Ronny Jänig

Commercial Law

Selected Essays on the Law of Obligation, Insolvency and Arbitration

Universitätsdrucke Göttingen

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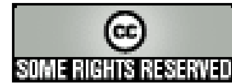

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Anschrift des Autors
Ronny Jänig
e-mail: rjaenig@arcor.de

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To my parents,
Katrin and our kids

Foreword

Das Recht, das das tägliche Handeln von Unternehmern bestimmt, hat unzählige Facetten. Die nachfolgende Sammlung von Essays kann daher nur einen kleinen Teil dessen aufgreifen. Sie hat zum Ziel, das Verständnis einzelner Probleme des Bereicherungs-, Schiedsverfahrens- und Insolvenzrechts, insbesondere aus Sicht des deutschen Lesers, zu fördern. Die Essays behandeln im Einzelnen folgende Themenbereiche: (a.) Fragen des deutschen und internationalen Insolvenzrechts, insbesondere des Unternehmensinsolvenzrechts; (b.) Fragen des deutschen und anglo-amerikanischen Schiedsverfahrensrechts, insbesondere der Überprüfbarkeit von Schiedsentscheidungen durch staatliche Gerichte und (c.) Fragen des deutschen und englischen Bereicherungsrechts im Zusammenhang mit der (sittenwidrigen) Ausübung wirtschaftlichen Zwangs. Alle Essays sind im Rahmen meines LL.M.-Studiums an der University of Durham, England, entstanden. Bedanken möchte ich mich der Georg-August-Universität Göttingen, hier insbesondere bei Professor Gerald Spindler, für die Unterstützung bei der Organisation meines LL.M.-Studiums.

Commercial Law, which governs the daily life of any business man, has innumerable faces. The following collection of essays can obviously represent only a fraction of it. The collection is meant to improve the understanding of a few single questions on the Law of Obligation, Arbitration and Insolvency, especially but not exclusionary for German readers. Three main topics are covered: (a.) German and international Insolvency Law, specifically corporate insolvency; (b.) English and American Arbitration Law, specifically the extent of judicial review of arbitral awards and (c.) German and English Law of Restitution, specifically economic dures. All essays were written during my LL.M. studies at the University of Durham, England.

Göttingen, Dezember 2011 *Ronny Jänig*

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Abbreviations

BGHZ - Entscheidungen des Bundesgerichtshofes in Zivilsachen [Decisions by the Federal Court of Justice in Civil Cases]

MDR - Monatszeitschrift des deutschen Rechts (legal journal)

NJW - Neue Juristische Wochenzeitschrift (legal journal)

NZI - Neue Zeitschrift für Insolvenzrecht (legal journal)

OLG - Oberlandesgericht [Higher Regional Court]

RG - Reichsgericht [Court of the German Empire, 1879-1945]

RGZ - Entscheidungen des Reichsgerichtes in Zivilsachen [Decisions by the Court of the German Empire]

WM - Wertpapiermitteilungen (legal journal)

ZIP - Zeitschrift für Wirtschaftsrecht (legal journal)

The (In)Coherence of the Unjust Factor of Economic Duress

I. What (Economic) Duress is about

1. Contract Law, Free Will and Duress

Duress became a legal concept a long time ago. Most notably, it made its first appearance in the context of contract law. Why? The essence of a contract is upon the free will of the contracting parties to be bound by the terms of the contract.[1] Over all, this free will encompasses the freedom to enter a contract in the first place. Where a contracting party is forced or coerced into a contract by some "blameworthy pressure," the fundament of the contract - free will - is somehow detracted. From its early beginning, it was perceived that a coerced party should not be bound by such a

1 Richards, *Law of Contract* (8th edn Pearson, Essex 2007) 275.

contract.[2] Common law has been challenging a "blameworthy pressure" in the process of consenting to a contract with the strict doctrine of duress.[3]

2. The Categories of Duress

There are three main categories of actionable duress which may here be distinguished.[4] A long established category is about pressure to contract imposed by a threat to cause physical harm (duress of the person).[5] Another old line of cases is about pressure imposed through a threat to damage goods (duress of goods).[6] A more recent line of cases added a third, and in scope, much wider category: economic duress.[7] Generally speaking, the concept of economic duress comprises of situations in which a "blameworthy" commercial pressure, classic examples are threats to breach a contract[8] or to sue[9], is exercised in order to induce another person to enter a contract. This may involve the constitution of a new obligation or the amendment of an existing obligation.[10] The concept of economic duress embarks upon these situations and the legal issues they generate.

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[2] For the Roman Law see *Paulus*, *Digest 4*, 2, 21, 5; no 399; for the Common Law see Bracton, *De Legibus Et Consuetudinibus Angliae*, Volume 2, p. 288 (, http://hlsl5.law.harvard.edu/bracton/index.htm, 2010-01-22, Thorne Edition, English); Dawson, 'Economic Duress - An essay in Perspective' (1947) 45 MichLawRev 253, 254 seq.

[3] Richards, *Law of Contract* (8th edn Pearson, Essex 2007) 275.

[4] Beaston, *Anson on Contract* (28th edn Oxford University Press, Oxford 2002), 278 seq.

[5] *Barton* v. *Armstrong* [1976] *AC* 104; *Duke de Cadaval* v *Collins* (1834) 4 AD & E 858; 111 ER 1006.

[6] *Fell v Whittaker* [1871] LR 7 QB 120; *Maskell* v. *Horner*, [1915] 3 KB 106.

[7] Early writing by Dawson, 'Economic Duress - An Essay in Perpective', (1947) 45 Mich.L.Rev, 253; Cornish, 'Economic Duress', (1966) 29 MLR 428.

[8] Beatson, The Use and Abuse of Unjust Enrichment (reprint Oxford University Press, Oxford 2002), 117 seq.; Lal, 'Commercial Exploitation in Construction Contracts: The Role of Economic Duress', (2005) 21 Const.L.J. 590; Vigor, *The Principles of the Law of Restitution* (2nd edn Oxford University Press, Oxford 2006), 201.

[9] Dawson, 'Duress through Civil Litigation', (1946) 45 Mich.L.Rev 571; Jaffey, The Nature and the Scope of Restitution (Hart Publishing, Oxford - Portland Oregon 2000), 183 seq.

[10] See Jaffey, The Nature and the Scope of Restitution (Hart Publishing, Oxford - Portland Oregon 2000), 189.

3. Linking Economic Duress with Unjust Enrichment

The effect of duress in general and of economic duress, specifically, is to render the relevant contract voidable.[11] When the contract in question is not yet completed, a court may just set aside the contract. It has long been accepted that economic duress is a vitiating factor in the context of unjust enrichment. It gives the person, who was pressured into the contract and transferred benefits because of it, a restitutionary claim for the recovery of the benefit. These legal effects of economic duress are more or less not argued. What is argued are the circumstances which establish economic duress as an unjust factor.

II. Case Law History

There is a short but distinctive line of English cases dealing with economic duress.[12] The different views which theses cases provide in their reasoning and the brief history of economic duress make it necessary to survey the line of cases thoroughly.[13]

1. The Siboen and The Sibotre

In *Occidental Worldwide Investment Corp v Skibs A/S Avanti (The Siboen and The Sibotre)*[14], D chartered two tankers to C for the period of three years. One year after entering the charter contract, C informed D that its financial position was deteriorating, that it was suffering enormous losses and would go into liquidation if the hire rates were not reduced. These statements

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[11] For common law: *North Ocean Shipping Co v Hyundai Construction Co (The Atlantic Baron)* [1979] QB 705, 719; Beatson, 'Duress as vitiating Factor in Contract' (1974) 33 CLJ 97; Vigor, *The Principles of the Law of Restitution* (2nd edn Oxford University Press, Oxford 2006), 190, 199; Lal, 'Commercial Exploitation in Construction Contracts: The Role of Economic Duress', (2005) 21 Const.L.J. 590, 599 seq.

[12] For an overview Ogilvie, 'Economic Duress in Contract: Departure, Detour or Dead-End', (2001) 34 CanBusLJ 194, 207 seq.

[13] It should be noted, that the facts of the surveyed cases are highly simplified and that there are other landmark cases which could not considered here because the lack of room.

[14] [1976] 1 Lloyd's Rep. 293.

were untrue. Since there was in fact a steep market slump D agreed on a rate reduction. Sometime later, when D discovered that C's statements were incorrect and that market prices started to go up, D demanded a restoration of the original hire rate. After C's refusal, D withdrew the oil tankers and defended the following action by C on the grounds of duress.

Kerry J. acknowledged for the first time the existence of economic duress as a vitiating factor in relation to contracts under English law. According to his view, the distinguishing feature of economic duress can be seen in the "overborne will" of the coerced party, which would deprive him of any animus contrahendi. Kerry J. did not explore in depth the facts which evidently constitute economic duress. Thus, he gave two examples: The coerced party protests at the time or shortly thereafter. The coerced party made it clear that he regarded the agreement as still open.

2. Pao On

In *Pao On v Lau Yiu Long (Pao On)*[15], P agreed to sell its shares in a private company to a public company of which D was a majority shareholder. It was agreed that in return, the purchasing company would issue shares to P. In order not to depress the market value of the shares of the public company, P and D entered into a subsidiary agreement. It provided, inter alia, that P would not sell 60% of his shares in the purchasing company until 30 April 1974, and that D would purchase them at the end of that period at USD 2.50 per share. Before the main agreement was completed, P realized that he would not participate in any increase in the share price until 30 April 1974. P therefore refused to complete the main agreement and demanded an amendment of the subsidiary agreement in his favour. D, being anxious about dwindling public opinion regarding any delay in the completion of the main agreement, deliberately decided against litigation and agreed on a clause which provided for P's indemnification in case the share price would drop below USD 2.50 per share. Subsequently the main agreement was performed. When the share price dropped below USD 2.50 before 30 April 1974, P claimed an indemnity. It was refused by D on the grounds of economic duress.

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[15] [1980] A.C. 614.

The Privy Council, per Lord Scarman, agreed with the observations of Kerry J in *The Siboen and The Sibotre*[16] approved the concept of economic duress. It explicitly adopted the overborne-will-theory holding that to establish economic duress 'There must be present some factor 'which could in law be regarded as a coercion of his will so as to vitiate his consent'.'. Besides, Lord Scarman added substantially to the facts which evidently constitute economic duress. His catalogue of criteria reads: effectiveness of alternative remedies available, the fact of protest, the availability of independent (legal) advice, the benefit received, and the haste with which the victim has sought to render the contract void. It was left unclear how these criteria correlate. However, D's claim for restitution was deferred by court on the grounds that he had considered 'the matter thoroughly, chose to avoid litigation, and formed the opinion that the risk in giving the guarantee was more apparent than real was upheld.'[17]. D's will was not overborne.

3. The Universe Sentinel

In *Universe Tankships Inc of Monrovia v International Transport Workers Federation (The Universe Sentinel)*[18], a cargo ship, owned by U, was docked to discharge its load. The ship was "blackened" by a trade union, so it could neither be unloaded nor leave the port. The trade union demanded from U the payment of USD 80,000 and the signing of employment contracts with the crew to the terms and conditions provided. U met those demands fearing that a further blacking of the ship would lead to disastrous economic consequences. Later, U claimed that the payment had been made under economic duress.

Obiter dicta, the House Lords consented to the concept of economic duress. Speaking for the majority, Lord Diplock identified the illegitimacy of the performed pressure as the juridical basis of economic duress, but he did not identify precisely when commercial pressures would be illegitimate. Lord Scarman, who gave a dissenting opinion, relied his reasoning on his

[16] [1976] 1 Lloyd's Rep. 293.

[17] 1980] A.C. 614, 635.

[18] [1983] 1 A.C. 366.

judgement in *Pao On*[19] and addressed a two-step-test in order to establish economic duress: (1) Pressure must amount to compulsion of the will of the victim and (2) the pressure must be illegitimate. Regarding step 1 Lord Scarman focused once again on the no-practical-choice test[20] and on the criteria evidently establishing the no-practical-choice, both applied in *Pao On*[21].[22] Regarding step 2 Lord Scarman and Lord Diplock agreed insofar that illegitimacy is determined by (i) the nature of the pressure and (ii) the nature of the demand to which the pressure is applied.[23]

4. DSND Subsea

In *DSND Subsea Ltd (formerly DSND Oceantech Ltd) v Petroleum Geo Services ASA (DSND Subsea)*[24] DSND was engaged by PGS to carry out subsea work. As a result of a delay in the entire project, the work which DSND had to carry out changed considerably by getting more complex and costly. For that reason, DSND was concerned about additional financial risks which would occur. DSND refused to proceed with the work unless PGS would give its assurances to bear the additional (financial) risks. Since PGS would be liable for any delay in the completion of the entire project it agreed with DSND on an amendment to the original contract by meeting all of DSND's demands. PGS later claimed it agreed to the amendment because of duress.

The court adverted to great extent to the reasoning in *The Universe Sentinel*[25]. But without explicitly dissenting, Dyson J expressed different views on the matter. Firstly, Dyson J modified the test used by Lord Scarman to establish economic duress in wording and substance to a three-step-test by holding: 'The ingredients of actionable duress are that there must be pressure,

[19] [1980] A.C. 614.

[20] In ddetail on this test MacDonald, 'Duress by threatened Breach of Contract', (1989) JBL 406, 464 seq.

[21] [1980] A.C. 614.

[22] [1983] 1 A.C. 366, 400.

[23] [1983] 1 A.C. 366, 401.

[24] 2000 WL 1741490.

[25] [1983] 1 A.C. 366.

(1) whose practical change effect is that there is compulsion on, or lack of practical choice for, the victim, (2) which is illegitimate, and (3) which is a significant cause inducing the claimant to enter into the contract.'.[26] Secondly, Dyson J applied the catalog of criteria, which was used by Lord Scarman to measure the compulsion/no-practical-choice, to establish the illegitimacy of the pressure and added two more criteria to the list: an actual or threatened breach of contract; alleged acting in good faith by the person exerting the pressure.[27] Because PGS had realistic and practical alternatives, the claim on grounds of duress was dismissed in the end.

III. Economic Duress Reconsidered

Since the time of *The Siboen and The Sibotre*[28]*,* economic duress has probably not made it to the front pages of newspapers. Nevertheless, cases dealing with it have consistently popped up and have triggered intensive debates. These debates have focussed on the general rationale of economic duress and the factors which establish it.

1. The General Rationale of Economic Duress

a) Overborne Will

In *The Siboen and The Sibotre*[29], Kerry J established the so called overborne-will-theory. The theory is built upon the concept of the freedom of contract according to which a legally binding agreement is based upon the free will of the contracting parties to be bound by the terms of the contract. It is argued that where a contracting party is forced or coerced into a contract by some "blameworthy pressure", like in the case of economic of duress, the free will to contract is somehow detracted or some would say "over-

[26] 2000 WL 1741490 p. 24, this test is supported by Goff/Jones, *The Law of Restitution* (7th edn Sweet/Maxwell, London 2007), 325 seq.

[27] 2000 WL 1741490 p. 24.

[28] [1976] 1 Lloyd's Rep. 293.

[29] [1976] 1 Lloyd's Rep. 293.

borne". The theory was later explicitly applied by Lord Scarman in *Pao On*[30] which is still followed to some extent by influential academic scholars.[31]

b) Illegitimate Pressure

In *The Universe Sentinel*[32], Lord Diplock focussed on another aspect when his Lordship held: 'The rationale is that his apparent consent was induced by pressure exercised upon him by that other party which the law does not regard as legitimate, with the consequence that the consent is treated in law as revocable unless approbated either expressly or by implication after the illegitimate pressure has ceased to operate on his mind.'.[33] Because Lord Diplock did not take reference to the overborne-will-theory it seems unclear whether his Lordship dissented deliberately from the theory.[34] Nevertheless, courts and academic writers have been reluctant to the overborne-will-theory since then.[35] Instead, the focus shifted entirely towards the illegitimacy of the performed pressure.

c) Supplement vs. Contradiction

It appears that the overborne-will-theory and the illegitimate-pressure-theory are seen as contradictory.[36] The preferable approach should be to understand both theories as supplementing concepts: The overborne-will-theory is about the general doctrinal idea which underlies the doctrine of

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30 [1980] A.C. 614.

31 Vigor, *The Principles of the Law of Restitution* (2nd edn Oxford University Press, Oxford 2006), 206.

32 [1983] 1 A.C. 366.

33 [1983] 1 A.C. 384.

34 For the same assessment Ogilvie, 'Economic Duress in Contract: Departure, Detour or Dead-End', (2001) 34 CanBusLJ 194, 207, 224.

35 *DSND Subsea* 2000 WL 1741490; *B&S Contracts and Design v Victor Green Publications* [1984] I.C.R. 419 CA; Burrow, *The Law of Restitution* (2nd edn Butterworths LexisNexis, London 2002); W, 'Case Note: Economic Duress', (1982) 45 MLR 556, 558.

36 See Vigor, *The Principles of the Law of Restitution* (2nd edn Oxford University Press, Oxford 2006), 206; Burrow, *The Law of Restitution* (2nd edn Butterworths LexisNexis, London 2002); Atiyah, 'Economic Duress and the "Overborne Will' (1982) 98 LQR 197, 200; Phang, 'Whither Economic Duress? Reflection to Two Recent Cases', (1990) 53 MLR 107, 113; Beatson, The Use and Abuse of Unjust Enrichment (reprint Oxford University Press, Oxford 2002), 117.

economic duress. The illegitimate-pressure-theory is about the facts and criteria which establish economic duress.

The overborne-will-theory has a reasonable and conceptional essence.[37] Undisputedly, where a contracting party is induced into a contract by some "blameworthy" pressure, the free will to contract is somehow detracted or overborne. This approach has been criticised as too simplistic and misleading insofar as it suggests some kind of automatism regarding the establishment of economic duress.[38] There are two persuasive objections to this criticism: Firstly, the law of contracts is to a great extent about a person's detracted will. The concepts of mistake, misrepresentation, and undue influence are based on the idea that if a person enters a contract with a somewhat "detracted" will, this contract is voidable. The overborne-will-approach to economic duress is insofar in line with other concepts of contract law and is insofar coherent. Secondly, the overborne-will-theory doesn't hold that every time when pressure is induced on a person's will economic duress is automatically established. According to the overborne-will-theory economic duress is only established by "blameworthy" pressure and the "blameworthiness" is to be determined separately. The "blameworthiness" is the linkage to the illegitimate-pressure-theory. The pressure is "blameworthy" when it is illegitimate. But illegitimacy is not about the idea of economic duress, it is about when this idea comes into life, i.e. which elements actually establish economic duress.

[37] The House Lords abandoned the overborne-will-theory in the context of criminal duress in *The DPP for Northern Ireland v Lynch* [1975] A.C. 653. There is no automatic repercussion of this case to duress in context of civil law; see iy, The Nature and the Scope of Restitution (Hart Publishing, Oxford - Portland Oreggon 2000), 191.

[38] See, inter alia, W, 'Note of Cases - Economic Duress', (1982) 45 MLR 556, 558; Phang, 'Whither Economic Duress? Reflection to Two Recent Cases', (1990) 53 MLR 107, 109; Beatson, 'Duress by Threatened Breach of Contract', (1976) 92 LQR 496.

2. Elements establishing Economic Duress

a) The Blur of Present Law

The elements which establish economic duress are still controversial.[39] Furthermore, the line of cases has shown vagueness, uncertainty, and confusion in the reasoning:

The simple two-step-test introduced in *The Universe Sentinel*[40] was abandoned en passant in favour of a three-step-test without anybody giving a reason for it. The practical-no-choice test might have seemed reasonable in the beginning, but the criterion which has been put forward to evidently establish the no practical choice are not quite convincing. Why does the consultation with your lawyer leave you no choice?[41] The same holds for the place of the practical-no-choice test in the maze of economic duress. Does is determine the pressure as suggested by Lord Scarman in *The Universe Sentinel*[42] or does it determine the illegitimacy of the pressure as held in *DSND Subsea*[43]? Linking illegitimacy with economic duress was apparently quite persuasive to courts and academic commentators in the beginning, but today, there is much confusion about its place and substance in the law of economic duress.[44] The catalogue of criteria introduced by Lord Scarman in *Pao On*[45] and meant to evidently show economic duress, is obviously the battlefield of discussion, so it becomes bigger and bigger[46] and sparks off new "illegitimacy-tests"[47]. Finally, case law and academics have indeed

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[39] For an detailed assessment Bigwood, 'Economic Duress by (threatened) Breach of Contract', (2001) 117 LQR 376, 378 seq.

[40] [1983] 1 A.C. 366, 400.

[41] See the no-practical-choice test established in *Pao On* [1980] A.C. 614 (per Lord Scarman).

[42] [1983] 1 A.C. 366, 400.

[43] 2000 WL 1741490.

[44] Burrow, *The Law of Restitution* (2nd edn Butterworths LexisNexis, London 2002), 230 seq. Presents three tests.

[45] [1980] A.C. 614.

[46] See Goff/Jones, *The Law of Restitution* (7th edn Sweet/Maxwell, London 2007), 347.

[47] Bad-faith-test: Burrow, The of Restitution (2nd edn Butterworths LexisNexis, London 2002), 233; *Huyton SA v Peter Cremer GmbHG* [1999] 1 Lloyd's Rep 620, 637; another

tackled concepts of contract law which are related to economic duress, like undue influence, consideration, and tort.[48] But they haven't drawn any clear borderline between them.

b) Rearrangement of Thoughts

The blur of present law is without doubt unsatisfactory for everyone and will certainly not vanish in the near future. But an open-minded, in-depth reconsideration of case law may point the way.

