculates in retained profits (other reserves, losses, and profits)
  - Equal to the par value if there are no retained profits or reserves in the company
- Market Value = price that a 3rd party is willing to pay to purchase a share of the company
  - Constantly fluctuates over time, taking other factors into account like the potential of the company, its ability to make future profits, etc.
  - Can substantially differ from the par value or the accounting value

EU Minimum Capital Requirement:

EU Directive: "*The laws of the member states shall require that in order for a company to be incorporated or obtain authorization, a minimum capital shall be subscribed the amount of which shall not be less than 25k.*"

- The EU requires member states to set a minimum FIXED amount of capital
- Member states can set higher thresholds if they want to
  - E.g. in Italy, the minimum is 50k for publicly limited companies
  - In Germany: 50k as well

Definitions & Terms

FIRST PARTIAL

TORT LAW
Governs how two people relate to each other who are not in a contract. If one commits a civil wrong (e.g. driving drunk) then the injured party can get financial compensation to be in the same position as before the civil wrong.

CIVIL LAW
Governs the relationships between people and things.

CONTRACT LAW
Tells us how two sides relate to each other once they enter into a contract. Often the injured side can recover more than just the original position, it can also recover the expected lost of profits.

CONTRACT
A legally enforceable agreement between parties that binds the behavior of said parties. The terms of the contract lie on the mutual agreement and the will between the parties. Contracts must be voluntary. For a binding contract, there also needs to be consideration.

CAUSA
The reason for entering the contract, which in the past was categorized as gift-giving or exchange. The reason normally is to receive something of equal value as counter-performance.

GRATIUITOUS CONTRACT
Donor must intend to benefit the other party, to enrich the other party without compensation. The gifts that are already given cannot be revoked. These types of contracts must be binding as long as the promisor at the time of contracting intended to give that gift. In French and German law, gifts must be certified via a notary to make sure the intention of the giver is clear.

EXCHANGE
Exchange of goods or money of equivalent value. Types: sale, lease, barter.

COMMON LAW
Common law is based on previous judicial decisions and opinions.

CONSIDERATION
There is consideration if there was a promise made to give up a legal right and both sides are giving up a legal right. So if one side does not give up anything (excluding gratuitor's contracts), then there is no legal consideration so no binding contract.

FREE REVOCATION
It is always possible to revoke the offer before acceptance, but you need to revoke the offer in front of the other party. Always in English law and American law. No free revocation in French law and German law.

MAILBOX RULE
The contract is binding as so on as the acceptance is put out of the offeree's possession. That means the offer can be binding also before it technically reaches the other party.

REASONABLE RELIANCE
The offer must be reasonably relied on and the costs suffered by the reliance can be compensated for. Prevalent in American law.

CULPA IN CONTRAHENDO
The fault in conclusion of the contract, the duty to negotiate in good faith and to prevent a party from concluding a contract to her detriment.

PROMISSORY ESTOPPEL
The promisor is liable to the promise who relies on the promise. Happens when the offeror should reasonably expect the promise to induce some action and then the offer does induce such action. This is used only in American law.

UNJUST ENRICHMENT
The keeping of a benefit from a party without offering compensation in circumstances where compensation is reasonably expected.

MISTAKE
At the time of contracting, a mistake is an error about the **essential assumption** of a contract. If there is an error about an essential quality then the contract is voidable. Exclusion for the existence of a mistake is if the risk of the mistake was assumed by one side or if fraud happened.

1. SUITABILITY OF PURPOSE – the purpose of the contract cannot be fulfilled due to the mistake (but it is hard to determine the general purpose of a contract)
2. ASSUMPTION OF RISK – if who takes on the risk is not discussed in the contract, it can be void for that reason (e.g. market fluctuations are a risk when you buy a painting → you cannot revoke a contract just because the price of your painting changed since buying it)
3. EVALUATIVE MISTAKE – if both sides made an error evaluating the value of the product at the time of the purchase. If the seller knew the value and the buyer failed to estimate it properly, that is not a mistake due to caveat emptor

CAVEAT EMPTOR
The idea that unassumed risks fall onto the buyer, aka the buyer has the responsibility to examine the product of sale well before purchase.

FAIRNESS
Fairness as it is does not deserve relief in contract law but we give relief for other things that are unfair like exploitation of the weaker party, clauses that are hidden in the contract, pressure (duress).

FAIRNESS OF PERFORMANCE TERMS
Performance terms are terms that you must be familiar with otherwise there is no contract. Essential terms are how much you will pay for the car or which car you are buying. Auxiliary terms are not essential terms, usually terms that allocate risk between the parties.