The right requirement to start with should be the illegitimacy of the performed pressure. It splits off illegitimate contracting from the rude and tumble but legitimate contracting of ordinary commercial life. But again, what makes pressure illegimate? Mostly unnoticed, Lord Scarman may have already found the key to the puzzle. In *The Universe Sentinel* he held: 'In determining what is legitimate, two matters may have to be considered. The first is as to the nature of the pressure. In many cases this will be decisive, though not in every case. And so the second question may have to be considered, namely, the nature of the demand which the pressure is applied to support.'[49] His Lordship identifies (i) the means by which the pressure is performed *(nature of the pressure)* and (ii) and the intention of the person performing the pressure *(nature of the demand)* as decisive elements of illegitimacy. Furthermore, his Lordship links both elements, hinting that illegitimacy is also established in case there is an inadequate correlation between legitimate means of the pressure and legitimate intentions of the person performing the pressure.

Accordingly, in the context of economic duress illegimate means (tort, crime) constitute illegimate pressure,[50] illegimate intentions (tort, crime)

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test by Tan, 'Constructing a Doctrine of Economic Duress', (2002) 18 Const.L.J. 87, 91.

[48] *Pao On v Lau Yiu Long* [1980] A.C. 614; North Ocean Shipping Co v Hyundai Construction Co (The Atlantic Baron) [1979] QB 707; Phang, 'Whither Economic Duress? Reflection to Two Recent Cases', (1990) 53 MLR 107, 115; Vigor, *The Principles of the Law of Restitution* (2nd edn Oxford University Press, Oxford 2006), 199; Cornish, 'Economic Duress', (1966) 29 MLR 428, 429.

[49] [1983] 1 A.C. 366, 401.

[50] Goff/Jones, *The Law of Restitution* (7th edn Sweet/Maxwell, London 2007), 326.

also constitute illegimate pressure, and an inadequate correlation between legitimate means of the pressure (contract of breach) and the legitimate intention (additional payment on reasons of increased costs faulted by the other party).[51] Certainly, the third element which links the *nature of the pressure* with the *nature of the demand* is the most controversial. At this point, the above mentioned catalogue of criteria first made up by Lord Scarman in *Pao On*[52], which has now advanced, may be helpful.[53] The catalogue is also important in order to determinate if the pressure was reasonable cause for entering the contract (e.g. no-alternative-choice test, but-for-test[54]).[55] Overall, the different thoughts expressed in different cases seem to fit together in this rearrangement and, furthermore, form a consistent picture.

IV. Final Observations

1. Courts have distilled an abstract concept of economic duress. Today, there is apparently no controversy about the eligibility of the concept of economic duress in general. Furthermore, there is apparently no controversy about economic duress acting as a vitiating factor in the context of contract and restitutionary law.

2. The rational of economic duress is thought to be controversial. A closer look at the competing ideas reveals that the overborne-will-theory and the illegitimate-pressure-theory are rather supplemental than contradictory.

3. The elements which establish economic duress are still quite controversial. Present case law even is somewhat blurry. This is especially true for

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[51] See Bigwood, 'Economic Duress by (threatened) Breach of Contract', (2001) 117 LQR 376, 379.

[52] [1980] A.C. 614.

[53] Goff/Jones, *The Law of Restitution* (7th edn Sweet/Maxwell, London 2007), 347.

[54] *Huyton SA v Peter Cremer GmbHG* [1999] 1 Lloyd's Rep 620; see also Vigor, *The Principles of the Law of Restitution* (2nd edn Oxford University Press, Oxford 2006), 194, 208; rejected by Birks, *An Introduction to the Law of Restitution* (revised edn. Claredon Press, Oxford 1989), 183.

[55] See Bigwood, 'Economic Duress by (threatened) Breach of Contract', (2001) 117 LQR 376, 379.

the illegitimacy of pressure which seems to be the pivot point in this context.

4. Finally, there is battle to be fought for the freedom and sanctity of contract.[56] As economic duress goes right to the heart of it, it should be applied with great care and retention. This holds particularly true for commercial contracts. A businessman must stand to his word and withstand the rude and tumble pressure of commercial contracting. Above all, a businessman ought to take precautionary measures which shield him from pressure. Appropriate contract clauses are a simple but very effective example.

[56] See the commentary by Lal, 'Commercial Exploitation in Construction Contracts: The Role of Economic Duress', (2005) 21 Const.L.J. 590, 597 seq.

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The Boundaries of Undue Influence, Unconscionability and Duress
Staying dissimilated or Being assimilated?

I. Introduction

The essence of a contract is the contracting parties' free will to enter into the contract.[1] Where one contracting party creates or takes advantage of a superior bargaining position, common law, including equity, is willing to assume that the weaker party has not been able to exercise a free will when entering the contract and, accordingly, is willing to grant relief.[2] Because there is no such thing as equal bargaining power in real life,[3] the boundaries between the legitimate use of bargaining power and an abuse of such power has been in question since the early beginning. This paper focuses

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1 Richards, *Law of Contract* (8th edn Pearson, Essex 2007) 275.

2 Ridge, 'Uncertainties Surrounding Undue Influence: Its Formulation, Application, and Relationship to Other Doctrines' (2003) NZ Law Review 329, 329.

3 See Tipping J in *Attorney-General for England and Wales v R* [2002] 2 NZLR 91, para 62.

on those boundaries. The arguments are developed as follows: First, a preliminary observation of the present doctrinal landscape is carried out. Based on the findings, common features and points of difference between those doctrines are examined in a second step. Finally, the question whether some or all of these doctrines should be merged will be discussed.

II. Preliminary Doctrinal Observations

1. Undue Influence

(a) The Doctrine's Essence. The doctrine of undue influence is of equitable origin. It provides for the rescission of a contract and consequently constitutes a ground for restitution.[4] The doctrine applies where the parties to a contract are in a relationship of trust and confidence or of ascendancy and dependence, and one of the parties (the "superior" party) abuses or presumably abuses that relationship in order to induce the other party (the "weaker" party) to enter a contract.[5] The rationale of the doctrine lies in the assumption that the "weaker" party's decision to enter the contract cannot be regarded as freely exercised.[6]

(b) Classes of Undue Influence. There are two established classes of undue influence: actual and presumed. In a broad sense, the distinction between the two classes of influence is evidential and linked to the kind of relationship between the parties.[7] In certain relationships of trust and confidence, like between trustee/beneficiary, solicitor/client, parent/child, and doctor/patient, guardian/ward, the exertion of undue influence is rebuttably

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[4] Burrow, *The Law of Restitution* (2nd edn Butterworths LexisNexis, London 2002), p. 245; Virgo, *The Principals of the Law of Restitution* (2nd edn, OUP 2006), p. 247.

[5] See *Royal Bank of Scotland v Etridge* [2002] 2 AC 773, 794; Virgo, *The Principals of the Law of Restitution* (2nd edn, OUP 2006), 247; Chew, 'Bank guarantees and undue influence: an Australian Perspective' (2010) 25 JIBLR 19, 19.

[6] *Hugenin v Basley* (1807) 14 Ves Jun 273, 296.

[7] *Allcard v Skinner* (1887) LR 36 ChD 145.

presumed (Class 2).[8] In all other cases (relationships) the claimant has to prove that the defendant actually influenced him unduly (Class 1).[9]

(c) Establishing Actual Undue Influence. To succeed in pleading actual undue influence, the claimant must show (i) that the defendant[10] had the capacity to influence the claimant; (ii) that influence was exercised over the claimant; (iii) that its exercise was undue; (iv) that its exercise caused the claimant to enter the contract.[11] The focal point of actual undue influence is on the undueness of the exercised influence and its causation. The influence is said to be undue, where the claimant was "victimised" in some way, for example by forcing, tricking, misleading, or even cheating. In this regard, guidance can be found in the American authority *Odorizzi*.[12] Fleming J held that if a number of circumstances are simultaneously present, the persuasion may be characterised as undue. He named, inter alia, discussion of the transaction at an unusual time or place, insistent demand that the business be finished at once, extreme emphasis on untoward consequences of delay, and the use of multiple persuaders by the dominant side against a single servient party. As for the causation Slade LJ in *Aboody*[13] stated that "it would not be appropriate for the court to [grant relief] in a case where the evidence establishes that on balance of probabilities, the complainant would have entered into the transaction in any event.". The requirement of a manifest and unfair disadvantage, which had been prominent around for a century, has been rejected by House of Lords in *Pitt*[14].[15]

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[8] Traditionally presumed undue influence is further subdivided into two sub-classes: Class 2A for well-established categories of relationships; Class 2B for less-well established categories of relationships. In all other cases (relationships) the claimant has to proof that the defendant actually influenced him unduly (Class 1) - see Virgo, *The Principals of the Law of Restitution* (2nd edn, OUP 2006), p. 253 seq.; Peel, *Treitel on The Law of Contract* (12 edn Sweet & Maxwell, London 2007), para 10-011 seq.

[9] Virgo, *The Principals of the Law of Restitution* (2nd edn, OUP 2006), p. 250 seq.; Peel, *Treitel on The Law of Contract* (12 edn Sweet & Maxwell, London 2007), para 10-009 seq

[10] Or someone who induced the transaction for his own benefit.

[11] *Bank of Credit and Commerce International SA v Aboody* [1992] 4 All ER 955, 967; for an overview Devenney/Chandler, 'Unconscionability and the taxonomy of undue influence'(2007) JBL 541, 552 seq.

[12] *Odorizzi v Bloomfield School District* 246 Cal. App. 2d 123, 54 Cal. Rptr. 533 (1966).

[13] *Bank of Credit and Commerce International SA v Aboody* [1992] 4 All ER 955, 971.

[14] *C.I.B.C. Mortgages Plc Respondents v Pitt and Another Appellant* [1994] 1 AC 200.

(c) Establishing Presumed Undue Influence. To succeed in pleading presumed undue influence, the claimant must show (i) a relationship of trust and confidence between the claimant and the defendant; (ii) and that the entered contract calls for an explanation. For certain types of relationship there is an irrebutable ("automatic") presumption of influence (see the list above).[16] In so-called factual relationships of influence the claimant must simply show by facts that there was relationship of trust and confidence.[17] The influence is then presumed. The second element that needs to be proved is a transaction that "calls for explanation".[18] This can be done by showing "unusual" circumstances within the time of entering of the contract, including the conduct of the defendant. A manifest and unfair disadvantage to the claimant by the contract works as a supporting factor in affirming that the contract calls for an explanation.[19] When the claimant has successfully established the evidential presumption, the defendant may rebut the presumption.[20] Prominent ways to ensure that the plaintiff exercised his or her own free will is the provision of independent and sufficient legal and

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[15] See also Capper, 'Undue Influence and Unconscionability: A Rationalisation' (1998) 114 LQR 479, 487 seq.

[16] Heavily debated are in this regard relationships among husbands/wives, finance/fiancée, man/mistress - see for example *Midland Bank plc* v *Shepherd* [1988] 3 All ER 17.

[17] Examples for such a factual relationship of influence are as follows: junior employee/older employer, soldier/commanding officer, elderly man/financial advisor (*Investors Compensation Scheme Limited v West Bromwich Building Society* [1999] Lloyd's Rep PN 496), Islamic wife/Islamic husband (*Bank of Credit and Commerce International SA (In Compulsory Liquidation) v Hussain* 1999 WL 1425708 High Court, ChD).

[18] *Turkey v Awadh* [2005] EWCA Civ 382, per Buxton LJ, para 29; for details see Burrow, *The Law of Restitution* (2nd edn Butterworths LexisNexis, London 2002), p. 256 seq.

[19] See *Bank of Credit and Commerce International SA v Aboody* [1992] 4 All ER 955, 967 seq.; *C.I.B.C. Mortgages Plc Respondents v Pitt and Another Appellant* [1994] 1 AC 200; *Royal Bank of Scotland v Etridge (No 2)* [2001] 4 All ER 449; Virgo, *The Principals of the Law of Restitution* (2nd edn, OUP 2006), p. 259; Lehane, 'Undue Influence, Misrepresentation and Third Parties' (1994) 110 LQR 167, 172; Devenney/Chandler, 'Unconscionability and the taxonomy of undue influence'(2007) JBL 541, 564.

[20] The weight of facts which are put forward to rebut varies from case to case, and "will depend both on the particular nature of the relationship and on the particular nature of the impugned transaction." - *Royal Bank of Scotland v Etridge (No 2)* [2001] 4 All ER 449, 500 per Lord Scott. For a general view see Peel, *Treitel on The Law of Contract* (12 edn Sweet & Maxwell, London 2007), para 10-023 seq.

economic information, such that the influence exercised, or the lack of independent advice was actually irrelevant.[21]

2. Unconscionability

(a) The Doctrine's Essence. The under English law rather less developed doctrine of unconscionability is also an equitable relief:[22] It allows a court to set aside a contract and, consequently, works as a ground for restitution. The doctrine applies to bargains where a party entered into a bargain of a more or less grossly unfair and unreasonable character as a result of its great weakness.[23] The rational of the doctrine of unconscionability lies in the assumption that the "weaker" party's decision to enter the contract cannot be regarded as freely exercised.[24]

(b) Establishing Unconscionability. The criteria establishing unconscionability are still vague. However, there are two commonly applied criteria: (i) a special disability on the claimant's side, and (ii) an unconscionable conduct on the defendant's side. With regard to special disadvantage case law has come up with some circumstances which may constitute it.[25] While English courts have adhered to the traditional categories such as "poor and ignorant"[26] and "expectant heirs",[27] an Australian court stated: "Among [these circumstances] are (i) poverty or need of any kind, (ii) sickness, (iii) age,

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[21] See *Royal Bank of Scotland v Etridge (No 2) (CA)* [1998] 4 All ER 705, 714 per Stuart-Smith LJ; *Credit Lyonnais Bank Nederland NV v Burch* [1997] 1 All ER 144; *Johnson v Buttress* (1936) 56 CLR 113, 120 per Latham CJ; *Allcard v Skinner* (1887) LR 36 ChD 145, 171 seq.

[22] Many early cases concerned the expectant heir who was just of age, and made an improvident bargain with respect to the inheritance yet to be received - *Fry v Lane* (1889) 40 ChD 312, 321per Kay J.

[23] In the Australian case *Bowkett v Action Finance Ltd* [1992] 1 NZLR 449, 460 Tipping J stated that unconscionability "is not the relief of the foolish from their foolishness but rather the relief of the weak in appropriate cases from bargains entered into as a result of their weakness.".

[24] *Hugenin v Basley* (1807) 14 Ves Jun 273, 296.

[25] For a collection of case Devenney/Chandler, 'Unconscionability and the taxonomy of undue influence'(2007) JBL 541, 543.

[26] *Fry v Lane* (1889) 40 ChD 312.

[27] See Burrow, *The Law of Restitution* (2nd edn Butterworths LexisNexis, London 2002), p. 262 seq.

(iv) sex, (v) infirmity of body or mind, (vi) drunkenness, (vii) illiteracy or lack of education [...]"[28] With regard to the unconscionability of the defendant's conduct the notion is not yet well defined. It is held the doctrine doesn't assist a claimant "where there was no victimisation, no taking advantage of another's weakness, and the sole allegation was contractual imbalance with no undertones of constructive fraud.".[29] Hence, some impropriety, like equitable or constructive fraud, has to be established. This embraces the defendant's constructive knowledge of the claimant's special disadvantage and the intention to take advantage of it. In many reported cases involving unconscionability a gross inadequacy of consideration attended the courts' intervention.[30] But there is no authority that explicitly requires the establishment of a gross inadequacy of consideration.[31] In any case, it acts as powerful evidential tool.[32]

3. (Economic) Duress

(a) The Doctrine's Essence. The doctrine of duress originates in the common law. It provides for the rescission of a contract and consequently acts as a ground for restitution. The doctrine operates in situations where an illegitimate threat is exercised in order to induce another person to enter a contract. The illegimate threat may be expressed directly or be implied by the circumstances. The rational is simply that when one party to a contract forces the other party to enter into a contract by means of an illegimate

[28] Notably, these categories are not closed: Capper, 'Undue Influence and Unconscionability: A Rationalisation' (1998) 114 LQR 479, 485.

[29] *O'Connor v Hart* [1985] AC 1000, 1018.

[30] *Fry v Lane* (1889) 40 Ch D 312; *Rooney v Conway* [1982] 5 NIJB; *Credit Lyonnais Bank Nederland NV v Burch* [1997] 1 All ER 144; *Alec Lobb (Garages) Ltd v. Total Oil (Great Britain) Ltd* [1985] 1 WLR 173.

[31] It is unclear whether older English decision, like *Garvey* v *McMinn* (1846) 9 Ir. Eq. Rep. 526; *Slator v. Nolan* (1876) I.R. 11 Eq. 367, say otherwise. In the leading Australian case *Commercial Bank of Australia Ltd v. Amadio* (1983) 151 CLR 447, 475 Deane J. stated that inadequacy of consideration is not essential.

[32] Capper, 'Undue Influence and Unconscionability: A Rationalisation' (1998) 114 LQR 479, 485;see also *Joan Humphreys v Dennis Michael Humphreys* [2004] EWHC 2201 (Ch).

threat, the decision to enter the contract cannot be regarded as freely exercised.[33]

(b) Categories of Duress. Originally, duress was limited to threats to cause physical harm to persons[34] and goods[35]. A more recent line of cases added a third and in scope much wider category: economic duress.[36] In the latter category, the threats advert to commercial disadvantages of the other party, like the threat to breach a contract[37], to sue[38], instigate criminal proceedings[39], or to publish delicate information[40].

(c) Establishing Duress. If the claimant wants to rely on duress as ground for rescinding a contract, he must show (i) the defendant exercised an illegitimate threat and (ii) that this threat reasonably caused the induction of entering the contract.[41]

Besides the clear cut cases of an unlawful act, [42] it is heavily debated under which circumstances (plain commercial) pressure may also amount to an illegimate threat. In *The Universe Sentinel*[43] Lord Scarman indentified (i) the

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[33] *Universe Tankships Inc of Monrovia v International Transport Workers Federation* [1983] 1 AC 366.

[34] *Barton* v. *Armstrong* [1976] *AC* 104; *Duke de Cadaval* v *Collins* (1834) 4 AD & E 858; 111 ER 1006.

[35] *Fell v Whittaker* [1871] LR 7 QB 120; *Maskell* v. *Horner*, [1915] 3 KB 106.

[36] Early writing by Dawson, 'Economic Duress - An Essay in Perspective', (1947) 45 Mich.L.Rev, 253; Cornish, 'Economic Duress', (1966) 29 MLR 428.

[37] Beatson, The Use and Abuse of Unjust Enrichment (reprint Oxford University Press, Oxford 2002), p. 117 seq.; Lal, 'Commercial Exploitation in Construction Contracts: The Role of Economic Duress', (2005) 21 Const.L.J. 590; Vigor, *The Principles of the Law of Restitution* (2nd edn Oxford University Press, Oxford 2006), 201.

[38] Dawson, 'Duress through Civil Litigation', (1946) 45 Mich.L.Rev 571; Jaffey, The Nature and the Scope of Restitution (Hart Publishing, Oxford - Portland Oregon 2000), 183 seq.

[39] For an example *Kaufman v Gerson* [1904] 1 KB 591.

[40] Obiter dicta in *Norreys v Zeffert* [1939] 2 All ER 187.

[41] See *Barton v Armstrong* [1976] AC 104, 121; *Universe Tankships Inc of Monrovia v International Transport Workers Federation* [1983] 1 AC 366, 400; The *Evia Luck* [1992] 2 AC 152, 165.

[42] Bigwood, 'Coercion in Contract: The Theoretical Constructs of Duress' 46 UTLJ 201, 214.

[43] *Universe Tankships Inc of Monrovia v International Transport Workers Federation* [1983] 1 AC 366 (401) - "In determining what is legitimate two matters may have to be considered. The first is as to the nature of the pressure. In many cases this will be decisive, though

means by which the pressure is performed *(nature of the pressure / conduct)* and (ii) and the intention of the person performing the pressure *(nature of the demand)* as decisive elements of illegitimacy. Furthermore, Lord Scarman linked both elements, hinting that illegitimacy is also established in case there is an inadequate correlation between legitimate means of the pressure and legitimate intentions of the person performing the pressure. Finally, it must be shown that the threat has had a causative effect. The respective test is still debated. In *Pao On*[44] the test was expressed to be "a coercion of the will so as to vitiate consent.". Factors to be considered in this regard are whether or the coerced person had alternative courses available such as a legal remedy or entering a contract with a third party; had independent advice; protested and after entering the contract, took steps to avoid it.[45] In *Barton v Armstrong*[46] it was held that the threats only had to be a reason, not the reason.

III. Common Features and Points of Differences

Common features and points of difference of and among the doctrines of undue influence, unconscionability, and duress have incidentally surfaced while observing each one of them singularly. A more detailed examination which is carried out below will advance further (dis-)similarities.

1. Undue Influence and Duress

(a) The Doctrines' Essences. In *Etridge*[47] Lord Nicholls stated "In everyday life people constantly seek to influence the decisions of others. They seek to persuade those with whom they are dealing to enter into transactions, whether great or small. The law has set limits to the means properly em-

not in every case. And so the second question may have to be considered, namely, the nature of the demand which the pressure is applied to support.".

44 *Pao On v Lau Yiu Long* [1980] AC 614.

45 Pao *On v Lau Yiu Long* [1980] AC 614; see also *Universe Tankships Inc of Monrovia v International Transport Workers Federation* [1983] 1 AC 366, 401; Ogilvie, 'Economic Duress in Contract: Departure, Detour or Dead End?' (2001) 34 CBLJ 194, 215.

46 [1976] AC 104.

47 *Royal Bank of Scotland v Etridge* [2002] 2 AC 773, 794 seq.

ployable for this purpose. To this end the common law developed a principle of duress. [...] Here, as elsewhere in the law, equity supplemented the common law. Equity extended the reach of the law to other unacceptable forms of persuasion. The law will investigate the manner in which the intention to enter into the transaction was secured: "how the intention was produced", [...] If the intention was produced by an unacceptable means, the law will not permit the transaction to stand. The means used is regarded as an exercise of improper or "undue" influence, and hence, unacceptable, whenever the consent thus procured ought not fairly to be treated as the expression of a person's free will." His Lordships, who was later positively cited in *R v Attorney General of England and Wales*[48], apparently pointed out a common rationale of undue influence and duress: a contract into which a party is induced to enter by some kind of improper influence should not stand.[49] Both are concerned with procedural impropriety (this counts for presumed influence as well)[50].[51] This common rationale consequently results in a common relief of undue influence and duress: the contract is voidable.[52]

(b) Kind and Level of Influence. The refined distinction between the two doctrines is sometimes seen in the kind and level of influence necessary to justify the court's interference with the contract. According to judgement in *Aboody*[53] pressure or a threat is not a prerequisite for undue influence.[54] This is true as far as it is said that the improper conduct in question is more subtle in the traditional cases of undue influence than of duress:[55] The

[48] *R v Attorney General of England and Wales* [2003] UKPC 22.

[49] This was applied by *R v Attorney General of England and Wales* [2003] UKPC 22.

[50] In cases of presumed influence (Class 2) a procedural impropriety is also established/constituted. The evidential presumption is just a way of proving actual undue influence - *Royal Bank of Scotland v Etridge (No 2)* [2001] 4 All ER 449, 477 seq. per Lord Clyde.

[51] Virgo, *The Principals of the Law of Restitution* (2nd edn, OUP 2006), p. 253..

[52] Phang, 'Undue Influence methodology, sources and linkages' (1995) JBL 552, 566; Burrows, 'We Do This At Common Law But That In Equity' (2002) 22 OJLS 1, 6.

[53] *Bank of Credit and Commerce International SA v Aboody* [1992] 4 All ER 955, 967. [1990] 1 QB 923, 935.

[54] See also *Dunbar Bank v Nadeem* (1999) 31 HLR 403, 409; *Allcard v Skinner* (1887) LR 36 ChD 145, 179.

[55] Chew, 'Bank guarantees and undue influence: an Australian Perspective' (2010) 25 JIBLR 19, 19.

category of economic duress narrows very much the small difference in the level and kind of improper influence. It is said that "[...] undue influence involves the use of psychological pressure while economic duress involves the use of economic pressure.".[56] But the question has to be raised whether economic pressure usually triggers psychological pressure.

(c) Establishing the Impropriety of the Influence. In both doctrines there is some vagueness about the distinct criteria which establish the impropriety of the influence. Case law has come up with a catalogue of circumstances for each one of the two doctrines. Both catalogues - undue influence: *Odorizz*[57]*;* (economic) duress: *Pao On*[58] - overlap greatly. Furthermore, undue influence and duress only apply to the party which shows the improper conduct.

2. Undue Influence and Unconscionability

(a) The Doctrines' Essences. In *Amadio*[59] Deane J held that "The equitable principles relating to relief against unconscionable dealing and the principles relating to undue influence are closely related". Dean J went on to state "The two doctrines are, however, distinct. Undue influence [...] looks to the quality of the consent or assent of the weaker party [...] Unconscionable dealing looks to the conduct of the stronger party in attempting to enforce, or retain the benefit of, dealing with a person under a special disability in circumstances where it is not consistent with equity or good conscience that he should do so." The first statement is insofar true as both doctrines share a common rationale: The somehow weaker party's decision to enter the contract cannot be regarded as freely exercised. Subsequently, both doctrines grant relief by setting aside the contract und constitute ground for restitution. There is some doubt about the second statement. This is because not only unconscionability looks at the conduct of the "stronger" party. As shown above and indicated by its name, undue in-

[56] Ogilvie, 'Economic Duress in Contract: Departure, Detour or Dead End?' (2001) 34 CBLJ 194, 227.

[57] *Odorizzi v Bloomfield School District* 246 Cal. App. 2d 123, 54 Cal. Rptr. 533 (1966), for detail see above p. 3.

[58] *Pao On v Lau Yiu Long* [1980] AC 614.

[59] *Commercial Bank of Australia Ltd v. Amadio* (1983) 151 CLR 447.

fluence is also about influence during the process of contracting.[60] Therefore, the distinction[61] referred to as plaintiff-sided (undue influence) and defendant-sided (unconscionability) is also disputable.

(b) Prior Special Relationship v Special Disadvantage. Despite these common features the two doctrines appear to be somewhat distinct. In *Irvani*[62] Buxton LJ held that undue influence is "concerned with prior relationships between the contracting parties" while "unconscionability can arise without there being any relationship, outside that of the immediate contract, between the parties." On the other hand, unlike unconscionability, undue influence does not require a special disadvantage on the claimant's side.

(c) Manifest or Gross Disadvantage. Both doctrines do not require the claimant to show that he has encountered a manifest or gross disadvantage by entering the contract. With regard to undue influence the prerequisite of a manifest disadvantage has been abandoned by House of Lords in *Pitt*[63]. With regard to unconscionability, a gross disadvantage, which is established in many cases, works as an evidential tool rather than an indispensable prerequisite.[64]

3. Unconscionability and Duress

(a) The Doctrines' Essences. It is submitted that there is a close correlation between (economic) duress on one side and unconscionability on the other.[65] Particularly in the context of so-called 'lawful' threats[66], (economic) duress does incorporate notions of unconscionability and is hardly to be

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60 *Bounstany v Pigott* (1993) 42 WIR 175, 180; Chen-Wishart, 'The *O'Brien* Principle and Substantive Unfairness' (1997) 56 CLJ 60, 64.

61 Birks/Chin, 'On the Nature of Undue Influence' in Beatson/Friedmann (ed), Good Faith and Fault in Commercial Law (1995), 57.

62 *Irvani v Irvani* [2000] 1 Lloyd's Rep 414, 493.

63 *C.I.B.C. Mortgages Plc Respondents v Pitt and Another Appellant* [1994] 1 AC 200.

64 Capper, 'Undue Influence and Unconscionability: A Rationalisation' (1998) 114 LQR 479, 485.

65 Phang, 'Undue Influence methodology, sources and linkages' (1995) JBL 552, 570.

66 *CTN Cash and Carry Ltd v. Gallaher Ltd* [1994] 4 All ER 714; *R v Attorney General of England and Wales* [2003] UKPC 22; see Chen-Wishart, *Contract Law* (2nd edn, OUP 2007), 334 seq.

separated from it.[67] This is due to the rationale both doctrines share: The decision of the weaker or pressured party to enter the contract cannot be regarded as freely exercised. Therefore, if applied, both doctrines render the contract voidable.[68]

(b) Special Disability v Illegitimate Pressure. The requirements which establish unconscionability and duress are quite different. On one side, there is the claimant's special disability on which unconscionability is based on. On the other, side there is illegitimate pressure imposed by the defendant. Both requirements have only a thin linkage. It could be argued that the illegitimate pressure causes a special disability, a special disadvantage.[69] But as it has been shown, courts have set a high standard under which a special disability may be assumed. In the majority of cases improper pressure will not amount to an unconscionable pressure.

(c) Defendant's Awareness. The most outstanding difference between unconscionability and duress can be seen in the awareness of the defendant about the claimant's conduct. In the case of duress, the pressured party is usually aware of the improper pressure. In the case of unconscionability the "weaker" party is usually not aware of the improper conduct of the defendant.

IV. Conclusion: Staying dissimilated or Being assimilated?

It is submitted that undue influence, unconscionability, and duress have much in common. The reason for this is their common rationale. All three doctrines are based on the idea, that a party's decision to enter a contract cannot be regarded as freely exercised, when the party's decision was influenced by an improper behaviour of the other party. All three doctrines grant the same relief: voidability of the contract. Because of this joint

[67] Bigwood, 'Coercion in Contract: The Theoretical Constructs of Duress' 46 UTLJ 201, 217; Chen-Wishart*, Contract Law* (2nd edn, OUP 2007), 334.

[68] With regard to duress, there are single voices who argue the contract is void, not voidable (see Lanham, 'Duress and Void Contracts', (1966) 29 MLR 615.

[69] Capper, 'Undue Influence and Unconscionability: A Rationalisation' (1998) 114 LQR 479, 504.

foundation, there is much discussion both on the jurisprudential[70] and judicial[71] side about a merger among the three doctrines. Many voices speak for a merger of undue influence and duress.[72] Further it is discussed whether duress should be subsumed under unconscionability[73] or vice versa[74]. In addition it may be questioned if actual and presumed undue influence should take different routes here. Other voices see unconscionability as the doctrine, which acts as an umbrella for the other two[75] or just for undue influence[76]. Another group of commentaries suggest that the three doctrines should stay separated.[77] Quo vadete undue influence, unconscionability, and duress? Should you stay dissimilated or being assimilated in one way or the other?

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[70] See for example Phang, 'Undue Influence methodology, sources and linkages' (1995) JBL 552; Capper, 'Undue Influence and Unconscionability: A Rationalisation' (1998) 114 LQR 479; Chew, 'Bank guarantees and undue influence: an Australian Perspective' (2010) 25 JIBLR 19; Birks/Chin, 'On the Nature of Undue Influence' in Beatson/Friedmann (ed), Good Faith and Fault in Commercial Law (1995), 57; Devenney/Chandler, 'Unconscionability and the taxonomy of undue influence'(2007) JBL 541; Ridge, 'Uncertainties Surrounding Undue Influence: Its Formulation, Application, and Relationship to Other Doctrines' (2003) NZ Law Review 329; Burrows, 'We Do This At Common Law But That In Equity' (2002)22 OJLS 1; Ogilvie, 'Economic Duress in Contract: Departure, Detour or Dead End?' (2001) 34 CBLJ 194-230.

[71] See the discussions about the linkages among the doctrines in *Lloyds Bank Ltd v Bundy* [1975] QB 326 per Lord Denning; *Bank of Credit and Commerce International SA v Aboody* [1992] 4 All ER 955, per Slade LJ; *Royal Bank of Scotland v Etridge (No 2)* [2001] 4 All ER 449, 477 seq. per Lord Clyde; *Dimskal Shipping Co. SA v International Transport Workers' Federation* (The Envia Luck) (No 2) [1992] 2 AC 152, 169 per lord Goff.

[72] The fact that one lies in equity and the other at common law does not pose a problem: Birks/Chin, 'On the Nature of Undue Influence' in Beatson/Friedmann (ed), Good Faith and Fault in Commercial Law (1995), 57, 63; Burrows, 'We Do This At Common Law But That In Equity' (2002)22 OJLS 1, 6.

[73] For example Ogilvie, 'Economic Duress in Contract: Departure, Detour or Dead End?' (2001) 34 CBLJ 194, 227.

[74] Birks/Chin, 'On the Nature of Undue Influence' in Beatson/Friedmann (ed), Good Faith and Fault in Commercial Law (1995), 57, 63.

[75] Phang, 'Undue Influence methodology, sources and linkages' (1995) JBL 552, 568; Lehane, 'Undue Influence, Misrepresentation and Third Parties' (1994) 110 LQR 167.

[76] Devenney/Chandler, 'Unconscionability and the taxonomy of undue influence'(2007) JBL 541, 569.

[77] For example Bigwood, 'Undue Influence: 'Impaired Consent' or 'Wicked Exploitation?' (1996)16 OJLS 503, 514 with explicit regard to undue influence and unconscionability.

It is submitted, that despite the joint foundation and despite some great overlaps which were presented above, the time for a merger has not yet come. The preliminary observations have shown that all three doctrines may be seen well established. The observation has also shown that all three doctrines may not be called well developed. Each one of them carries a great deal of vagueness. The number of views expressed in the field of compulsion, exploitation, and equal bargaining proves this. As long as the circumstances which are supposed to justify an intervention by the court are not defined more precisely, any merger would exponentiate the vagueness. Furthermore, the collaboration of this vagueness and the specific prerequisites of each doctrine jeopardises the individual and collective scope of the doctrine(s). Therefore, if any attempts are made, it is argued that they should be made with great care. These attempts, it is submitted, should involve a close examination of the linkages between the three doctrines discussed on one side and fiduciary law[78] and contract law on the other side.

[78] See *O'Sullivan and Another v Management Agency and Music Ltd. and Others* [1985] QB 428. This view is opposed by Birks/Chin, 'On the Nature of Undue Influence' in Beatson/Friedmann (ed), Good Faith and Fault in Commercial Law (1995), 57, 91 seq. On the fiduciary nature of undue influence Bigwood, 'Undue Influence in the House of Lords: Principles and Proof' (2002) 65 (3) MLR 435, 441; Birks, *An Introduction to the Law of Restitution* (Oxford, Clarendon 1985), 184.

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The Theory of Contract Modification in the Vicinity of Economic Duress
A Comparative Analysis of German and English Law

The modification of contracts is an essential constituent of contractual activity. It usually is about rough bargaining, opportunistic rent seeking, and harsh commercial pressure. The question which kind of commercial pressure is regarded unlawful is the domain of the doctrine of economic duress which is inherently tied to freedom of contract and freedom of contract modification. The comparative assessment of German and English law on economic duress shows great resemblance on the main ingredients necessary for the avoidance of contract modifications agreed under blameworthy pressure.

I. Prospectus

1. Starting Points

Contracts are entered into, contracts are terminated - a somewhat simplified description of the life of a contract but one that is prominently assembled by legal doctrine. Contract law apparently worries itself for a huge part with those two episodes in a contract's life: its birth and its death. This narrow view overlooks a whole constituent of contractual activity which comes between birth and death: the modification of contracts.[1] Life teaches that the modification of contracts is of gross practical importance. Circumstances may change in a second. Likewise, a party's assumptions, which were essential for deciding to contract, may be dramatically overturned. The contract can become a risk, which even threatens the party's commercial well-being. In such a situation the affected party will be desperately concerned about modifying the contract. Life also teaches that contract modification isn't always about exchanging amicabilities. It usually is about rough bargaining, opportunistic rent seeking, and commercial pressure. Commercial pressure employed by one of the contracting parties may force the other party to agree to a contract modification what this party wouldn't have done in absence of this pressure. From the early beginning of law it is perceived that a party who has been inappropriately pressured shouldn't be bound to a contract.[2] [3] The pressure can be manifold:[4] threats to breach a

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1 For the same assessment Ulyatt, 'Should Consideration be Required for the Variation of Contracts?' (2000-2003) 9 AULR 883, 884.

2 For the Roman Law see *Paulus*, *Digest 4*, 2, 21, 5; no 399; for the Common Law see Bracton, *De Legibus Et Consuetudinibus Angliae*, Volume 2, 288 (http://hlsl5.law.harvard.edu/bracton/index.htm, 2010-09-01, Thorne Edition, English); Dawson, 'Economic Duress - An essay in Perspective' (1947) 45 Mich.L.Rev. 253, 254 seq.

3 Bar-Gill/Ben-Shahar, 'The Law of Duress and the Economics of Credible Threats' (2004) 33 JLS 392 argue that enforcement of an agreement, reached under a threat to refrain from dealing, should be conditioned solely on the threat's credibility.

4 Dalzell, 'Duress by Economic Pressure I' (1941-1942) 20 N.C.L.Rev. 237; Probst, 'Defects on the Contracting Process' in: *International Encyclopaedia of Comparative Law*, Volume II, Contracts in General (Mohr Siebeck, Tübingen 2008) II-407; Bigwood, 'Coercion in Contract: The Theoretical Constructs of Duress' (1996) 46 UTLJ 201, 218 seq.; Dawson, 'Duress through Civil Litigation', (1946) 45 Mich.L.Rev 571.

contract, threats to file a civil action ore a criminal complaint, threats to initiate insolvency proceedings or to discontinue a business relationship entirely.

2. Scope

A closer scrutiny of the law, especially contract and restitution law reveals that courts and legislators have addressed the inappropriateness of employed pressure in situations where parties modify a contract many times. This paper surveys the finding of courts and the views of legal scholars. A comparative approach, encompassing German and English law, is applied.[5] German law deals with the question of inappropriate commercial presses under statutory law, while in England the question is the domain of economic duress[6], a doctrine developed by case law. It appears promising to assess and compare jurisdictions with different legal backgrounds: civil law on one and common law on the other.

This paper doesn't deal with other forms of contract modification such as contract clauses, statutory law, and case law which allows for a contractual modification under special regulated circumstances.[7] The focus is solely on ad-hoc modifications. Furthermore, this paper doesn't deal with related doctrines such as undue influence, and unconscionability.[8] The focus is solely on inappropriate commercial pressure in the vicinity of contract modification.

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[5] For a wider comparative assessment see Probst, 'Defects on the Contracting Process' in: *International Encyclopaedia of Comparative Law*, Volume II, Contracts in General (Mohr Siebeck, Tübingen 2008) II-417 seq.

[6] This papers doesn't deal with the traditional doctrines of duress to the person and duress to goods.

[7] From a German perspective Hau, *Vertragsanpassung und Anpassungsvertrag* (Mohr Siebeck, Tübingen 2003).

[8] For the controversial relation among duress, undue influence, and unconscionability see for example Phang, 'Undue Influence methodology, sources and linkages' (1995) JBL 552; Ogilvie, 'Economic Duress in Contract: Departure, Detour or Dead End?' (2001) 34 CBLJ 194; Ridge, 'Uncertainties Surrounding Undue Influence: Its Formulation, Application, and Relationship to Other Doctrines' (2003) NZ Law Review 329.

II. Preliminary Observations

It is imperative, at the outset, to recall some of the fundamental theories of contract law which are inherently tied to the issue of this paper. Among those are freedom of contract and contract modification. Because the appraisal of factual circumstances of contractual negotiations is the key to delimitate blameworthy pressure which amounts to duress, a deeper look on the reality of contractual negotiations is taken.

1. Freedom of Contract

(i) Classical View. One, maybe the most, fundamental principle of contract law is freedom of contract. The classical view of contract is that parties have the freedom to enter into any agreement or bargain as equals whatsoever.[9] The law's task is solely to enable people to realise their wills and, hence, to enforce their inalienable right to enter into a contract. This view was traditionally based on the philosophies of natural law and laissez-faire. Economists have added another grounding thought during the last decades. They see contract law as a simple mean to maximize efficiency.[10] It is assumed that if people are able to voluntarily exchange goods and services on an informed base, they will promote their own welfare and, in the end, the welfare of the society by entering into contracts. This is because parties will only enter into contracts, if they think they will be better off by entering the contract than not entering the contract. This moves a resource to the party which has a 'higher use' of it, or at least thinks that it has a higher use.

Despite these different theoretical foundations, both approaches to contract law prominently accentuate the free will of the parties. Consistently, the classic view of contract is that a contract doesn't stand if the will of the contracting parties is impaired in a certain manner. Thus, contracting par-

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9 Peel, *Treitel, The Law of Contract* (12th edn Sweet & Maxwell, London 2007) 1-004; Bigwood, *Exploitative Contracts* (OUP, Oxford 2003) 62 seq.; for a historical perspective Atiyah, *The Rise and Fall of Freedom of Contract* (Clarendon Press, Oxford 1979).

10 See Posner, *Economic Analysis of Law* (6th edn Aspen, New York 2003) 93 seq.; Jolls 'Contracts as bilateral Commitments: A new Perspective on Contract Modification' (1997) 26 JLS 203; Schäfer/Ott, *Lehrbuch der ökonomischen Analyse des Rechts* (4th edn Springer, Berlin 2005) 393 seq.

ties are protected from any conduct which hampers the parties to exercise their free will. Prominent and classical examples are fraud and duress. Some scholars see these limitations as a restriction to the freedom of contract. Precisely the opposite is true. By not giving a contract effect in cases of fraud and duress, the classic view does indeed not protect the expressed will, but it does, however, protect the actual - and in such case relevant - free will of the betrayed party. This finding is quite obvious from a natural law and laissez-faire approach. But also from an economist point of view, it is easily comprehendible. If a party is coerced into a contract, the party isn't promoting any welfare, neither its own nor society's.

(ii) Social Justice through Contract Law? Notably, the classic view has been challenged over the last forty years from different directions. Especially philosophers of social justice[11] argue that any inequality among the contracting parties, like different levels of knowledge, competence, (financial) resources, and other, shall be challenged by contract law. The law should bring these inequalities into balance in order to bring justice to the disadvantaged party. The freedom of contract is understood a mean to promote social justice through contractual justice.[12] Courts and legislators have seized these arguments, some with great enthusiasm some with little. Classic examples are the body of rules intended to protect consumer and small private investors.

(iii) Two Limbs of the Freedom of Contract. In today's understanding, the 'freedom of contract' involves two distinct conceptions of freedom: party-freedom and term-freedom.[13] Party-freedom encompasses the freedom to positively decide to enter a contract and, hence, to select a fellow contracting party. Party-freedom also has a negative side in terms of a freedom 'from' contract. On one side, a person is - in general[14] - free to choose not

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[11] Rawls, *A theory of Justice* (OUP, Oxford 1973).

[12] For a discussion see Bigwood, *Exploitative Contracts* (OUP, Oxford 2003) 60 seq.; see also Collins, *The Law of Contract* (4th edn LexisNexis, London 2003) 16 seq.; Study Group on Social Justice in European Private Law, 'Social Justice in European Contract Law: a Manifesto' (2004) 10 Eu.L.J. 653.

[13] See for example Kimel, *From Promise to Contract* (Hart, Oxford 2003) 117 seq.

[14] In many jurisdictions providers of 'basic needs' (electricity, water, etc.) have an obligation to enter into a contract with any party who wishes to do so - see Beatson, *Anson's Law of Contracts* (28th edn OUP, Oxford 2002) 5; Peel, *Treitel, The Law of Contract* (12th

to contract when an offer is made. On another side, a person is also not bound to a contract, as mentioned earlier, in case of fraud or duress. The principle of term-freedom relates to the freedom to choose the substance of a contract without any restraints. The contracting parties aren't - as from a historical perspective - bound to certain pre-defined types of contracts, like a contract regarding the sale of goods. Parties are free to determine the subject-matter and content of their contract. By doing so, they may even 'invent' contracts. Finance and operating lease contracts are a fine example insofar. Such contracts became a distinct type contract just a century ago.