UNCONSCIONABILITY
Allows you to set aside the contract when it is oppressive or unfair. Substantive unconscionability is when there is gross disparity in the price or unfair allocation of risks without compensation. Procedural unconscionability arises when something in the process of contracting was unfair, aka there was more bargaining power on one side than the other, one side is an expert (imbalance in knowledge) or duress.

DURESS
When one party influences or creates a constraint on the other (creating fear or harm), then it is a ground for nullity. When one party exploits the state of dependence or desperateness of the other party, that is also duress.

WEIRD TERMS
Clauses that limit personal liberties or are offensive morally, e.g. nor allowing women to wear a hijab at work. A contract can generally be nulled when it disproportionately disadvantages one side in the contract or it is unclear.

EXCUSES FOR NON-PERFORMANCE
Excuses that allow you not to perform a contract, either impossibility or change of circumstances. You are only liable for mistakes that could have been prevented. Also, impossibility of performance only makes a contract terminated if impossibility could not have been assumed at the time of contracting.

FORCE MAJEURE
Provision in a contract that frees both parties from performing their contractual duty if an extraordinary event prevents one or both parties from performing. It becomes impossible to perform after signing the contract.

VOID
The contract was never correct due to mistakes or duress, so a contract becomes void when it still has not become binding.

TERMINATION
There was a correct and binding contract but now it is cancelled due to excuses for non-performance.

CHANGE OF CIRCUMSTANCES
If there are unforeseeable + substantial change of circumstances and none of the parties had accepted those risks when contracting then they can terminate the contract or renegotiate.

FRUSTRATION OF PURPOSE
Performing the contract does not make sense anymore, the contract becomes totally useless.

HARDSHIP
The contract could still be performed but it becomes really expensive so economically unfair to perform. Hardship arises due to change in circumstances (e.g. a canal becomes unavailable). Hardship must be substantial to cite this clause (extreme increase in costs or decrease in revenues).

DAMAGES
Compensation must be given if the loss would not have occurred if the contract had been performed. In some jurisdictions, it includes expectation damage as well, not only direct losses from non-performance. Usually remedies are in financial terms (money), not asking for the performance (except in German law).

UNFORESEEABLE HARM
A person causing the injury is not at fault of the reason for the injury was unforeseeable. You are only liable for what is foreseeable.

SECOND PARTIAL

PUBLIC REGULATION
Laws that must be followed by everyone. These include constitutions, statues of legislatures (laws created and approved by national or regional bodies), administrative regulation and case law (rulings of judges in specific cases that can be reapplied in similar cases due to precedent)

PRIVATE REGULATION
Law that are voluntarily adopted by the participants of the law. There are two types of private regulation, the first is HARD LAW which includes contracts, bylaws, shareholder agreements and articles of associations. These are made by the company to govern its own members, and it is mandatory to follow within the company. If a breach is made, then the contract or internal law can be enforced. The second type is SOFT LAW which is mainly corporate governance best practices of the company, which are encouraged to be followed but are not mandatory (hence the term "soft").

BOARD OF DIRECTORS
The BoD is the governing body of the company, elected by the shareholders. Their task is to make major decisions such as investment decisions, or mergers. The Chairman is the head of the Board who has the final say, and there are further committees to discuss specific issues.

SOURCES OF EU COMPANY LAW
Firstly, there is REGULATION that is binding and applicable in all member states. Then, DIRECTIVES are binding in each member state, but how to implement it is left to the member states. DECISIONS are only binding in states which it concerns. RECOMMENDATIONS are of no binding nature but they can be adopted by member states on a voluntary basis.

GOALS OF EU COMPANY LAW
EU law exists to manifest the the internal market, specifically the freedom of internal trade and the freedom of establishment. To do this, firstly the EU focused on harmonization that intends to introduce EU-wide legislation that is the same or similar in all member states as to develop the free internal market. The 2nd goal of EU company law is competition, aka to still motivate member states to develop and compete with each other

SOLE TRADER
When there is only one person employed by the company. This is an overly simplified structure which allows the owner to keep full control over decision-making and lower its costs due to the lack of bureaucracy and lower taxes. However, as the owner wants to expand, a sole trader meets its limits as one person cannot do everything and the need for specialized managers and a more complex structure arises.

CORPORATION
A corporation is legal entity that is separate and distinct from its owners; it elects a Board of Directors to manage the business. The 5 main characteristics of a corporation are: legal personality, limited liability, transferable shares, delegated management, and investor ownership.

LEGAL PERSONALITY
This means that the entity of the corporation is completely separate and distinct from the owners, or the person(s) that formed it. It is a clearly distinguishable entity.