2. Contract Modification

As already mentioned, the issues surrounding the modification of contracts are barely visible among today's legal scholarly work.[15] This isn't only true for English but also for German law. This reluctance is quite surprising because the modification of contract holds some distinctive features. These are important for the understanding of the modification of contracts in the vicinity of duress.

a) Starting Point: Pacta sunt servanda (Sanctity of Contract)

(i) General. Closely linked with the concept of freedom of contract, as wells as the concept of contract modification, is yet another principle: the sancti-

edn Sweet & Maxwell, London 2007) 1-004. There are further exceptions to freedom of contract - see Chitty, *The Law on Contracts,* Volume I (29th edn Sweet & Maxwell, London 2004) 1-013 seq.

[15] A brief assessment is found by Chitty, *The Law on Contracts,* Volume I (29th edn Sweet & Maxwell, London 2004) 3-039.

ty of contracts.[16] It rests on the consideration that once a contract is 'freely and voluntarily entered into, it should be kept sacred'[17].

Contracting parties, businesspeople in particular, are concerned that the other party sticks to his promise made when entering into the contract. Apparently, contracting parties are also concerned that there are very few ways which allow the other party to get away from his contractual obligations. The (economic) reason for this is clear. Nobody would enter into a contract, if the other party wouldn't be bound to the terms agreed.[18] Therefore, English[19] and German[20] contract law have been quite reluctant to admit excuses for non-performance. The doctrine of frustration[21], as well as its German equivalent, the doctrine of Störung der Geschäftsgrundlage[22], indeed asserts that the parties are relieved from their contractual obligation

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16 Parry, *The Sanctity of Contracts in English Law* (Stevens & Son, London 1959); Chitty, *The Law on Contracts,* Volume I (29th edn Sweet & Maxwell, London 2004) 1-017; Atiyah, *An Introduction to the Law of Contract* (3rd edn Clarendon Press, Oxford 1981) 12 seq.; Weller, *Die Vertragstreue* (Mohr Siebeck, Tübingen 2009) 118 seq. (English contract law from a German perspective); Lorenz, *Der Schutz vor dem unerwünschten Vertrag* (C.H.Beck, München 1997) 28 seq.; from a historical perspective Zimmermann, *The Law of Obligation, Roman Foundations of the Civilian Tradition* (1st edn, C.H.Beck 1992), 576 seq.

17 Atiyah, *An Introduction to the Law of Contract* (3rd edn Clarendon Press, Oxford 1981) 12; *Pao On v Lau Yiu* Long [1980] AC 614, 634 per Lord Scarman '[...] justice requires that men, who have negotiated at arm's length, be held to their bargains unless it can be shown that their consent was vitiated by fraud, mistake or duress.'.

18 Jhering, *Der Zweck im Recht*, Volume 1, (3rd edn Breitkopf & Härtel, Leipzig 1893) 265 stresses the guarantee which comes with the promise of the contracting parties to perform.

19 See above footnote [16].

20 See above footnote [16].

21 For an overview of this doctrine see Chen-Wishart, *Contract Law* (3rd edn OUP, Oxford 2010), 315 seq.

22 Sec. 313 par. 1 Bürgerliches Gesetzbuch (BGB, German Civil Code) reads 'If circumstances which became the basis of a contract have significantly changed since the contract was entered into and if the parties would not have entered into the contract or would have entered into it with different contents if they had foreseen this change, adaptation of the contract may be demanded to the extent that, taking account of all the circumstances of the specific case, in particular the contractual or statutory distribution of risk, one of the parties cannot reasonably be expected to uphold the contract without alteration.'; RGZ 99, 115 (116).

to perform.[23] Though, these doctrines are very limited in their scope and apply only in fundamental events of a fundamental and crucial character.[24]

Notably, there are some critics of sanctity of contract. A more fundamental opposition is articulated by American legal realist Holmes: 'The only universal consequence of a legally binding promise is that the law makes the promisor pay damages if the promised act doesn't come to pass'[25]. The second opposition comes from scholars who argue that common law and, in particular, equity have come up with doctrines which override the sanctity of contracts such as fraud, misrepresentation, mistake, duress (including economic duress), undue influence, and unconscionability.[26] The opposing views bear some truth but come in short. First, sanctity of contract is indispensable for the normative character of a contract as the consensual agreement among two persons. Second, sanctity of contract is based on a validly entered contract.[27]

(ii) Sanctity and Contract Modification. What does sanctity of contracts imply for the modification of contracts? The above assessment has revealed that the sanctity of contracts chains each contracting party to the contract. None of the parties is, in general, able to unilaterally change the contractual right and obligations. From this follows that any modification of a contract, be the modifications narrow or wide in scope, has to be made bilateral. Not just the seller or the buyer can change the contractual terms of a

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[23] For a comparative analysis Hammer, *Frustration of contract, Unmöglichkeit und Wegfall der Geschäftsgrundlage - ein Vergleich der Lösungsansätze englischer und deutscher Rechtsprechung* (Duncker & Humblot, Berlin 2001).

[24] *White and Carter (Councils) Ltd. v. McGregor* [1962] AC 413; *Davis Contractors v Fareham Urban DC* [1956] AC 696.

[25] Holmes, *The Common Law* (reprint Cambridge/Massachusetts 1963) 236.

[26] Beatson, *Anson's Law of Contracts* (28th edn OUP, Oxford 2002) 7. They name the well-known doctrines of fraud, misrepresentation, mistake, duress (including economic duress), and undue influence, unconscionability as examples.

[27] See *Pao On v Lau Yiu* Long [1980] AC 614, 634 per Lord Scarman '[...] justice requires that men, who have negotiated at arm's length, be held to their bargains unless it can be shown that their consent was vitiated by fraud, mistake or duress.'.

sales contract, both contracting have to consensually agree on any change the terms.[28]

b) Freedom of Modification

It is commonly agreed that the parties to a contract may effect a variation of their contract by amending or modifying the terms by a consensual agreement.[29]

(i) Germany. German law implicitly addresses the modification of contract in sec. 311 para 1 Bürgerliches Gesetzbuch (BGB, German Civil Code). It reads, 'In order to […] alter the contents of an obligation, a contract between the parties is necessary […]'.[30] With exception to formalities,[31] there aren't any constraints with regard to the modification of a contract. Parties may rescind the original contract and enter into a new contract. They may also continue the original contract while altering some of the original contractual terms. When the parties' intentions are doubtful, there is no default rule regarding the contractual continuity or discontinuity.

(ii) England. In English contract law, there seems to be no question about the general admissibility of a contract modification.[32] [33] In *Fenner v. Blake*[34]

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[28] Chitty, *The Law on Contracts,* Volume I (29th edn Sweet & Maxwell, London 2004) 22-032 'by mutual agreement'.

[29] See Art 1:107 of the European Principles of Contract Law and the corresponding commentary; from an English perspective see for example Collins, *The Law of Contract* (4th edn LexisNexis, London 2003) 341 seq.; Chitty, *The Law on Contracts,* Volume I (29th edn Sweet & Maxwell, London 2004) 22-032 seq.

[30] Besides contract modification German statute law provides for a novation (substitution of an existing contract by a new contract) - for details see Gernhuber, *Das Schuldverhältnis* (Mohr Siebeck, Tübingen 1989) 609 seq.; Lehmann, *Recht der Schuldverhältnisse* (15th edn Mohr Siebeck, Tübingen 1958) 185 seq.

[31] Where the original contract had to be in a written form courts have shown a tendency to require the same formality for the contract modification - Löwisch, in *Staudinger BGB* (de Gruyter, Berlin 2004) § 311 para 61 seq.

[32] Chitty, *The Law on Contracts,* Volume I (29th edn Sweet & Maxwell, London 2004) 22-032 seq.; Halson, 'The Modification of Contractual Obligations' [1991] 44 CLP 111; Halson, *Contract Law* (Harlow, Longman 2001) 325 seq.; Collins, *The Law of Contract* (4th edn LexisNexis, London 2003) 341; Chen-Wishart, *Contract Law* (3rd edn OUP, Oxford 2010) 141 seq.

[33] There is, like under German law, some hesitation about the formalities of the variation of a contract Chitty, *The Law on Contracts,* Volume I (29th edn Sweet & Maxwell, Lon-

where a tenant and a landlord had agreed on the modification of a contractual termination clause, Channell J noted 'It is by no means uncommon for a landlord and tenant to agree […] to a variation of the terms of an existing tenancy, such as an alteration in the amount of the rent. […] And if an agreement as to an alteration of the rent may be made […], why may not equally an agreement as to an alteration of the date at which the tenancy is to be determinable?'.

The principal question of contract modification remains a matter of discussion: the interaction with the consideration doctrine, namely the pre-existing duty rule[35]. According to this rule, parties may consent on the modification of a contract ("a pre-existing duty") in a way that can possibly benefit either party.[36] This is because such modification generates its own consideration. If the parties consent in a way that only one party benefits from the modification of a contract, it is questionable if there is any consideration. Two sets of cases are of feasible relevance: cases where a party promises more than originally agreed ('the-same-for-more') and cases where a party agrees to get less than originally agreed ('less-for-the-same').

Authority for the 'same-for-more-cases' was, for a long time, *Stilk v. Myrick*[37], which concerned a higher pay by the master to his crew members. The court, narrowing freedom of contact, ruled against the modification of the pay for want of consideration.[38] About a century later, the Court of

don 2004) 22-033. If a subsequent agreement manifestly demonstrate the parties' intention to modify (However far-reaching this modification may be) the terms of the original contract while not extinguishing the original contract, the modification doesn't have to fulfill the formalities of the original contract.

[34] [1900] 1 QB 426.

[35] Chitty, *The Law on Contracts,* Volume I (29th edn Sweet & Maxwell, London 2004) 22-035; for more details on the pre-existing duty rule see Chen-Wishart, *Contract Law* (3rd edn OUP, Oxford 2010) 138 seq.; for an (critical) US-American view see Farnsworth, *Farnsworth on Contracts*, Volume I (3rd edn Aspen, New York 2004) 520 seq.

[36] *WJ Alan & Co Ltd v EI Nasr Export &Import Co* [1972] 2 Q.B. 189. This is because such a variation generally generates its own consideration.

[37] (1809) 2 Campbell 317 = 170 E.R. 1168.

[38] This reasoning was given in Campbell's Law Report [1809] 2 Campbell 317 (as is found in Westlaw UK). According to the Espinasse Law Report (170 E.R. 1168) the claim failed on the ground of public policy: the law of a maritime nation like England can't give seaman any incentives to coerce the ship master.

Appeal took in *Williams v. Roffey Brothers & Nichols*[39], a more pragmatic approach to the pre-existing rule. In this case, the court ruled in favour of the claimant who was promised an additional sum on the timely completion of carpentry work. In essence, *Williams v. Roffey Brothers & Nichols* proposes that a contract modification which confers at least some additional practical benefit, even it is only the timely completion of promised work, is supported by some consideration. The traditional authority for the 'less-for-the-same-cases' is *Foakes v. Beer*[40], where the defendant's promise to abandon her claim for interest was held to be unenforceable for want of consideration. The controversial decision still hinders the courts to come to pragmatic and viable rulings.[41] It is common sense that a bird in the hand is worth more than a bird in the bush. So why is an agreement to receive parts of a promised sum only enforceable by a consideration? Not surprisingly, courts have tried to circumvent the application of the consideration doctrine by stretching the notion of 'benefit'[42] or relying on promissory estoppel[43].[44]

The analysis of the pre-existing duty rule in the vicinity of a contract modification reveals the changed relationship among the doctrine of consideration and the doctrine of economic duress. While in former times, the former doctrine watch over for seriousness of an agreement, the doctrine of economic duress has taken over the gatekeeper function. It decides on the enforceability of contracts modifications.

(iii) Further Implications of Contract Modification. Advocates of the law and economics movement have contributed some useful thoughts.[45] It is stated

[39] [1991] 1 QB 1 (CA).

[40] [1881-5] All ER 106.

[41] See for example *Re Selectmove* [1995] 2 All ER 531 and *Ferguson v. Davis* [1997] 1 All ER 315.

[42] *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130.

[43] *Combe v Combe* [1951] 2 KB 215.

[44] Ulyatt, 'Should Consideration be Required for the Variation of Contracts?' (2000-2003) 9 AULR 883, 900 provides alternatives for the consideration doctrine; see also Collins, *The Law of Contract* (4th edn LexisNexis, London 2003) 314 seq.; Halson, 'The Modification of Contractual Obligations' (1991) 44 CLP 111, 113 seq.

[45] Jolls 'Contracts as bilateral Commitments: A new Perspective on Contract Modification' (1997) 26 JLS 203; Aivazian/Trebilcock/Penny, 'The Law of Contract Modifica-

that parties recognize their bounded rationality regarding future contingencies. Parties therefore generally value the possibility of future contract modifications.[46] Furthermore, the admissibility of contract modification gives way to gap-filling renegotiations. This can save pre-contractual negotiations costs by entering into simpler and, hence, faster drafted contracts. But there may also be some less positive aspects of contract modification. If contract parties anticipate future renegotiations, they may not respect the terms of the original contract which then cannot fulfil its behaviour guiding function.[47] Thus, it is suggested that parties can mutually agree on enforceable clauses which constrain renegotiation.[48] Examples for an expedient application of such clauses is given by Eggleston/Posner/Zeckhauser: A company won't locate a power plant at the entrance of a coal mine if the mine can hold it up by demanding a higher price or take its business elsewhere in the future, and the company cannot obtain an adequate remedy from a court.[49] Insofar, contractual clauses constraining the modification of contracts may be seen as a means to prevent the abuse of bargaining power and, thus, the use of economic duress while negotiating the modification of a contract.

3. The 'Reality' of Contractual Consent

Finally, some words have to be said about the reality of consent in the vicinity of contractual agreements. This reality is valid for entering into a

tions: The uncertain Quest for a Benchmark of Enforceability' (1984) 22 Osgoode Hall L.J. 173.

[46] For an overview see Eggleston/Posner/Zeckhauser, 'The Design and Interpretation of Contracts: Why Complexity matters' (2000-2001) 95 NWULRev 91, 122 seq.

[47] Milgrom/Roberts, *Economics, Organisation and Management* (1st edn Prentice Hall, Englewood Cliffs 1992), 127; Eggleston/Posner/Zeckhauser, 'The Design and Interpretation of Contracts: Why Complexity matters' (2000-2001) 95 NWULRev 91, 123.

[48] Eggleston/Posner/Zeckhauser, 'The Design and Interpretation of Contracts: Why Complexity matters' (2000-2001) 95 NWULRev 91, 123; Jolls 'Contracts as bilateral Commitments: A new Perspective on Contract Modification' (1997) 26 JLS 203; according to Hau, *Vertragsanpassung und Anpassungsvertrag* (Mohr Siebeck, Tübingen 2003) 55 such clauses are inadmissible under German law.

[49] Example taken from Eggleston/Posner/Zeckhauser, 'The Design and Interpretation of Contracts: Why Complexity matters' (2000-2001) 95 NWULRev 91, 123.

contract in the first place, but also for a subsequent modification of contract.

The classic view of freedom of contract is strongly identified with the idea of equality of opportunities.[50] Each individual has the same opportunity to enter into any kind of contract with any person whatsoever in order to achieve the self-defined objectives in life. Hence, the achievement of these objectives depends upon one's merit. This seems to differ from social order. Status, rank, education, knowledge, experience, but also race, religion and gender are characteristics which may determine the way every one's life goes, the way every one is bargaining.

The classic view is accused of focusing on the theoretical equality and not taking account of the described actual differences in human characteristics.[51] It is argued that the initial inequalities in characteristics inevitably lead to inequalities in the outcome of the contract. There are some opposing thoughts to this argument. First of all, the named characteristics aren't inequalities they are just characteristics of autonomous individuals. Second, just a few of the named characteristics are inborn, like race or gender. The majority of them are, by nature, rather open to change. Third, not every difference in human characteristics can be and must be equalized. Summarizing, the described characteristics are a natural feature of human individuals, of human existence. And so it must be of bargaining and of bargains.[52]

Moreover, the way human individuals are bargaining doesn't depend solely on certain human characteristics. There are also external factors which take effect on the bargaining process. A representative factor is insofar the condition of the relevant bargaining market.[53] In a buyer's market, a buyer of usually little bargaining strength may be able to get a usually strong seller to agree on individual terms instead of the seller's standard terms. In a

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50 Chen-Wishart, *Contract Law* (3rd edn OUP, Oxford 2010) 15.

51 Chen-Wishart, *Contract Law* (3rd edn OUP, Oxford 2010) 14.

52 Hale, 'Bargaining, Duress, and Economic Liberty' (1943) 43 Colum.L.Rev. 603; Bigwood, 'Coercion in Contract: The Theoretical Constructs of Duress' (1996) 46 UTLJ 201, 201

53 Peel, *Treitel, The Law of Contract* (12th edn Sweet & Maxwell, London 2007) 1-004.

seller's market a buyer will tend to agree to any terms which are provided by the seller. These conjunctions aren't artificial they are a product of commonly accepted competition for limited resources.

Yet, there are undoubtedly limits to the use of strength in bargaining; a strength which may result from different human characteristics and external factors. The limits are clear-cut in some areas like the capacity of the contracting parties, tenancy law, employment and consumer law.[54] They are visible in other areas like misrepresentation. Though, there are areas where the limits of the use of bargaining strength are more or less blurry. It is generally the burden of the doctrine of economic duress to draw the line between illegitimate commercial pressure, hence economic duress, and ordinary legitimate commercial pressure.

III. The Coerced Contract Modification under German Law

1. Introduction

A doctrine or a concept of economic duress in itself is unknown to German law.[55] German law deals, as many civil law countries do, with economic duress under statutory law. The relevant provision is primarily[56] § 123 BGB[57]. Paragraph 1 of § 123 BGB reads: 'A person who has been induced to make a declaration of intent by deceit or an illegitimate threat may avoid his declaration.' Following German law tradition, the remarks below concentrate on the interpretation and understanding of § 123 BGB by case law

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54 A short enumeration of examples provides Peel, *Treitel, The Law of Contract* (12th edn Sweet & Maxwell, London 2007) 1-005.

55 For a detailed view on the topic see Lorenz, *Der Schutz vor dem unerwünschten Vertrag* (C.H. Beck, München 1997) and Schindler, *Rechtsgeschäftliche Entscheidungsfreiheit und Drohung* (Mohr Siebeck, Tübingen 2005) - both with further references.

56 Some of the cases of economic duress may fall also under § 138 BGB which shows similarities with the doctrine of undue influence - see Dawson, 'Economic Duress and the Fair Exchange in French and German Law' (1937) 12 TulLawRev 42.

57 Bürgerliches Gesetzbuch [Civil Code] - a translation can be found under www.gesetze-im-internet.de/englisch_bgb/index.html (accessed 1 September 2010).

and legal scholars. The focus is on economic duress in general and in relation to contract modification in particular.

2. Threats in General

(i) Introduction. The notion of 'threat' is conventionally interpreted as proclamation of a future disadvantage (serious wrong) whose incidence is manageable or at least appears to be manageable by the threatening person.[58] The proclamation may not only be by explicit but also by hidden or implied conduct.[59] It is stated that the perception of the conduct as a threat depends solely on the (subjective) view of the threatened party. Thus, there may be a threat despite the lack of seriousness on the side of the threatening person. It is generally agreed that the level of the threat's severity is irrelevant for the constitution of a threat. However, the threat's severity plays an important role for the threat's causation.

(ii) Desperate Situations of the contracting party. There is also no threat when somebody is only taking advantage of an already existing desperate situation of somebody else.[60] The Bundesgerichtshof has stated repeatedly that such taking advantage is no threat in the meaning of § 123 BGB.[61] In addition, the court has stressed - while opposing other views[62] - that the concept of § 123 BGB doesn't intend to protect the declaration of one's free

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58 BGHZ 2, 287, 295; BGHZ 6, 348, 351; Hau, *Vertragsanpassung und Anpassungsvertrag* (Mohr Siebeck, Tübingen 2003) 124; Flume, *Allgemeiner Teil des Bürgerlichen Rechts*, Volume 2, (4th edn Springer, Berlin 1992) 534.

59 RG JW 1905, 200; BGH NJW 1988, 2599, 2601; Lorenz, *Der Schutz vor dem unerwünschten Vertrag* (C.H. Beck, München 1997) 349.

60 It shall be pointed out that § 138 BGB may apply in such situations. The underlying thought of § 138 BGB is similar to the doctrine of undue influence.

61 BGHZ 2, 295 = NJW 1951, 643; BGHZ 6, 348; BGH NJW 1988, 2599, 2601; Hefermehl, in: *Soergel Bürgerliches Gesetzbuch* (13th edn Kohlhammer, Stuttgart 1999) § 123 para 40.

62 Sack, 'Zur Sittenwidrigkeit von anläßlich sogenannten „Kaffeefahrten" abgeschlossenen Kaufverträgen' NJW 1974, 564, 565; ambiguous Kramer, in: *Münchener Kommentar BGB* (5th edn C.H. Beck, München 2006) § 123 para 52 seq.

will under any circumstances. Only if the coercive conduct causes[63] a desperate situation, then it can be viewed as threat.[64]

(iii) Mere Warnings and References. The distinction between threats and mere warnings of or references to possible difficulties is expounded among courts and scholars. It is obviously commonly agreed that a mere warning or reference is affirmative if an objectively existing disadvantage or future disadvantage is proclaimed and the proclaiming person purports not to have influence on the incidence of the disadvantage (any more).[65] An example for a warning is remarks during contract negations suggesting possible difficulties in case the negotiations will fail if the difficulties aren't influenceable by the acting person.[66] No threat is provided by the mere notice of an already filed criminal complained.[67]

For drawing of the borderline between threats and warnings in situations where parties renegotiate, the missing influence on the incidence of the disadvantage is seen of utmost importance. In many cases when circumstance have changed after the parties entered into the contract, the debtor will tell his creditor - this may be even true - that he is in commercial terms not able to fulfill his obligations under the primary contract unless its terms are modified. However, the debtors bears the risk of any commercially undesirably developments and the capability if his performance. Consequently, the debtors cannot legally argue in such situations that he has no influence on his future non-performance. If he could do so, the risk allocation undertaken in the primary contract would be pointless. The fact that the other party may be interested in renegotiating, for instance to prevent the other party's insolvency, isn't of relevance for the constitution of threat. It is of relevance yet to constitute causation. As long as the debtor

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63 For causation see below.

64 RG Recht 1927 Nr. 219; Kramer, in: *Münchener Kommentar BGB* (5th edn C.H. Beck, München 2006) § 123 para 45.

65 Probst, 'Defects on the Contracting Process' in: *International Encyclopaedia of Comparative Law*, Volume II, Contracts in General (Mohr Siebeck, Tübingen 2008) II-395.

66 Hefermehl, in: *Soergel Bürgerliches Gesetzbuch* (13th edn Kohlhammer, Stuttgart 1999) § 123 para 40.

67 Singer/von Finckenstein in: *Staudinger BGB* (de Gruyter, Berlin 2004) § 123 para 63; Hefermehl, in: *Soergel Bürgerliches Gesetzbuch* (13th edn Kohlhammer, Stuttgart 1999) § 123 para 40.

isn't excused for non-performance by law, any notice of non-performance may constitute a (illegitimate) threat under § 123 BGB.

(iv) Person threatening. A threat within the scope of § 123 BGB doesn't have to be conducted by the contracting party.[68] A contract may even be voidable on duress if the threat is carried out by a third person. Thus, if A threatens B so that B modifies an existing contract with C, B's contract modification with C may also be voidable.

(v) Person threatened. The proclaimed future disadvantage doesn't have to be directed to the threatened person. Hence, a threat is also constituted if the threat is directed to a person whose well-being is of importance to the relevant contract party. Thus, if A threatens B to cause a disadvantage to B's wife in order to get a modification of their contract, B's contract modification with A may also be voidable.

3. Illegitimacy of the Threat

Not every threat affecting the freedom of will of a contracting party establishes duress. Under German law, duress can only be established where the threat is illegitimate or more precisely, where the threatened party was induced illegitimately.

According to the commonly held view, the threat can be illegitimate for three reasons:[69] First, and most usually, because of the illegitimacy of the means (nature of the pressure) which are used to induce the other person. Secondly, it is because of the illegitimacy of the intended purpose (demand) pursued by the threatening person. Thirdly, and most arguably, because the used means are themselves legitimate but socially inadequate compared to the intended legitimate purpose. Social inadequacy is established if the threat fails the good faith test.[70]

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[68] Singer/von Finckenstein, in: *Staudinger BGB* (de Gruyter, Berlin 2004) § 123 para 64.

[69] Singer/von Finckenstein, in: *Staudinger BGB* (de Gruyter, Berlin 2004) § 123 para 67: Kramer, in: *Münchener Kommentar BGB* (5th edn C.H. Beck, München 2006) § 123 para 47; BGHZ 25, 217, 218 seq.; BGH LM § 123 Nr. 32.

[70] BGH 2, 287, 297; BGH NJW 384; BAG NJW 1970, 775.

a) Threat to Breach a Contract

Based on the postulation that the illegitimacy of a means which is used to induce another person provides for the illegitimacy of a threat, the threat to breach a contract in order to have the contract modified is illegitimate, unless - as pointed out before - the threatening person is excused for non-performance by law. This is the standpoint of case law[71] as well as the prevailing opinion among legal scholars[72] [73].

In RGZ 108, 102 the claimant alleged that he had entered into a contract with the defendant on the sale of 10.000 kilograms of vinegar. In contrast, the defendant alleged that he had purchased 16.000 kilograms of vinegar and made clear he wouldn't pay nothing until he would receive the entire 16.000 kilograms and sue the claimant in order have the 16.000 kilograms affirmed. Therefore, the claimant demanded a declaration by the defendant that only 10.000 kilograms of vinegar had to be delivered. The defendant, being wary he would get nothing, agreed but claimed later he was illegitimately pressured. The Reichsgericht did follow the defendant's argument. According to the court, the claimant had a right of retention and a right of declaration because he had to fear serious troublemaking by defendant.

In BGH NJW 1995, 3052, the claimant, a doctor, conducted his surgery in a rented premise. When he wanted to sell the surgery he was in urgent need of the approval of his landlord, the defendant, in order to have the lease contract to be transferred to the new buyer of the surgery. The landlord said he would agree on the transfer if he got an extra sum of 100.000

[71] RGZ 108, 102, 104; BGH WM 1983, 1017, 1019; BGH NJW 1995, 3052; OLG Jena ZIP 1996, 34; OLG Saarbrücken MDR 1999, 1313.

[72] For more details Schindler, *Rechtsgeschäftliche Entscheidungsfreiheit und Drohung* (Mohr Siebeck, Tübingen 2005) 196 seq.; Hefermehl, in: *Soergel Bürgerliches Gesetzbuch* (13th edn Kohlhammer, Stuttgart 1999) § 123 para 44; Ellenberger, in: *Palandt BGB* (68th edn C.H.Beck, München 2009), § 123 para 19; Kramer, in: *Münchener Kommentar BGB* (5th edn C.H. Beck, München 2006) § 123 para 42; Mankowski, *Beseitigungsrechte* (Mohr Siebeck, Tübingen 2003) 366 seq.; Karakatsanes, *Die Widerrechtlichkeit in § 123 BGB* (Duncker & Humblot, Berlin 1974) 43 seq.; Hau, *Vertragsanpassung und Anpassungsvertrag* (Mohr Siebeck, Tübingen 2003) 126 seq.

[73] Hau, *Vertragsanpassung und Anpassungsvertrag* (Mohr Siebeck, Tübingen 2003) 126 seq., 131 disagrees with case law and the prevailing opinion among legal scholars and proposes the application of an the 'reasonable alternative approach' of English law on duress.

Deutsche Mark. The claimant ran the risk that without the payment the transfer of the lease contract and, consequently, the proposed sale would fail. In addition, any delay in the sale would reduce the value of the surgery because of the patient leaving the surgery. Finally, the claimant couldn't have hoped that the landlord would agree in case of a different buyer. Therefore, the claimant agreed to pay the 100.000 Deutsche Mark but avoided his payment afterwards. The Bundesgerichtshof allowed the claim. The court pointed out that the defendant had no right to an extra payment under the original lease contract.

The relevance of the allocation of the contractual right for the illegitimacy is illustrated in RGZ 104, 79. In this case, the claimant had promised to deliver certain goods. When the goods where not delivered after six months, the defendant insisted on the immediate delivery. The claimant then pointed out that they hadn't agreed on a specific date for delivery. He offered to deliver the goods immediately if the defendant would agree to pay the current daily price of the delivery date (which was higher than the original price). Thereby, the claimant implicitly hinted a later delivery in case the defendant would deny the offer. The defendant agreed but later refused to pay the daily price. The court stated that the conduct of the claimant didn't constitute an illegitimate threat. It stressed the claimant's right to decide bona fides on the date of delivery under the original contract.

The brief assessment of the case reveals a wider approach to the notion of the breach of contract. Any threat with any breach of a contractual obligation is illegitimate. Consequently, the exercise of a contractual right or comments about its existence aren't illegitimate and, hence, don't amount to duress.

b) Threat to Litigate or to Use other Legal Remedies

The threat to litigate, to judicial enforce a judgment or to us another legal remedy is commonly seen as a legitimate act.[74] This is in particular true if

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[74] Kramer, in: *Münchener Kommentar BGB* (5th edn C.H. Beck, München 2006) § 123 para 42; Singer/von Finckenstein, in: *Staudinger BGB* (de Gruyter, Berlin 2004) § 123 para 75; Mankowski, *Beseitigungsrechte* (Mohr Siebeck, Tübingen 2003) 357.

the threatening person is entitled to the claim against the threatened person and could enforce the claim by litigation or other legal remedies like an injunction. It is argued that litigation is designed to pursue personal interests in cases where there is a dispute about the legal rights of the parties. A person threatened with the instigation of civil proceedings must stand in principle this threat, even if the claim is unfounded in reality.[75]

In BGH JZ 1963, 318[76] the claimant, a bank, granted a commercial loan to the defendant's wife. In order to secure the loan, the defendant gave a personal loan guarantee. The loan was later transferred to another person because of financial difficulties of the defendant's wife's business. The claimant told the defendant that he would call upon the personal loan guarantee if he isn't willing to give a personal loan guarantee with regard to the person to whom the loan was transferred. The defendant agreed in order to avoid to be called upon the first guarantee, but later avoided the agreement with regard to the 'second' guarantee. The Bundesgerichtshof didn't allow the avoidance. The court perceived that a threat had been established but that the threat itself wasn't illegitimate: Who takes an objectively fungible standpoint on a disputable legal situation and threatens to claim and enforce rights accordingly doesn't act illegitimately.[77] In BGH WM 1972, 946 the Bundesgerichtshof stated the threat to litigate against a debtor or an alleged debtor, with the intent to enforce the claim is illegitimate only if additional inappropriate circumstances are present. The courts haven't come up with clear definition of the notion 'inappropriate circumstances'. It is just pointed out that any inequitable or bad faith acting may render the threat illegitimately. However, the Bundesgerichtshof, a party's inexperience in legal matter is inter alia not such an inappropriate circumstance.[78]

[75] Flume, *Allgemeiner Teil des Bürgerlichen Rechts*, Volume 2, (4th edn Springer, Berlin 1992) 536.

[76] See Lorenz, 'Commentary to BGH JZ 1963, 318', JZ 1963, 319 seq.

[77] This was followed by BGH NJW 2005, 2766.

[78] WM 1972, 946; supported by Singer/von Finckenstein, in: *Staudinger BGB* (de Gruyter, Berlin 2004) § 123 para 75.

Legal scholars have added another thought. They have stressed the irrelevance of the factual merit of the claim which is the origin of the threat.[79] As long as the threatening person is acting in good faith concerning the claim's merit, the threat isn't illegitimate. The same is supposed to be true if the threatening person is pursuing a legitimate interest. Such an interest is provided when the modified contract presents a commercially 'appropriate development' of the parties' legal relationship.[80]

c) Threat to Initiate Insolvency Proceedings

A considerable menace, especially in a commercial context, is the threat to initiate insolvency proceedings.[81] German scholars, building on the approach of threats to litigate, perceive a threat to initiate insolvency proceedings generally as legitimate. It is accentuated that insolvency law provides a creditor with the right to initiate insolvency proceedings.[82] In BGHZ 36, 18 the Bundesgerichtshof, deciding on a action for damages incurred because of the an unjustified initiation of insolvency proceedings, stated: A creditor who uses a proceeding which is provided and well-regulated by law doesn't illegitimately intervene with the rights of the debtor, even if the creditors misjudges in the legal requirements or the debtor incurs costs when the relevant proceeding is executed. In fact, the creditor has no obligation for a due diligence of the proceeding's legal requirements and he has no obligation to weight his interests against the debtor's. The debtorsis rather supposed to be protected by the body of rules of the rele-

79 Flume, *Allgemeiner Teil des Bürgerlichen Rechts*, Volume 2, (4th edn Springer, Berlin 1992) 536.

80 Lorenz, 'Commentary to BGH JZ 1963, 318', JZ 1963, 319 seq; Singer/von Finckenstein, in: *Staudinger BGB* (de Gruyter, Berlin 2004) § 123 para 75; Karakatsanes, *Die Widerrechtlichkeit in § 123 BGB* (Duncker & Humblot, Berlin 1974) 116.

81 LG Hamburg NZI 2002, 164; AG Oldenburg NZI 2002, 391.

82 Hefermehl, in: *Soergel Bürgerliches Gesetzbuch* (13th edn Kohlhammer, Stuttgart 1999) § 123 para 53; Kramer, in: *Münchener Kommentar BGB* (5th edn C.H. Beck, München 2006) § 123 para 42; Singer/von Finckenstein, in: *Staudinger BGB* (de Gruyter, Berlin 2004) § 123 para 68; apparently disagreeing Mankowski, *Beseitigungsrechte* (Mohr Siebeck, Tübingen 2003) 361 seq.

vant proceeding.[83] For this reason, and an en passant saying in BGH NJW 2005, 2766[84], one may assume that case law understands a threat to initiate insolvency proceeding as legitimate as long as the threatening person is acting in good faith.

d) Threat to File Criminal Complaint

One of the reasons why a threat may be illegitimate is because the used means are themselves legitimate but socially inadequate compared to the intended legitimate purpose. A traditional category of such social inadequacy is the filing of an objectively justified criminal complaint if the intended goal isn't linked with the criminal action in question.

In RGZ 110, 382 the defendant had promised to deliver 20.000 kilograms of sodium sulphate. The sodium sulphate was agreed to be free of iron and acid but was in fact not. The claimant told the defendant he would file a criminal complaint because of a possible fraudulent behaviour on the defendant's side if the defendant wouldn't enter into an agreement providing for the repayment of the sales price and for the reimbursement for any cost occurred to the claimant in relation to the deal. The defendant entered into the agreement, but later refused to repay and reimburse the claimant. When the claimant sued, the defendant argued that the agreement modifying the initial contract was void because of duress. The Reichsgericht didn't follow this argument.[85] It referred to the claimant's contractual remedies resulting from the breach of contract, namely the repayment of the sales price by way of rehibitory action. The court stressed that it was sufficient that the claimant had good faith in his contractual remedies. The Bundesgerichtshof continued this judicature. In BGH WM 1963, 511, a company was under administration. The company had before entered into a contract with A at a time when A was in financial difficulties and not able to be pay the

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[83] The creditor may have to bear all the costs - see Mankowski, *Beseitigungsrechte* (Mohr Siebeck, Tübingen 2003) 363 with further references; LG Münster ZIP 1993, 1103; LG Meiningen ZIP 2000, 1451; AG Holzminden ZIP 1987, 1272.

[84] In BGH NJW 2005, 2766 the Bundesgerichtshof stated en passant that the threat to initiate insolvency proceedings is in general legitimate.

[85] Hefermehl, in: *Soergel Bürgerliches Gesetzbuch* (13th edn Kohlhammer, Stuttgart 1999) agrees with the court's reasoning.

agreed sum. The administrator told A that he would file a criminal complaint because of the fraud on A's side, if A wouldn't agree to a composition which provided for a payment by instalments. A entered into the composition agreement but later avoided it. He argued he was coerced into the agreement. The Bundesgerichtshof denied this.[86] It stated that the composition agreement was an adequate compensation for the damages received by A's fraud.

The importance of the linkage between the goal intended by the threat and the relevant criminal action reveals RG HRR 1930 Nr. 1595. In this case a company and an employee had agreed on a contractual penalty clause according to which the employee had to pay 25.000 Reichsmark for any breach of contract as far as damages wouldn't exceed this sum. When the employee fraudulently breached the contract, damage amounted to less than 25.000 Reichsmark. However, the company threatened to file a criminal complaint unless the employee would enter into an agreement formally acknowledging a payment exceeding 25.000 Reichsmark and a mortgage in favour of the company. The employee signed the agreement but later called for its avoidance. The Reichsgericht approved this argument and founded the judgement on the absence of a claim for the promises the employee gave. Furthermore, the employee's promises exceeded, by far, the company's loss.[87]

Summarizing, the threat to file a criminal complaint is legitimate if the threatening person has good faith in the justification of the criminal complaint and pursues an adequate (civil law) compensation for the criminal action in question. In addition, scholars stipulate some appropriate time for the threatened person to consider and reflect on the threat.[88]

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[86] Consenting Singer/von Finckenstein, in: *Staudinger BGB* (de Gruyter, Berlin 2004) § 123 para 71.

[87] For this argument Karakatsanes, *Die Widerrechtlichkeit in § 123 BGB* (Duncker & Humblot, Berlin 1974) 91; OLG Saarbrücken, MDR 1999, 1313 the claimant threatened to defer payment unless the defendant declare a formal recognition of debt regarding an older debt.

[88] Singer/von Finckenstein, in: *Staudinger BGB* (de Gruyter, Berlin 2004) § 123 para 71; Flume, *Allgemeiner Teil des Bürgerlichen Rechts*, Volume 2, (4th edn Springer, Berlin 1992) 537.

4. Subjective Test

Under § 123 BGB, it is commonly accepted that the motives of the threatening person are of some relevance. It is stated that the threatening person must have intended to induce the threatened person. Thereby, the threatening person must be aware of the coercive character of his action.

It is disputed among courts and scholars whether the threatening person must have been aware or negligently unaware of the illegitimacy of the threat. Case law has strongly supported this view for a long time.[89] However, the Bundesgerichtshof has pointed out that a wrong legal assessment of contractual rights and remedies (based on correct factual circumstances), which may be the tipping point for a threat, is of no relevance for establishing duress under § 123 BGB.[90] Legal scholars have opposed this.[91] They argue that § 123 BGB is claimant orientated (the threatened person) and, therefore, the autonomy of the threatened person's free will is decisive, and not any intrinsic thoughts of the person exerting the threat. However, there is no signal that case law will adopt this view.

5. Causation

a) General

Once an illegimate threat has been established, the threatened person must also have been induced to modify a contract. This is a question of another element of § 123 BGB: causation. Causation is established under § 123 BGB if the threatened person wouldn't have agreed at all without the threat or would have agreed to different terms[92] or at a different point of time[93]. It is the general understanding of case law and scholarly work that

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[89] RGZ 104, 79, 80; RGZ 108, 102, 104; RGZ 112, 226, 227; BGHZ 25, 217, 225; BGH JZ 1963, 381; BGH WM 1982, 821, 823.

[90] BGHZ 25, 217, 224; see also OLG Hamm, TranspR 1998, 160, 161 seq.

[91] For details and further references Hau, *Vertragsanpassung und Anpassungsvertrag* (Mohr Siebeck, Tübingen 2003) 128 seq.

[92] BGH NJW 1964, 811.

[93] RGZ 134, 51; BGHZ 2, 287.

the exerted threat doesn't have to the only cause.[94] It is sufficient when the threat was a contributory cause. Thereby, the time between the exertion of the threat and the induced modification of the contract is of little relevance.[95] However, the more time is passing, the more reasoning is needed to establish causation.

Most importantly, the question of causation is commonly judged from the threatened person's view. Accordingly, it doesn't matter whether a reasonable person would have been induced by the threat.[96] All what matters is whether the particular threatened person, be it a strong or a weak person, perceived the behaviour as a threat. Even a fictitious threat or a threat whose occurrence is very unlikely under the given circumstance may cause a threat.[97]

b) Causation in the Vicinity of Contract Modification

As far as can been seen, there is little discussion about the question of causation in the vicinity of contract modification in particular.[98] Hence, the general principles rule. This comes as a surprise. If causation is defined as the threatened person wouldn't have agreed at all without the threat or would have agreed to different terms[99] or at a different point of time[100], any kind of threat would have been a cause in such situation. Consequently, in the vicinity of contract modification any threat - having in mind that under

94 BGHZ 2, 287, 299 = NJW 1951, 643; BGH BB 1963, 452, 453; BGH NJW 1991, 1673, 1674; Singer/von Finckenstein, in: *Staudinger BGB* (de Gruyter, Berlin 2004) § 123 para 66; Kramer, in: *Münchener Kommentar BGB* (5th edn C.H. Beck, München 2006) § 123 para 47.

95 Singer/von Finckenstein, in: *Staudinger BGB* (de Gruyter, Berlin 2004) § 123 para 66.

96 RG JW 1929, 242; BGH NJW 1967, 1222; Hefermehl, in: *Soergel Bürgerliches Gesetzbuch* (13th edn Kohlhammer, Stuttgart 1999) § 123 para 43; Ellenberger, in: *Palandt BGB* (68th edn C.H.Beck, München 2009), § 123 para 24.

97 Kramer, in: *Münchener Kommentar BGB* (5th edn C.H. Beck, München 2006) § 123 para 47.

98 For a brief discussion see Schindler, *Rechtsgeschäftliche Entscheidungsfreiheit und Drohung* (Mohr Siebeck, Tübingen 2005) 211 seq.

99 BGH NJW 1964, 811.

100 RGZ 134, 51; BGHZ 2, 287.

German law the severity of the threat is of no relevance - any coercive behaviour would make a contract modification voidable.

In BGH WM 1974, 1023 the claimant was an employee and a limited partner of the defendant partnership. The claimant was fired by the partnership. Shortly after the termination of the employment, the contract was consensually recalled, but at the same time the claimant resigned as a limited partner and received as compensation, a very small amount of money. He then applied to court to have the agreement of his resignation as limited partner declared void on the grounds of duress. This may not be a traditional case of contract modification. However, the Bundesgerichtshof turned down the claim and reasoned his decision on the swift dealing of the claimant and the alternative to have the termination of the employment contract judicially reviewed. In another case the Bundesgerichtshof denied the claim by referring to subjective factors, namely the age, the economic independence and the legal advice the claimant had received.[101] Courts neglected these cases as far as the question of causation is concerned. Scholars apparently haven't even noticed the cases' relevance for the question of causation. With regard to the cases it is sporadically argued that causation is established if the threat has produced a coercive situation which still operated at the time when the threatened party entered into the relevant contract.[102]

[101] BGHZ 2, 287, 299.

[102] Schindler, *Rechtsgeschäftliche Entscheidungsfreiheit und Drohung* (Mohr Siebeck, Tübingen 2005) 214 seq.

IV. The Coerced Contract Modification under English Law From a Comparative Perspective

1. Introduction

While economic duress has a long history of case law and scholarly work in US-American[103], Australian[104] and Canadian[105] contract and restitution law, economic duress has been recognized as a doctrine in its own rights in English law only relatively recently. Not surprisingly, the requirements for establishing it remain a matter of some uncertainty.[106] In the following, the doctrine of economic duress and its application is analysed. Thereby, the findings from the forgoing exploration into German contract law are comparatively assessed. Furthermore, points of difference and similarities are accentuated.