ENTITY SHIELDING
Shareholder's creditors —> company's assets. This prevents the creditors of the shareholders from claiming the company's assets, so the shareholder's debt cannot be paid with the company's assets, except for the share the shareholder has in the company.

PRIORITY RULE
The law grants priority to the corporation's creditors that in case of bankruptcy, first they can make the claims on the company's assets. Then, the shareholder's creditors can make their claims and only after that the shareholders can divide everything that is leftover.

LIQUIDATION PROTECTION
Shareholders cannot withdraw their shares from the firm as they wish which intends to protect the continuous value of the firm. However, shareholders can indeed withdraw their shares when major changes are made in the company (e.g. they have a merger).

AUTHORITY ALLOCATION
The power to buy and sell assets on behalf of the firm is allocated to the delegated management, oftentimes the Board.

COORDINATION ISSUES
When communicating between concerned parties, there are high communication costs, hence the Board only needs to have majority and not unanimity when making decisions (otherwise this cost would be too high).

BUSINESS JUDGMENT RULE
When the Board makes decisions, they have to make that decision to the best of their ability given their skills, information and expertise. Only if the Board was negligent and left out an important detail when making a decision can the shareholders sue the Board.

LIMITED LIABILITY
The company's creditors can only make claims against assets owned by the company itself, not the assets of the shareholders. This prevents shareholders from taking excessive risk and promotes investment therefore.

ASSET PARTITIONING
Owner shielding (limited liability) and entity shielding equal asset partitioning, so the almost complete separation of assets between the corporation and the shareholders.

TRANSFERABLE SHARES
Shares can be transferred from one owner to another which makes it easy for shareholders to exit the business by simply selling their shares. However, transferable shares DO NOT equal freely tradeable shares, which is the case in publicly listed corporations where shareholders can freely trade their share in the firm. In other companies, such as privately owned corporations, the exiting shareholder can choose a successor but the buyer has to be approved by all other shareholders (hence the term transferABLE shares).

CENTRALIZED MANAGEMENT
Control over the company is transferred from the owners to the Board of Directors, which lowers the cost of decision-making significantly. This creates the agency problem because different parties might have distinct interests, hence there has to be monitoring in place. Centralized management basically means that decisions are delegated to specialized managers, usually the BoD.

INVESTOR OWNERSHIP

Investors own a portion of the firm, which comes with certain rights, specifically the right to control the firm and the right to receive profits in the form of dividends or the increased value of the stock.

PRIVATE LIMITED LIABILITY COMPANY

The shares of this company are not freely transferable as opposed to a public LTD, however investors still enjoy limited liability. This business form is good for medium-sized companies as well because it comes with lower requirements, however there are some constraints on size.

GENERAL PARTNERNSHIP

A business established by two or more owners, this is the default business structure for multiple owners. Owners do not have limited liability, and there is a weaker sense of asset partitioning.

LIMITED PARTNERSHIP

A mix of a general partnership and a corporation, since it contains two types of partners: limited partners enjoy limited liability but have no managing authority, but general partners have managing power but are not protected by limited liability.

PROCESS OF INCORPORATION

1. Shareholders negotiate the business arrangement in writing, and set up the constitutional documents of the corporation.
2. The documents are notarized, mistakes are corrected.
3. Documents are registered and made public (to inform 3rd parties about the state of the company)
4. The company officially exists.

MINIMUM CAPITAL REQUIREMENT

This is the minimum amount shareholders must put together as an initial investment for the company before it can start its operations, this is 25,000 euros in the EU. This is done to ensure that creditors have some guarantee in exchange for limited liability.

VOLUNTARY V. INVOLUNTARY CREDITORS

VOLUNTARY creditors chose to enter into a business relationship with the company such as banks, employees, or suppliers. INVOLUNTARY creditors did not choose to enter into a business relationship, like product liability claimants. Credit protection is more important for involuntary creditors since they could not examine the company's assets and decide whether to do business with it or not.

ADJUSTING V. NON-ADJUSTING CREDITORS

ADJUSTING creditors can alter the terms of their contract to factor in the risk they are taking, while NON-ADJUSTING creditors are not capable of factoring in this risk of insolvency.

TYPES OF LEGAL CAPITAL

AUTHORIZED capital is the formally set capital amount in the bylaws. The SUBSCRIBED capital is the amount which creditors commit to in a binding and enforceable manner. The EXISTING capital is the amount actually paid, the investment that actually got to the company.

PAR VALUE

The value of each share that is issued after capital formation, that is legal capital / number of shares, set in the bylaws. The ACCOUNTING value is the net equity / number of shares, which factors in retained earnings. The MARKET value is the price at which an outside party is willing to

purchase the shares of the company, this changes all the time and can substantially differ from the other types of values.

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