2. Threats

a) General

(i) Explicit and implied Threats. The vast majority of English cases deal with situations where a party explicitly threatened to breach an existing contract, namely not to perform, or strike.[107] Because of these straightforward cases,

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[103] See for example Hale, 'Bargaining, Duress, and Economy Liberty' (1943) 43 Colum.L.Rev. 603; Dawson, 'Economic Duress - An essay in Perspective' (1947) 45 MichLawRev 253; Hillman, 'Contract Modification under the Restatement (Second) of Contracts' (1981-1982) 67 Cornell L. Rev. 680; Mather, 'Contract Modification under Duress' (1982) 33 S.C.L.R. 615; Farnsworth, *Farnsworth on Contracts*, Volume I (3rd edn Aspen, New York 2004) 501 seq.

[104] See the authority *Smith v William Charlick Ltd.* [1924] 34 CommwLR 38; for a reconsideration Bigwood, 'Coercion in Contract: The Theoretical Constructs of Duress' (1996) 46 UTLJ 201, 231.

[105] *Knutson v The Bourkes Snydicate [*1941] S.C.R. 419; for a review of the case Sutton, 'Duress by Threatened Breach of Contract' (1974) 20 McGill L.J. 554, 561; Ogilvie, 'Economic Duress in Contract: Departure, Detour or Dead-End', (2001) 34 CanBusLJ 194.

[106] Virgo, *The Principles of the Law of Restitution* (2nd edn OUP, Oxford 2006) 198.

[107] For an similar evaluation Chen-Wishart, *Contract Law* (3rd edn OUP, Oxford 2010) 348; for an evaluation of the leading cases Bigwood, 'Coercion in Contract: The Theoretical Constructs of Duress' (1996) 46 UTLJ 201, 238 seq.

case law hasn't produced an exhaustive definition of what may constitute a threat and what may not.[108] Furthermore, scholars haven't discussed the issue in detail. However, *B&S Contracts and Design v Victor Green Publications*[109] demonstrates that a threat can also be implied. In *B&S Contracts and Design v Victor Green Publications*[110], the claimant had entered into with the defendant promising to erect stands which were to be used for a trade exhibition. The claimant's workers went on strike and demanded extra pay (GBP 9.000) to which they were contractually not entitled. The claimant offered them GBP 4.500 but the workers insisted on the full amount. The claimant then indicated the defendant that he would have to cancel the contract unless the defendant paid the remaining GBP 4.500, not as an advance on the contract price but as an additional sum to meet the workers' demands. The defendant paid the sum but later deducted it from the originally agreed contract price and avoided the second agreement because of economic duress. The claimant's indication to the defendant was made without any specific demands but was held as an implied threat by the Court of Appeal. As Eveleigh L.J. put it: 'There was here, as I understand the evidence, a veiled threat although there was no specific demand [..]'[111].

(ii) Threats and Warnings. The line between a threat and a mere warning is very narrow as *Williams v. Roffey*[112] hints. In this case, which was landmark decision in area of consideration and duress,[113] the performance by the claimant was delayed by some financial difficulties on his side. The defendant, being simply informed by the claimant about these circumstances, became worried about a contractual penalty he had promised to another person. Because of this, the defendant offered the claimant an extra sum in order to have the work done in time. The court denied the claim. It was

[108] For a more detailed assessment see Beatson, *The Use and Abuse of Unjust Enrichment* (reprint Oxford University Press, Oxford 2002) 118 seq. and Schindler, *Rechtsgeschäftliche Entscheidungsfreiheit und Drohung* (Mohr Siebeck, Tübingen 2005) 154 seq.

[109] [1984] I.C.R. 419 CA.

[110] [1984] I.C.R. 419 CA.

[111] [1984] I.C.R. 419, 424 CA.

[112] *Williams v. Roffey* [1991] 1 QB 1.

[113] See for example Carter/Phang/Poole, 'Reactions to Williams v Roffey' (1995) 8 JCL 248.

held the information about the financial difficulties and, hence, the possible breach of contract, didn't amount to a threat.[114]

Different tests are suggested by scholars in order to define the line between threats and warnings. Beatson points to principles of economic tort law, namely the 'lack-of-control' criteria known form intimidation.[115] In an early work, Birks took a similar approach.[116] He distinguished mere warnings from threats where the defendant was simply informing the claimant about circumstances which were not of his own making. Smith, in contrast, seems to stress the intention of the defendant when he states: 'A threat is a proposal to bring about an unwelcome event unless the recipient of the proposal does something (e.g., enter a contract), where the proposal is made because the event is unwelcome and *in order to induce the recipient* to do the thing requested'.[117]

(iii) Duress and Third Parties. The question of third parties exerting pressure was apparently never raised in any reported case. Virgo argues that it should be of no relevance that duress came from a third party.[118] For this he stresses the coercion of the claimant's freedom of choice to transfer a benefit to the defendant.[119]

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114 *Williams v Roffey* [1991] 1 QB 1, 16: 'There is no finding, and no suggestion, that in this case the promise was given as a result of fraud or duress.' per Glidewell LJ; see also Chen-Wishart, 'Consideration: Practical Benefit and the Emperor's New Clothes', in: *Good Faith and Fault in Contract Law* (Clarendon, Oxford 1995) 123, 145.

115 Beatson, *The Use and Abuse of Unjust Enrichment* (reprint Oxford University Press, Oxford 2002) 118 seq.

116 Birks, *An Introduction to the Law of Restitution* (Oxford, Clarendon 1985) 183; Birks, 'The Travails of Duress' (1990) LMCLQ 342, 346 later stated that a distinction may be 'too fine and to easily abused".

117 Smith, 'Contracting under Duress: A Theory of Duress' (1997) 56 CLJ 343, 346 [italicized by the author].

118 Virgo, *The Principles of the Law of Restitution* (2nd edn OUP, Oxford 2006) 195.

119 According to Virgo, *The Principles of the Law of Restitution* (2nd edn OUP, Oxford 2006) 195 seq. any actual or constructive notice by the defendant is of relevance for his liability to make restitution.

b) Comparative Assessment

English and German law has dealt with different impetus with the question what constitutes a threat. German law, rooted in the Roman law tradition, has taken a quite dogmatic approach by trying to define exactly the notion of threat. Despite this special effort, there seems to be a general understanding about the perception of threats. First, pressure by threats cannot only be exerted in a direct way, but also in a more subtle, implied way. Second, there is a distinction to be made between threats and mere warnings. The criteria for distinguishing the two are subject to an intensive discussion in England, as well as in Germany. *Williams v. Roffey*[120] and Beatson's 'lack-of-control' criteria convincingly show that a notice or indication, of facts, which aren't influenceable by the 'threatening' person and which is given without making a specific demand, is rather a warning than a threat. Third, where a third person threatens the claimant in order to induce him to transfer benefits to another party the doctrine of duress may also be applied.

Notably, the assessment of what constitutes a threat is quite difficult as case law and scholarly work show. The reason for this, inter alia, is that in the area of economic duress the threat is so closely related and enmeshed with the criteria which are traditionally primarily applied, namely illegitimacy and causation, that the finding a clear-cut definition for threat is unfeasible. Instead of trying to exactly define the notion, the focus should be shifted to illegitimacy and causation.

3. Illegitimacy of the Threat

In *Barton v. Armstrong*[121] Lord Wilberforce and Lord Simon of Glaisdale said '[...] for in life, including the life of commerce and finance, many acts are done under pressure, sometimes overwhelming pressure, so that one can say that the actor had no choice but to act. Absence of choice in this sense doesn't negate consent in law: for this the pressure must be one of a kind

[120] *Williams v. Roffey* [1991] 1 QB 1.

[121] [1976] AC 104.

which the law doesn't regard as *legitimate*. [...]'[122]. What the Lords described is the intractable question of economic duress: What makes a threat illegitimate?

a) Starting point: The reasoning in The Universe Sentinel

The brief history of economic duress and, hence, the uncertainty about its application may be the reason why the illegitimacy of the threat hasn't been discussed much analytically in most reported cases. A slight exception is the *Universe Sentinel*[123]. Obiter dicta, the House of Lords consented to the principle of illegitimacy. Speaking for the majority, Lord Diplock identified the illegitimacy of the performed pressure as the juridical basis of economic duress. Lord Scarman, who gave a dissenting opinion, relied his reasoning on his judgement in *Pao On v Lau Yiu Long*[124] and addressed, inter alia, the illegitimacy of the threat. According to Lord Scarman the illegitimacy '[...] depends on whether the circumstances are such that the law regards the pressure as legitimate. In determining what is legitimate, two matters may have to be considered. The first is as to the nature of the pressure. In many cases, this will be decisive, though not in every case, and so the second question may have to be considered, namely, the nature of the demand which the pressure is applied to support.'[125]. In short, the (i) nature of the pressure and (ii) the nature of the demand to which the pressure is applied are supposed to be the decisive factors for the illegitimacy of a threat. This general approach was apparently supported by later decisions like *The Evia Luck*[126] and *DSND Subsea Ltd*[127]. In *R v Attorney General of England and Wales*[128] the Privy Council (New Zealand) explicitly stated: 'Wheth-

[122] [1976] AC 104, 121D [italicized by the author].

[123] Universe Tankships Inc of Monrovia v International Transport Workers Federation (The Universe Sentinel) [1983] 1 AC 366.

[124] [1980] AC 614.

[125] [1983] 1 AC 366, 401.

[126] [1992] 2 AC 152.

[127] [2000] WL 1741490.

[128] [2003] UKPC 22.

er the pressure was legitimate depended on the nature of the pressure and the nature of the demand that it was applied to support.'[129]

b) Supplemental Criteria: What else?

As pointed out earlier, case law hasn't analytically discussed the idea of illegitimacy. Instead, courts have typically relied on the particular circumstances of the case. They assembled a collection of different criteria which have been identified by courts to be decisive on the threat's illegitimacy. Scholars have joined in the quest and added further. What seems commonly agreed is (with some exceptions)[130] that a threat to breach a contract doesn't automatically constitute illegitimacy of the threat. There have to be supplemental factors.[131]

(i) Bad Faith. It is suggested to apply some kind of a bad-faith-test. According to Birks, a threat is illegitimate if it was 'intended to exploit the plaintiff´s weakness rather than to solve financial or other problems of the defendant'.[132] One decision which obviously supports the bad-faith-test is *D & C Builders Ltd v Rees*[133]. Lord Denning and Danckwerts LJ held that the defendants had acted inequitably in intimidating the claimants. Although the defendant were able to pay at least part of the agreed sum and knew the claimants' need for the money to fend off bankruptcy, the defendant threatened to pay nothing unless the claimants would accept a small sum as originally agreed. Danckwerts LJ's stated: 'The Rees really behaved very badly. They knew of the plaintiffs' financial difficulties and used their awkward situation to intimidate them.'[134] Likewise, Goff and Jones refer to the possible relevance of the threatening person not believing that the

[129] [2003] UKPC 22 H7.

[130] Virgo, *The Principles of the Law of Restitution* (2nd edn OUP, Oxford 2006) 206 apparently opposes the concept of illegitimacy (in favour of the coercion of will theory).

[131] See for instance *Pao On v Lau Yiu* Long [1980] AC 614, 635 where relief was refused on the ground that there had been 'commercial pressure but no coercion'; Halson, *Contract Law* (Harlow, Longman 2001) 343.

[132] Birks, *An Introduction to the Law of Restitution* (Oxford, Clarendon 1985) 183.

[133] [1966] 2 QB 617.

[134] *D & C Builders Ltd v Rees* [1966] 2 QB 617, 626.

threat, if carried out, could pass as a breach of contract.[135] There is some support of his approach in *Huyton v Peter Cremer*[136]. There Mance J didn't dismiss this test, although he considered its significance to be contentious: 'The law will of course be cautious about re-opening an apparent compromise made in good faith on both sides. [...] But it seems, on the one hand, questionable whether a 'compromise' achieved by one party who doesn't believe that he had at least an arguable case is a compromise at all - though it may be upheld if there is other consideration [...] and, on the other hand, difficult to accept that illegitimate pressure applied by a party who believes bona fide in his case could never give grounds for relief against an apparent compromise.'

(ii) Substantive Fairness and other Commercial Factors. There are some approaches which relate to the substance of the modified contract. Burrow has brought forward the thought that the threat's illegitimacy may be decided in the substantive fairness of the terms put forward by the threatening person.[137] If the terms of the contract are substantially unfair, the threat will be considered as illegitimate. Halson[138] and Burrow[139] have suggested considering the commercial circumstance of the coercive demand to modify the contract when deciding on the illegitimacy of the threat. In *Huyton v Peter Cremer*[140], Mance J criticised this approach 'Another commentator [...] has suggested concept of legitimacy is open to some flexibility or at least qualification, so that a threatened or actual breach of contract may not represent illegitimate pressure if there was a reasonable commercial basis for the threat or breach, e.g. because circumstances had radically changed. This suggestion, too, is by no means uncontentious.' Notably, the latter approach is very close to doctrine of frustration.

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[135] Goff/Jones, *The Law of Restitution* (6th edn Sweet & Maxwell, London 2002) 10-027 seq.

[136] *Huyton v Peter Cremer* [1999] 1 Lloyd's Rep 620, 637 = [1999] C.L.C. 230.

[137] Burrow, *The Law of Restitution* (2nd edn Butterworths LexisNexis, London 2002) 232.

[138] Halson, *Contract Law* (Harlow, Longman 2001) 343 seq.

[139] Burrow, *The Law of Restitution* (2nd edn Butterworths LexisNexis, London 2002) 232 seq.

[140] *Huyton v Peter Cremer* [1999] 1 Lloyd's Rep 637 [1999] C.L.C. 230.

(iii) Lawful Act Duress. In *Universe Sentinel*[141] Lord Scarman has pointed out that there may be illegitimate threats even if there is a lawful behaviour: 'Duress can, of course, exist even if the threat is one of lawful action: whether it does so depends upon the nature of the demand. Blackmail is often a demand supported by a threat to do what is lawful, e.g. to report criminal conduct to the police. In many cases, therefore, 'What [one] has to justify isn't the threat, but the demand ... ': see per Lord Atkin in *Thorne v. Motor Trade Association* [1937] AC 797 , 806.'[142] This view was recently explicitly supported by the Privy Council (New Zealand) in R *v Attorney General of England and Wales*[143] but has some critics[144] about its scope.

c) Comparative Assessment

In *Universe Sentinel*[145] Lord Scarman convincingly pointed out that the illegitimacy of a threat must be examined from two aspects: (1) the nature of the pressure and (2) the nature of the demand which the pressure is applied to support. This test for illegitimacy, which was recently held up by the Privy Council, exhibits strong and visible links to the approach German law takes in this issue.

Regarding the more detailed and thoroughly assessment of 'the nature of the pressure' and 'the nature of the demand' both English and German law still lack clarity and, hence, legal certainty. Court and scholars of both jurisdictions have tried to find a clear-cut solution, a straightforward test to identify the illegitimacy of a threat. Thereby similar supplemental criteria have been assessed and applied: bad faith, bona fide, lawfulness of the breach of contract, knowledge of any unlawfulness to name a few. Furthermore, both jurisdictions deny an automatism between a lawful threat

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141 *Universe Tankships Inc of Monrovia v International Transport Workers Federation* (The Universe Sentinel) [1983] 1 AC 366.

142 [1983] 1 AC 366, 401; see also R v A-G of England and Wales [2003] UKPC 22.

143 [2003] UKPC 22 H6 'On the other hand, the fact the threat was lawful would not necessarily make the pressure legitimate if the demand was not.'.

144 See for example Beatson, *The Use and Abuse of Unjust Enrichment* (reprint Oxford University Press, Oxford 2002) 129 seq., 134 with an in-depth discussion.

145 *Universe Tankships Inc of Monrovia v International Transport Workers Federation* (The Universe Sentinel) [1983] 1 AC 366.

and a legitimate threat. The mere fact that a threat is lawful doesn't necessarily make the threat legitimate. Regarding the question whether a threat to breach a contract is illegitimate or not, English and German law generally see such threats as illegitimate if there is no legal reason for breach.

However, it appears that German law has accepted that there isn't a single clear-cut solution, and that there isn't a single straightforward test to identify the illegitimacy of a threat. The named factors aren't to be applied singularly, they are to be applied side-by-side. Hence, in some cases, several or all factors may be decisive for the illegitimacy of the threat. In other cases just one of the factors may be decisive. Burrow apparently supports this view when saying 'It has to be accepted, however, that no test can reconcile all the English cases [...]'.[146]

There is one final point. It appears English courts are a little more reluctant to an ex-post control of contracts in the vicinity of economic duress. This is in terms of entering into a contract as well as of the substance of a contract. As Mance in *Huyton v Peter Cremer*[147] put it: 'The law will of course be cautious about re-opening an apparent compromise made in good faith on both sides.' This is appealing.

4. Causation

The question of causation, which is about the intensity of the connection between the pressure employed by the threatening party and the (re)action by the other party, has itself never been in the spotlight in English law. The causation has rather been mixed with other criteria which were given a more prominent place like the question for reasonable alternative. The following remarks try to separate the relevant issues of causation.

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[146] Burrow, *The Law of Restitution* (2nd edn Butterworths LexisNexis, London 2002) 234; this appears to be also the view of Goff/Jones, *The Law of Restitution* (6th edn Sweet & Maxwell, London 2002) 10-027.

[147] *Huyton v Peter Cremer* [1999] 1 Lloyd's Rep 620, 637 = [1999] C.L.C. 230.

a) The 'but-for' Test

In *Barton v Armstrong*[148], a case of duress to the person, the Privy Council accepted 'a-cause' test to establish duress: '[..] the illegitimate means used was a reason (not the reason, nor the predominant reason nor the clinching reason) why the complainant acted as he did.'[149]. Case law and scholars have since then argued for a more rigid view of causation in cases of economic duress. In *The Evia Luck*[150] Lord Goff, stressed two points. First, he opined that causation, besides the threat's illegitimacy, is an additional requirement of economic duress. Second, there has to be not just a cause, but a 'significant cause to induce the plaintiff to enter into the relevant contract'. Mance J followed and advanced these findings in *Huyton v Peter Cremer*[151]. He concluded that a 'but-for' test should be applied 'The minimum basic test of subjective causation in economic duress ought, it appears to me, to be a 'but for' test. The illegitimate pressure must have been such as actually caused the making of the agreement, in the sense that it wouldn't otherwise have been made either at all or, at least, in the terms in which it was made. In that sense, the pressure must have been decisive or clinching.' Consequently, the threat must have been conditio sine qua non for the modification of the agreement.[152]

b) No reasonable Alternative

Many of the cases dealing with economic duress go the question whether the threatened person had a reasonable practical alternative instead of agreeing to the proposed terms.[153] The House of Lords in *The Universe Sentinel*[154] describes the traditional case of duress '[as] the victim's intentional submission arising from the realisation that there is no other practicable

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[148] [1976] AC 104.

[149] [1976] AC 104, 121 per Lord Wilberforce and Lord Simon of Glaisdale.

[150] [1992] 2 AC 152.

[151] *Huyton v Peter Cremer* [1999] 1 Lloyd's Rep 620, 637 = [1999] C.L.C. 230.

[152] Chitty, *The Law on Contracts,* Volume I (29th edn Sweet & Maxwell, London 2004) 7-022.

[153] Halson, 'Opportunism, Economic Duress and Contractual Modifications' (1991) LQR 649 presents different variants of the test.

[154] *Universe Tankships Inc of Monrovia v International Transport Workers Federation* (The Universe Sentinel) [1983] 1 AC 366.

choice open to him.' In *Huyton v Cremer*, Mance J said that the 'but for' test '[...] 'could lead too readily to relief being granted. It wouldn't [...] cater for the obvious possibility that, although the innocent party would never have acted as he did, but for the illegitimate pressure, he nevertheless had a real choice and could, if he had wished, equally well have resisted the pressure and, for example, pursued alternative legal redress.'.

The relevance of the threatened person to have no reasonable alternative rather than submitting to the threat appears to be in general well accepted.[155] Nevertheless, the principle conceals two distinct questions which are still not answered thoroughly. First, it is disputed whether the factor of no reasonable alternative is simply an evidential factor to assist courts to decide on the causal link between threat and (re)action[156] or whether the factor is a separate essential ingredient of economic duress[157]. Second, it isn't settled whether the test of the reasonable alternative is a subjective test[158] or is assessed objectively[159]. In other words, are the thoughts and the will of the threatened person decisive or the thoughts and the will of a reasonable person in threatened person's position? Case law and legal scholars have taken a different view on these distinct questions, although there appears to be a noticeable tendency towards an objective assessment of the reasonable alternative in case law.

Notably, there are some who suggest to shift the focus away from the reasonable alternative test towards 'the illegitimacy of the pressure applied

[155] Goff/Jones, *The Law of Restitution* (6th edn Sweet & Maxwell, London 2002) 10-032 analyse older cases which seem to be contrary to today's law.

[156] So *Huyton v Peter Cremer* [1999] 1 Lloyd's Rep 620, 637 per Mance J = [1999] C.L.C. 230.

[157] *DSND Subsea Ltd* [2000] WL 1741490; Chen-Wishart, *Contract Law* (3rd edn OUP, Oxford 2010) 352; Macdonald, 'Duress by Threatened Breach of Contract' (1989) JBL 460, 465.

[158] So apparently Lord Scarman in *The Universe Sentinel* [1983] 1 AC 366, 400.

[159] *Huyton v Peter Cremer* [1999] 1 Lloyd's Rep 620, 637 per Mance J = [1999] C.L.C. 230; see also *B&S Contracts and Design v Victor Green Publications* [1984] I.C.R. 419, 425 per Kerr J; *Hennessy v Craigmyle & Co. Ltd* [1986] I.C.R. 461; *Vantage Navigation Corporation v Suhail and Saud Bahwan Building Materials (The Alev)* [1989] 1 Lloyd's Rep 138; Virgo, The Principles of the Law of Restitution (2nd edn OUP, Oxford 2006) 211.

with the causation requirement stabilised at the level of the 'but for' standard.[160]

c) Comparative Assessment

The question of causation, meaning the linkage between the pressure employed the threatening party and the (re)action of the threatened party, remains in Germany, as well as in England, a matter of disarrangement and, hence, legal uncertainty.

In both jurisdictions it is settled that economic duress in the vicinity of a contract modification can't be established on 'a mere cause'. The particularities of contract modification, especially the pre-contractual relationship and the presumption of a freely entered contract, demand a higher level of causation. It appears that English law is, despite the discussions about the 'but-for' and 'reasonable alternative' tests, far more advanced with regard to causation. Especially the arguments developed in relation to reasonable alternatives seem to help the courts when deciding on the avoidance of contract modifications under alleged economic duress.

There is one obvious difference between English and German law with regard to causation. English case law shows a strong tendency to follow a more objective approach when determining if the threat has been causal. Therefore, English courts ask whether a reasonable person would have stood the threat because there may be reasonable practical alternatives. In contrast German law focuses on the actual threatened person.

The described difference leads to a more question: Is economic duress in the vicinity of contract modification claimant or defendant sided? Traditionally, the doctrine of duress has been a claimant sided remedy. The doctrine is supposed to protect the threatened person's will. This is true for Germany as well as England.

It is here suggested to reconsider this traditional idea of duress as a claimant sided remedy for the domain of economic duress in the vicinity of con-

[160] Chen-Wishart, *Contract Law* (3rd edn OUP, Oxford 2010) 353 obviously wants to abandon the reasonable alternative test in favour of a mere 'but for' test.

tract modification.[161] The reason is as follows: Contract law is based on an objective standard which each contracting party can rely on. When A promises B to paint B's apartment, B can expect that A paints the apartment in the way an ordinary painter would do. The same must be true in situations of contract formation or modification. If B employs commercial pressure on A, B must rely on an objective standard to which A must withstand the pressure. Generally, it shouldn't matter whether A personally is smart enough to know consequence of or alternative to the employed commercial pressure. Therefore, the doctrine of economic duress must take into account the defendant's legitimate interest in the sanctity of the entered contract and then balance these interests with the claimant's legitimate interest in action on his free will[162]

V. Conclusion

1. The modification of contracts is an essential constituent of contractual activity. It usually is about rough bargaining, opportunistic rent seeking, and harsh commercial pressure. The question of which kind of commercial pressure is regarded unlawful is the domain of the doctrine of economic duress.

2. It is imperative to recall some of the fundamental tenet of contract law which are inherently tied to the doctrine of economic duress. Specifically, freedom of contract and freedom of contract modification are indispensable for understanding economic duress. The analysis reminds of the importance of the parties' free will to enter and to modify contracts.

3. The comparative assessment of German and English law on economic duress has shown great resemblance on the main ingredients necessary for the avoidance of contract modifications agreed under blameworthy pressure. This is despite different approaches to economic duress. While Ger-

[161] Generally, Posner, *Economic Analysis of Law* (6th edn Aspen, New York 2003) 117, differentiates traditional duress to goods and persons and economic duress from an economist's view.

[162] Arguing from a comparative view Probst, 'Defects on the Contracting Process' in: *International Encyclopaedia of Comparative Law*, Volume II, Contracts in General (Mohr Siebeck, Tübingen 2008) II-399 seq.

man law relies to a great extent on a single statutory provision, English case law is dominating the realm of economic duress. What follows is the opportunity to learn from each other. German law puts straight forward the element of economic duress: threat, the threat's illegitimacy, subjective test, causation. In this regard, English law is still blurry coping especially with the issue of causation.[163] In contrast, English law - building on the advantages of case law - puts forward a number of remarkable thoughts. This is in particular for the circumstances possibly relevant for causation. The test for the no reasonable alternative should indeed be adopted by German law.

4. There is one final point. The comparative assessment has shown some of the relevance and value of comparative law.[164] It enriches the reservoir of explanations for social problems, such as blameworthy commercial pressure (école de vérité); it helps to interpret the existing law (école de interpretation); and verifies the solutions of existing law (école de vérification).

[163] Evidence for this are the unorthodox and varying structures of textbooks in this area of law.

[164] For a general assessment of the value of comparative law see Zweigert/Kötz, *Einführung in die Rechtsvergleichung* (3rd edn Mohr Siebeck, Tübingen 1996) 14 seq.

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The Quest for the Ideas of Corporate Rescue

I. Introduction

New York, September 15, 2008. The entire business world stopped breathing for a moment. What had happened? Lehman Brothers, one of the world's largest investment banks went bankrupt. According to the company's official press release, the filing of a Chapter 11 petition was in order "to protect its assets and maximize value".[1] Since then, there is almost no day that passes without news reports about insolvent companies and the efforts for a rescue of these companies. Company rescue has become (once again) a dictum of our times.

This essay is concerned with the ideas underlying the rescue of companies. It presents the argument that the quest for rescue ideas is a bumpy road which may not lead to a final destination. The arguments are developed by taking a wider approach to corporate insolvency and rescue. Part II focuses

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1 www.lehman.com/press/pdf_2008/091508_lbhi_chapter11_announce.pdf, retrieved 2009-11-28.

on its economic and social implications. The development of insolvency and rescue law presented in Part III is employed to enrich the discussion from the historical perspective. A philosophical approach is taken when visions of insolvency and rescue are debated in Part IV. Finally, in-depth observations are made in order to enhance the quest for rescue ideas.

II. Framework I: Insolvency and Rescue as Facts of Life

1. The Credit-Society

There used to be a time when business transactions were carried out on a simultaneous exchange basis involving barter or cash ("credit-free-society"). Today, the vast majority of business transactions involve the use of credit. Apparently, this bears the risk that the debtor is later unable to fulfil his financial commitments, especially in periods of an economic downturn.[2] Nevertheless, this risk has generally become accepted in all civilised societies on reasons of its advantages.[3] The still ongoing rise of specialised creditors, such as banks and other lending institutions, seem to be proof of the social and economic advantages of credit.[4]

2. The Link between Insolvency and Rescue

Rescue is one of the two routes that a company in severe financial difficulties may take. When a company is unable or is about to become unable to meet its financial commitment,[5] the company may undergo a reorganisation or go straight into liquidation. The latter one is the end of the road for a

[2] Goode, *Principles of Corporate Insolvency Law* (3rd edn Sweet &Maxwell, London 2005) 2 seq; Tolmie, *Corporate and personal insolvency law (*2nd edn Cavendish Publishing, London 2003) 15.

[3] Fletcher, *The Law of Insolvency* (4th edn Sweet & Maxwell, London 2009) 5.

[4] See Report of the Review Committee, *Insolvency Law and Practice* (Cmnd 8558, London 1982), hereafter referred to as the Cork Report, 11 seq.

[5] For an extensive review of the tests for insolvency see Keay, *Insolvency Law - Corporate and* Personal (2nd Jordans Publishing, Bristol 2008), 16 seq.

company. It entails the winding up by collecting and selling the company's assets, either piecemeal or as a going concern, in order to distribute the proceeds to the creditors. In contrast, reorganisation is a fresh start for a company.[6] It goes beyond ordinary managerial mechanism[7] and may involve changes in the company's management, staffing, modus operandi and finances. In many cases, changes in financing entail a debt-equity-swap which helps the company to straighten its balance sheet. All those reorganizational changes serve one purpose: the rescue of the company.[8]

3. The Actors on the Playing Field

When a company becomes insolvent, a number of persons are directly affected: the company, its shareholders, its managers, its employees, and its creditors. In addition, quite often a number of persons are indirectly affected (public interest groups such as unions, politicians, communities). All of these actors want their own interests to prevail within insolvency proceedings.[9] An understanding of their interests is, therefore, essential for the ideas of rescue.

If the company has or seems to have a viable future, any of the actors will in general favour a rescue. But the actors will not favour any rescue measures which are in some way or the other disadvantageous to them and, hence, opposing to their interests. Shareholders might be opposed to new shareholders (debt-equity-swaps) because they may have a different opinion about the modus operandi. Shareholders will certainly contest any obligation to add equity to the company. Managers might also be opposed to new shareholders who could favour a new management. Employees will for

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[6] There is also an informal rescue meaning the rescue is not governed by insolvency regulation - see McCormack, *Corporate Rescue Law: An Anglo-American Perspective* (Edward Elgar Publishing, Glos 2008) 10 seq; Finch, *Corporate Insolvency Law* (2nd edn Cambridge University Press, Cambridge 2009), 251 seq.

[7] Finch (note 6), 243.

[8] A distinction may be made between the rescue of the company itself and the rescue of the company's business - see Frisby, 'In Search of a Rescue Regime: The Enterprise Act 2002' (2004) 67 MLR 247 at 248. For the purpose of generalisation, the essay does not make this distinction.

[9] For the various actors and their interests see Keay, 'Balancing Interests in Bankruptcy Law' (2001) 30 Common Law World Review 206 at 222.

sure combat any job-cuts, and in many cases, any reduction of overdue wages. They might also go up against a prospective reduction of wages. The creditors will certainly oppose any compulsory cut in their claims against the company without getting an equivalent. This is for banks, lessors, any other contracting party, and the crown, too. Secured creditors will challenge any loosening of their security. Public interest groups such as, unions, employers' associations, and parties, including their respective local, regional, and state representatives, will publicly oppose any measure which is contrary to their clientele's interests. On a more general scale, representatives of rescue practitioners will fight for a large piece of service fees involved in any reorganisation process.

4. The Economic Implications

From economic perspective, a vast amount of social cost is at stake when a company becomes insolvent and especially when it must take the route of liquidation. In fact, there are three main social costs to the insolvency of a company.

First, the social value of physical and human assets is reduced when a new allocation of assets takes place.[10] The loss is mostly due to the fact that a given company's asset is integrated into a specific production or service process. The value of this asset is reduced when it is sold piecemeal and fitted into another specific production or service process. The same is true with human capital regarding specifically acquired knowledge. Its value lessens when the employee on reason of insolvency has to take a new job. Generally, it seems that the loss of value of physical and human assets is less when a company is sold as going concern. This can be used as an argument in favour of rescue instead of liquidation.

Secondly, almost inevitably, there will be losses in social value because of a downfall of efficiency during insolvency proceedings.[11] If assets are sold, there will be times when assets are inoperative. Human capital will also be

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[10] Cabrillo/Depoorter, 'Bankruptcy Proceedings' in: Bouckaert/Geest (eds.), *Encyclopaedia of Law and Economics, Volume V, The Economics of Crime and Litigation* (Edward Elgar, Cheltenham 2000) 267 seq.

[11] Easterbrook, 'Is corporate bankruptcy efficient?' (1990) 27 JFE 411.

less productive because of psychological implications which uncertainty triggers. Apparently, these social costs will increase with the length of the time period the insolvency proceedings are pending. Since physical assets season, and humans tend to lose knowledge, the increase of social costs is even disproportionate.

Thirdly, insolvency related expenditures, especially for legal services and insolvency practitioners' services, form an important part of social costs.[12] These expenditures are, generally speaking, inevitable, especially if the route of reorganization is chosen. Compared to the aforementioned costs are the expenditures insofar different as they have to be actually spent in insolvency proceeding and, hence, reducing the assets left to the company. As to the rescue of a company the assets have to be in place in order to start and undergo reorganization proceedings.

III. Framework II: Development of Insolvency and Rescue as Facts of Law

Insolvency and reorganisation are not merely facts of life, they are also facts of law. A detailed analysis of the law of insolvency and reorganisation is not intended, but a few comments on the development of reorganisation enhance the framework of rescue culture.

1. Early Insolvency Law

Insolvency, as formerly pointed out, has been around since credit started to succeed the simultaneous exchange of barter or cash in trading. Early history was dominated by individual insolvency law which was formulated to act as a "remedy" for the creditor. The remedy's substance changed over time. However, there were three main remedies. First, the creditor could either seize the person because of his debt and compel him to labour for him ("slavery"). Secondly, the creditor could seize the person because of

[12] See for a discussion Hunter, 'The Nature and Function of a Rescue Culture' JBL 1999, Nov, 491 at 512 seq.; Tolmie (note 2) 375 seq.; DBIS, The Insolvency Service, 'Annual Report and Accounts 2008–09' (The Stationery Office, London 2009) 15 seq.; Easterbrook, n 11.

his debt and invoke his imprisonment ("debtors' prisons").[13] Thirdly, the creditor could attach only the property of the debtor.

The first English Bankruptcy Act was enacted in 1542 dealing only with individual insolvency. It established the principal of collective creditor's action. ´The Winding-up Act 1844 was a starting point for corporate insolvency law in providing for the first time that creditors' remedies could only extend to the company's assets.[14] In the following years, corporate insolvency law underwent several more or less minor changes when the Bankruptcy Act 1869, the Bankruptcy 1883, and the Bankruptcy Act 1914 came into force.

2. The Cork Report and the Raise of Rescue Culture

In 1982, the Review Committee on Insolvency Law and Practice strongly supported the idea that an insolvency regime should facilitate reorganisation of an insolvent company and its rescue rather than just sending it to the road of liquidation.[15] The recommendations of the Review Committee were not all implemented by subsequent legislation (IA 1985, IA 1986, CDDA 1986). However, the IA 1986 did establish formal legal procedures for the reorganisation and rescue of companies.[16] The general idea of rescue has been pursued since then by legislation. The Insolvency Act 2000 as well as the Enterprise Act 2002[17] did bring changes which all aimed at enhancing the possibility to rescue an insolvent company. Today, formal res-

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[13] Cork Report (note 4), 7; Keay (note 5) 8, this remedy was most common with so-called non-traders.

[14] Fletcher (note 3), 13; see also *Salamon v A . Saloman & Co Ltd* [1897] AC 22.

[15] Cork Report (note 4), 54 "We believe that the aims of a good modern insolvency law are these: [...] (i) to recognise that the effects of insolvency are not limited to the private interests of the insolvent and his creditors, but that other interests of society or other groups in society are vitally affected by the insolvency and its outcome, and to ensure that these public interests are recognised and safeguarded [...] (j) to provide means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country.".

[16] Finch, 'The Measures of Insolvency Law' (1997) 17 OJLS 227 at 230

[17] Frisby (note 8) 247 seq; from a German perspective Ehricke/Köster/Müller-Seils, 'Neuerungen im englischen Unternehmensinsolvenzrecht durch den Enterprise Act 2002' NZI 2003, 409

cue procedures[18] are in place: (i) CVAs which can be entered into in- and out-side formal insolvency;[19] (ii) administration[20] which is in some way analogous to the reorganization procedure under Chapter 11 of the US Bankruptcy Code; (iii) receivership which enables the receiver to pursue, in the interest of the relevant creditor, a rescue of the company.[21] Courts also follow the rescue culture.[22] It has to be pointed out that informal rescue measures may also be taken. These are entirely contractually based and include changes in management structure and staff, financing, and share capital structure (e.g. takeover).

IV. Framework III: Measure of Corporate Insolvency and Rescue

In Part II and III of this essay, some of the most important parts of the factual and present legal framework of insolvency and rescue haven been laid out. This gives the indispensable background to analyse different visions (theories) of corporate insolvency.

1. Starting Point: Visions of Corporate Insolvency

a.) Creditors' Wealth Maximization Theory

The creditors' wealth maximization theory, sometimes called the creditors' bargain theory, is based on the idea that insolvency law should maximize the collective returns to creditors.[23] The theory is derived from general contractarian theory and substantively inspired by the law and economics movement. According to this theory, insolvency law is a plain collectivized

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[18] The same notation is used by Hunter (note 12).

[19] IA 1986 (Schedule A1); Finch (note 6), 470 seq; from a German perspective Windsor/Müller-Seils/Oliver/Burg, 'Unternehmenssanierungen nach englischem Recht - Das Company Voluntary Arrangement' NZI 2007, 7.

[20] Para 3(1)(2) Schedule B1 of the IA 1986.

[21] Finch (note 6) 327.

[22] See Powdrill v Watson [1995] 2 W.L.R. 312.

[23] Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' The Yale Law Journal, Vol. 91, No. 5 (Apr., 1982), 857 seq.

debt collection device. Furthermore, insolvency should be regarded as a system which mirrors the "hypothetical bargain" that creditors would have made (ex ante) if they had the chance prior entering into the transaction with the insolvent company (this is the reason why the theory is also called creditors' bargain theory). Following the law and economics approach, the obligatory collectivized debt collection is reasoned by the reduction of transaction costs. Besides the collectivity of debt collection, the theory argues for the protection of pre-insolvency property rights and the creditors' interests as the single relevant interests.

b.) Communitarian Theory

The communitarian theory is in stark contrast to the creditors' wealth maximization approach. It does not put emphasis on the creditors' private rights but on the interests of a number of people, such as employees, suppliers, customers, neighbours, the local and wider community, and the government. Hence, the theory is public interests group orientated rather than creditor orientated. Proponents of this theory claim that a communitarian approach is quite efficient, because it takes into account the creditors' bargain but also the economic effects of insolvency on communities, and insofar takes a much wider economic approach.[24] With regard to rescue, the communitarian theory suggests that high priority creditors are obliged to (partially) waive their claims in favour of others affected by a firm's insolvency, including the community at large.[25]

c.) Ethical Theory

The ethical theory on insolvency argues that insolvency law regimes usually miss a solid philosophical foundation in so far as the formal body of insolvency ignores issues of ethical (moral) concern.[26] As relevant aspects for the redistribution of assets of the insolvent company are seen, inter alia, present and prospective needs, income, the moral, and the kind of the un-

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[24] Gross, Taking Community Interests into Account in Bankruptcy: An Essay' (1994) 72 WashULQ 1031 at 1033.

[25] See Warren, 'Bankruptcy Policy' (1987) 54 UChiLRev. 775; Gross (note 24), 1033 seq.

[26] The primary proponent of this theory is Shuchman, 'An Attempt at a "Philosophy of Bankruptcy*' (1973) 21 UCLALRev 403.

derlying transaction. Therefore, it is contended that a distinction is to be drawn between debts which have arisen out of a contractual relationship which personally benefit the creditor and debts arising from involuntary act.[27] Subsequently, the theory suggests that in a rescue environment, tort debts are preferred debts compared to debts flowing from a sales or any contract.

d.) Other Approaches

A description of all approaches to insolvency law which have developed over time cannot be accomplished here.[28] Yet it is worthwhile to mention that insolvency may be viewed from an incentive approach. According to this approach, the objective of insolvency law is to impose (social) costs to actors on the playing of insolvency in order to give incentives to perform well.[29] The directors' disqualification orders are insofar a handsome example. Another approach may be taken from the debtor's perspective. It is generally referred to as the discharge theory.[30] The non-fraudulent debtor enjoys discharge to free his future income "from the chain of previous debts" in order to help him for fresh start.

2. Settling Point: The Quest for the "right" Vision

Any vision of insolvency will propose a rescue if the way the rescue is performed complies with or enhances the objectives of each vision. The creditors' wealth maximization theory will suggest a rescue if it maximizes the creditors' wealth. The communitarian theory will suggest a rescue if it enhances the well-being of the community as a whole. This is also for other approaches to insolvency. However, which vision is the most convincing one in terms of rescue, is the best one or is the "right" one?

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[27] Shuchman (note 26), 447.

[28] For a more comprehensive analysis of approaches to insolvency see Hunter (note 12), 507 seq.

[29] Easterbrook (note 11), 411 seq; Cabrillo/Depoorter (note 10), 264; see also Hunter (note 12), 492.

[30] Cabrillo/Depoorter (note 10), 265.

Creditor wealth maximization is narrow in its exclusiveness regarding the interest of creditors, the absolute conservation of pre-insolvency rights, and in its conception of the insolvent company as a pool of assets - all derived from disputable and disputed law and economics theory. The communitarian vision escapes the narrowness of creditor wealth maximization but faces the problems to indentify, balance and resolve the different interest of the actors on the playing field. Finally, the ethical approach encounters difficulties in determining the ethical substance and the boundaries of ethical concerns with regard to the relevant transaction of debt. The ethical vision also struggles with the balancing of different aspects of decisions on insolvency proceeding and dissolving conflicting aspects.

To propel the search for rescue ideas in corporate insolvency, looking for benchmarks might be helpful. When corporate insolvency is at stake corporate (company) law theory seems to be a good thing to start with. But which visions does corporate/company law follow? Without going into the details it becomes clear that again different approaches are competing: strictly shareholder orientated, communitarian orientated, and ethical orientated.

What lessons can be learned by this? Visions of insolvency law and, hence, visions of corporate reorganisation and rescue differs from the persuasion of fundamental issues like society, economy, and law. Should individuals be able to decide completely on their own or should mandatory law guide them? Is it fair to pursue its own destiny? Are private rights recognised to be relative (contractual rights) and absolute (property rights)? Transforming this into terms of corporate reorganisation and rescue: Should the creditors and the debtor be able to reach a complete contractarian solution to insolvency? Should creditors, among each other, be able to reach a complete contractarian solution despite the potential disadvantages of the race to collect debts? Is it fair that secured creditors like banks collect all their debts without regard to other (unsecured) creditors? Or, in contrary, is it fair that a secured creditor's claim is mandatorily reduced, let say by 10%, in favour of unsecured creditors?

The answer to these and other fundamental questions concerning corporate reorganisation and rescue can only be argued for by weighting or prioritizing the different interests of the different actors on the playing field. Such

weighting or prioritizing is absolutely based on individual visions of society, economy, and law.[31] The quest for the idea of corporate reorganisation and rescue is, therefore, a matter of persuasions.

V. Final Observations

When looking into the wider framework of corporate reorganisation and rescue, a series of essential rationales are encountered. The analysis of the framework based on facts of life in Part II stressed the implications of credit and its non-reimbursement. The different interests of the actors and the immense economic repercussions give assistance in formulating guiding principles of corporate reorganisation and rescue. The framework based on facts of law presented in Part III illustrates not only the historical development of rescue culture up to the present day, it also shows tendency to a broader approach to rescue as in terms of actors ("society as a whole") and potential rescue measures ("debtors' prisons", CDDA 1986). This again gives assistance in formulating guiding principles. Finally, the analysis of different visions of corporate insolvency, reorganization, and rescue in Part III lays down the theoretical (philosophical) framework revealing the trouble of giving an ultimate answer to the ideas which a rescue regime should pursue[32]. The answer can only be argued for by weighting or prioritizing the different interest of the different actors. Such weighting or prioritizing is absolutely based on individual visions of society, economy, and law.

Having accepted there is no definite answer to rescue culture, there are some thoughts to be observed.[33] Some of them are well known but have to be re-focussed, and others are less known but demand wider attention in order to enhance the evolution of rescue culture.[34] (i) Any rescue culture should pay greatest respect to legal rights based on property and contract

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[31] See Finch (note 13) 248.

[32] Finch (note 13) 250.

[33] See Keay (note 9), 235.

[34] Hunter (note 12) 500 seq. lays down 10 principles which should govern rescue culture from his point of view; Dal Pont/Griggs, 'A Principal Justification for Business Rescue Laws: A Comparative Perspective (Part II)' (1996) 5 INSOL 47-79 lay down a series of "desirable criterias"

in order to non-interfere with the rule of law. (ii) As it seems that CVAs have already stood the test of time, any rescue culture should enhance the options of the actors to reach a contractual solution to the dilemma of insolvency and rescue. (iii) Any rescue culture should enhance the bona fide principle within the process of insolvency and rescue. (iv) Any rescue culture should provide rules in order to meet the different needs of different corporate entities in the vicinity of insolvency: small and big companies (local farmer vs. Bosch), listed and unlisted companies (XY Ltd vs. Vodafone plc), specialised and less specialised companies (software engineering vs. hairdresser), and companies of different business sectors (banks vs. retailers). (v) Any rescue culture should take into account ancillary measures (e.g. financial reporting, risk management).[35]

[35] See Finch, 'The Recasting of Insolvency Law' (2005) 68 MLR 713.

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The UNCITRAL Legislative Guide on Insolvency Law and the Convergence of Insolvency Law A German Perspective

I. Introduction

The ongoing technological and socio-political development around the world brings goods and people closer together and facilitates an uninhibited exchange among them. However, the exchange is not limited to goods and people. Over the last one or two decades, the exchange in the field of law has increased enormously. Today, legal scholars, law firms, and governmental institutions, as well as supranational institutions, like the IMF or the UN, are not just working in one jurisdiction. They often cope with different legal systems. Not surprisingly, comparative law work produces

legal transplants[1] which are becoming a common tool of law making. This road obviously leads to a convergence of different national and supranational legal systems.

This paper examines the convergence of national insolvency laws in the vicinity of the UNCITRAL Legislative Guide on Insolvency Law (in the following "Guide")[2]. It presents two arguments. First, the Guide itself indicates some level of convergence among existing national insolvency laws ("internal convergence"). Secondly, national insolvency laws show a broad convergence with the Guide's recommendations ("external convergence"). The arguments are developed by taking a closer look at the Guide (B.) and by researching two selected issues of insolvency law (C.): the treatment of contracts and the creditors' participation in insolvency proceedings. Thereby, the Guide will be compared to German insolvency law as stated in the Insolvenzordnung.

II. Reflections on the Guide's Internal Convergence

1. Observations: (Un-)Complexity of Recommendations

The Guide's purpose is to assist national legislative bodies on the establishment of an efficient and effective legal framework for dealing with the financial difficulties of debtors.[3] Following its soft approach, the Guide does not provide a complete and exhaustive set of ready-to-adopt insolvency rules. On over 400 pages, it provides all the legal issues which a modern insolvency law should address. The issues cover the entire lifecircle of a financially distressed debtor; beginning with the commencement of insolvency proceedings, via the rights and obligations of the persons involved, the reorganization procedure, and ending with closure of the proceedings. Each of the covered issue is discussed thoroughly, solutions

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[1] See Watson, *Legal Transplants*, An Approach to Comparative Law (Scottish Academic Press, Edinburgh 1974).

[2] UNCITRAL, *Legislative Guide on Insolvency Law* (New York 2005); Block-Lieb / Halliday, "Harmonization and Modernization in UNCITRAL's Legislative Guide on Insolvency Law" (2007) 42 TexIntLJ 1, 22 seq. desribes the design of the Guide.

[3] UNCITRAL, *Legislative Guide on Insolvency Law* (New York 2005), 1.

from different legal systems are presented,[4] and finally, recommendations are made.

The Guide, however, does not treat the relevant issues equally.[5] Some of the recommendations are exhaustive and seem to cover every detail of the legal issue in question. Some even appear to be perfectly written statute law and some are rather imperative[6]. Striking examples are the recommendations regarding the commencement of insolvency proceedings, which, inter alia, give detailed advice under which circumstances insolvency proceedings shall be commenced on the application of a debtor or a creditor.[7] Other examples are the recommendations on avoidance provisions,[8] and above all the reorganization proceedings[9]. In contrast, other recommendations are of very general nature. They leave room for almost any solution to the legal issue at question. Sometimes, the Guide just recommends that insolvency law should deal with the issue. An example is the specification of claims which have higher priority[10]. The Guide provides: "The insolvency law should minimise the priorities accorded to unsecured claims. The law should set out clearly the classes of claims, if any, that will be entitled to be satisfied in priority in insolvency proceedings."[11] Even though the Guide discusses the question whether taxes should have a higher priority,[12] the Guide does not make any recommendations on this issue.

4 The Guide does not mention any specific national law system.

5 For a wider (more technical) approach Block-Lieb / Halliday, "Harmonization and Modernization in UNCITRAL's Legislative Guide on Insolvency Law" (2007) 42 TexIntLJ 1, 26.

6 Block-Lieb / Halliday, "Harmonization and Modernization in UNCITRAL's Legislative Guide on Insolvency Law" (2007) 42 TexIntLJ 1, 26 uses this term.

7 UNCITRAL Guide, pp. 64.

8 UNCITRAL Guide, p. 73.

9 UNCITRAL Guide, pp. 233.

10 UNCITRAL Guide, p. 275.

11 UNCITRAL Guide, p. 275 (recommendation 187).

12 UNCITRAL Guide, p. 273; Day, "Governmental Tax Priorities in Bankruptcy Proceedings: An International Comparison" (2006) 15 Norton J. Bankr. L. & Prac. 5 Art. 2 comparatively studies different insolvency law in the light if the Guide.

2. Explanation: Existing Convergence among Insolvency Laws

Why are the various recommendations so different? Why are they sometimes very complex and sometimes very minimal? A reasonable explanation is an already existing convergence of national insolvency laws.

UNCITRAL consists of representatives from 60 different states around the world.[13] These states represent different levels of economic development, different geographic regions and, most notably, different legal traditions. If the UNCITRAL wants to deliver a legal instrument[14], be it a convention, a model law or legislative guide, a consensus among the (majority of) the member states must be reached. What does that mean for the Legislative Guide on Insolvency Law and the (un-)complexity of the Guide's recommendations? There is a presumption that a convergence among existing insolvency laws on a certain legal issue would result in a more detailed and exhaustive recommendation by the Guide. On the other hand, it seems reasonable that little convergence among existing insolvency laws on a certain legal issue would result in a more general recommendation or even in the omission of a recommendation. In plain words: A very detailed recommendation suggests great consensus among the UNCITRAL and, hence, a great convergence of present national insolvency laws. A less detailed recommendation suggests less consensus among the UNCITRAL and, hence, little convergence of present national insolvency laws. This explanation is apparently backed by public choice theory.[15]

3. Assessment

The Guide's recommendations are of different complexity. Some of them are very detailed, others are very general. There is the presumption that there is an existing convergence among national insolvency laws on the

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[13] States include 14 Western European states, 8 Eastern European states, 14 Asian states, 10 Latin American and Caribbean states, and 14 African states.

[14] Block-Lieb / Halliday, "Harmonization and Modernization in UNCITRAL's Legislative Guide on Insolvency Law" (2007) 42 TexIntLJ 1 describes the different legal techniques which UNCITRAL uses.

[15] For public choice theory on law making Buchanan, *The Limits of Liberty. Between Anarchy and Leviathan.* (Liberty Fund 2000 1975), 136 seq.

issues which are dealt by Guide in detail and that there is little convergence on the issues which are dealt by Guide in general.

III. Reflections on the Guide's External Convergence

1. Treatment of Contracts in Insolvency Proceedings

a) Background

Since the beginning of business and trade, contracts have been exceptionally vital for enterprises.[16] This is simply because they are inherently tied to claims and/or liabilities. When a company becomes insolvent a challenging decision has to be made as to the future of these claims and liabilities. Furthermore, there are many different types of contracts. Some of those, like lease, license or loan contracts, may even be of vital importance for the company's livelihood. The legal issues which relate to the handling of contracts within insolvency proceedings are all about the relation between general contract law on one hand and insolvency law, including reorganisation law, on the other hand. In simple terms, how much should insolvency law interfere with established principals of contract law?

b) Overview on the Continuation and Rejection of Contracts

aa) Legislative Guide. The Guide makes several detailed recommendations on how insolvency law should deal with the issues just mentioned.[17] Generally speaking, it recommends that insolvency law should entitle the insolvency representative to decide on the continuation or rejection of the performance of a contract, depending on the benefits of the contract's performance to the insolvency estate.[18] If the insolvency representative decides to continue the contract, the Guide suggests that the representative can only do so with regard to the whole contract and to the original terms which are

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[16] Tintelnot, "Die gegenseitigen Verträge im neuen Insolvenzverfahren" (1995) ZIP 1995, 616, 616.

[17] UNCITRAL Guide, pp. 119, 132.

[18] UNCITRAL Guide, p. 120.

entirely enforceable. Respectively, the right to reject a contract's performance should apply to the contract as a whole.[19]

bb) German Law. According to § 103 Insolvenzordnung ('InsO' - German Insolvency Act) the insolvency representative may opt to continue to perform any mutual contract[20] which has not (or not completely) been performed by the debtor and the other party at the date when the insolvency proceedings were opened.[21] Any claims arising from the contract are regarded as claims of higher priority. If the insolvency representative refuses to perform a contract, the other party is entitled to claims for non-performance only as a creditor of the insolvency estate.

c) Automatic Termination and Acceleration Clauses

aa) Legislative Guide. Contracts often include clauses which entitle a party to rescind a contract in case the counterparty becomes insolvent. The Guide recommends that any contract clause that automatically terminates or accelerates a contract upon the occurrence of certain events is unenforceable as against the insolvency representative and the debtor.[22] The Guide states the following events as relevant: (i) an application for commencement, or commencement of insolvency proceedings; (ii) the appointment of an insolvency representative. Following the recommendations, insolvency law should exempt certain types of contracts, such as financial contracts, or should make them subject to special rules, as in the case of labour contracts.

bb) German Law. Under German law it is arguable under which circumstances an automatic termination or acceleration clause is void.[23] The rele-

[19] UNCITRAL Guide, p. 133 (recommendation 73).

[20] For this expression see Huber, "Die Abwicklung gegenseitiger Verträge nach der Insolvenzordnung" (1998) NZI 97, 97.

[21] For a detailed discussion Graf/Wunsch, "Gegenseitige Verträge im Insolvenzverfahren" (2002) ZIP 2117 and Tintelnot, "Die gegenseitigen Verträge im neuen Insolvenzverfahren" (1995) ZIP 1995, 616.

[22] UNCITRAL Guide, p. 122, 132 (recommendation 70).

[23] With further references Huber, Münchener Kommentar zur Insolvenzordnung (2nd edn C.H. Beck, München 2008), § 119 recitals 12 seq.; see also Wilmowsky, „Lösungsklauseln für den Insolvenzfall“ (2007) ZIP 553 seq.

vant § 119 InsO provides for the voidance of any agreement which excludes or limits the right of the insolvency representative to opt for the continuation of contract pursuant to § 103 InsO is invalid. The *Bundesgerichtshof* (German Supreme Court) recently ruled that any automatic termination or acceleration clause which does explicitly relate to insolvency law is void.[24] Such insolvency related clauses are for instance clauses, which take reference (i) to formal and substantial preconditions of insolvency proceedings like the cash-flow or balance sheet test, or (ii) to the commencement of insolvency proceedings, or (iii) to the insolvency representative's decision about the handling of the contract.

d) Special Provisions for certain Types of Contracts

aa) Legislative Guide. The Guide suggests exempting certain types of contracts from the powers of the insolvency representative with respect to the treatment of contracts. According to the Guide, exemptions may be desirable for the following types of contracts: insurance contracts, loan contracts, labour agreements, agreements where the debtor is a lessor or franchisor or a licensor of intellectual property, and contracts with government, such as licensing agreements and procurement contracts.

bb) German Law. The Insolvenzordnung provides special rules for a number of types of contracts. § 108 alt. 1 InsO explicitly orders the continuation of any rent or lease contract of immovables or premises in case of an insolvency. The termination of the relevant contract is subject to the general rules.[25] However, if the debtor is the tenant or lessee, the lessor is not entitled to rescind the contract after the opening of the insolvency proceedings on reason of default in the payment of tenancy or lease fees arising before the opening of the insolvency proceedings was requested, and on reason of degradation of the debtor's financial situation (§ 112 InsO). This holds true for both immovables and movables. Another important exemption from the general powers of an insolvency representative concerns labour contracts. According to § 108 alt. 2 InsO an employment contract continues in case of the employer's insolvency. Claims by employees for their wage are

24 BGH NZI 2006, 229.

25 Bork, Einführung in das Insolvenzrecht (3rd edn Mohr Siebeck, Tübingen 2002) 82.

of higher a priority against the estate. Despite the continuation, each party to an employment contract may rescind the contract at the ordinary statutory period of notice. Furthermore, the ordinary provisions regarding the grounds for termination of an employment contract and the safeguards for certain employees, like pregnant women and disabled persons, apply within insolvency proceedings.[26]

e) Assessment

The brief survey of the Guide's recommendations and German insolvency law on the treatment of contracts in insolvency proceedings shows a broad consensus. The Insolvenzordnung complies with the recommendations made by the Guide to great extent. The practically most essential and certainly most argued issue is the automatic termination and acceleration of contracts in the vicinity of insolvency proceedings. It is unclear whether the Guide and the German law differ with respect to this issue. It sounds reasonable that any insolvency law must respect the principals of contract law. Anyhow, as long as contracts do not take explicitly reference to insolvency institutions they should be upheld.

2. Creditors' Participation in Insolvency Proceedings

a) Background

Creditors are apparently affected when their debtor, contractual or non-contractual, becomes insolvent. In some cases, creditors may even be vitally affected. Just imagine a producer of some sort of goods who delivered 30% of its annual production to his debtor in advance. If the debtor becomes insolvent and cannot pay for the already delivered goods, the producer is obviously facing immense problems. Not just these great economic implications have driven most, if not all, insolvency laws to provide for some creditor's participation in insolvency proceedings. Creditors have the power to discharge the debtor from its liabilities. Therefore, creditors' par-

[26] Löwisch/Caspers, Münchener Kommentar zur Insolvenzordnung (2nd edn C.H. Beck, München 2008), § 113 recital 19; Bork, Einführung in das Insolvenzrecht (3rd edn Mohr Siebeck, Tübingen 2002) 86.

ticipation in insolvency proceedings may be the key to rescue or reorganisation.[27] Last but not least, there is a continuing legal relationship of some sort between the creditor and debtor which does not leave the creditor without any rights.[28] There is a range of mechanisms to administer creditors' participation in insolvency proceedings.[29] The following remarks focus on the level of participation in general and the design of participation in detail.

b) Institutionalised Levels of Participation

aa) Legislative Guide. The Guide presents two general approaches to creditor participation: the "low level of participation" and the "greater participation" approach.[30] The former is based on a heightened role of the insolvency representative who is empowered to make all key decisions within the insolvency. Consequently, the creditors are assigned only a marginal role with little influence. In contrast, the "greater participation" approach assigns the creditors a much bigger task. As the Guide points out, this task may range from a mere advisory or supervisory function to a "having-a-say" role of creditors. The Guide apparently favours a wider participation of creditors. It recommends in detail provisions which intend to institutionalize creditors' participation, like the establishment of a creditors meeting, This meeting is supposed to play the main role in representing the creditors' interest in insolvency proceedings. Additionally, the Guide recommends the installation of another creditors' institution: the creditors committee.[31] This committee shall take over the role from the creditors'

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[27] UNCITRAL Guide, pp. 192.

[28] Similar thoughts by Tomasic, "Creditor Participation in Insolvency Proceedings - Towards the Adoption of International Standards" (http://ssrn.com/abstract=1443762, retrieved 01.03.2010), he also points the function of creditors' participation as brake against any abuse by corporate insiders (p. 10).

[29] For a comparative study see Block-Lieb, "Representing the Interests of Unsecured Creditors: A Comparative Look at UNCITRAL's Legislative Guide on Insolvency Law" (http://ssrn.com/abstract=1337824, retrieved 25.02.2010).

[30] UNCITRAL Guide, p. 191; assessed alike Tomasic, "Creditor Participation in Insolvency Proceedings - Towards the Adoption of International Standards" (http://ssrn.com/abstract=1443762, retrieved 01.03.2010), 12.

[31] UNCITRAL Guide, p. 203, speaks of "a creditor committee, a special representative or other mechanism for representation".

meeting when there is large number of creditors, making the creditors' meeting a lame duck.

bb) German Law. The Insolvenzordnung takes a wide approach with respect to the creditors' participation in insolvency proceedings.[32] It provides for a creditors' meeting (*Gläubigerversammlung*) and a creditors' committee (*Gläubigerausschuss*).[33] The creditors' meeting and the creditors' committee represent what German insolvency law calls *Gläubigerautonomie* (creditors' autonomy). It is based on the idea that the money at stake in insolvency proceeding is the creditors' money and, hence, the creditors should be in power as much as possible.

c) Design of Participation in Detail

aa) Legislative Guide. The Guide's recommendations as to the creditors' meeting as the central institution for creditors are very detailed. It recommends rules regarding eligibility, voting requirements, and rules regarding the matters on which the creditors' meeting has a say (e.g. approval or rejection of a reorganization plan).[34] The Guide further provides exhaustive recommendations for the creditors committee. According to the Guide, insolvency law should specify the following matters: whether a committee is required in all insolvency proceedings, the relation between the committee and the insolvency representative, the eligibility to the committee, the mechanism of appointing the committee's members, and the rights of the committee.[35] In addition, the Guide suggests the incorporation of ancillary matters, like the liability, enumeration and employment of committee's members, within insolvency law.

bb) German Law. The creditors' meeting (*Gläubigerversammlung*) is where the creditors to the estate, the insolvency representative and the debtor occasionally meet (§ 74 InsO). The meeting itself is presided by the insolvency

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[32] For overview Block-Lieb, "Representing the Interests of Unsecured Creditors: A Comparative Look at UNCITRAL's Legislative Guide on Insolvency Law" (http://ssrn.com/abstract=1337824, retrieved 25.02.2010) 15 seq.

[33] For an overview see Bork, Einführung in das Insolvenzrecht (3rd edn Mohr Siebeck, Tübingen 2002) 34.

[34] UNCITRAL Guide, pp. 203.

[35] UNCITRAL Guide, pp. 204.

court. It takes its decisions by a simple majority, for which the sum of claims held by the creditors with voting rights is decisive.[36] The Gläubigerversammlung is empowered to replace the (court appointed) insolvency representative, to stop operating the business or to request the debtor / insolvency representative to prepare a reorganisation plan (§§ 157, 284 InsO). Actions by the insolvency representative which are of particular substance are subject to the Gläubigerversammlung's approval, e.g. the sale of the debtor's business to an affiliate or for a price below the highest bid, or the taking of a large value loan (§§ 160-164 InsO).[37]

The creditors' meeting[38] may[39] appoint a creditors' committee (*Gläubigerausschuss*). The committee shall consist of representatives of creditors with a right to separate satisfaction, the creditors of the insolvency proceedings holding the maximum claims, and the small sum creditors. The committee shall also include a representative of the debtor's employees if the latter are involved as creditors of the insolvency proceedings holding considerable claims. Notably, the members of the committee need not themselves be creditors.[40] The committee shall support and monitor the insolvency representative. In order to fulfil this task, the committee has broad powers.[41] They are entitled to demand information, to inspect the books and business documents and the monetary transactions taken by the debtor or insolvency representative. In addition, the committee - as representative of the creditors' meeting - has to approve any material action by the insolvency representative. Members of a creditors' committee are entitled to remu-

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[36] For details Ehricke, Münchener Kommentar zur Insolvenzordnung (2nd edn C.H. Beck, München 2007), § 76 recitals 28 seq.

[37] In case there is a creditors' committee (Gläubigerausschuss), the committee the power to approve the named actions lies in the committee, not in the Gläubigerversammlung.

[38] The insolvency court may appoint a creditors' committee, as long as the creditors' meeting has not met for the first time yet. The creditors' meeting shall decide whether it is to be maintained in office (§ 68 (1) InsO).

[39] It usually makes an appointment when there is a larger number of creditors involved.

[40] § 67(2) InsO. The rule intends to bring special outside knowledge to the committee (see Schmid-Burgk, Münchener Kommentar zur Insolvenzordnung (2nd edn C.H. Beck, München 2007), § 67 recitals 21.

[41] Uhlenbruck, "Ausgewählte Pflichten und Befugnisse des Gläubigerausschusses in der Insolvenz" (2002) ZIP 1373; Frege, "Die Rechtsstellung des Gläubigerausschusses nach der Insolvenzordnung (InsO)" (1999) NZG 478, 483.

neration and reimbursement of their expenses. On the other hand, the members of the committee are liable for any damage caused to the creditors by faulty breach of their duties.

d) Assessment

The brief comparison of creditor's participation in insolvency proceeding demonstrates, in general, a broad consensus among the Guide and German insolvency law. The Insolvenzordnung mostly matches the recommendations to be found in the Guide. As suggested in the Guide, German law holds heightened importance in the Gläubigerautonomie. Insofar, it follows the "greater participation" approach which is obviously favored by the Guide. In addition, the Insolvenzordnung is a perfect match with respect to the institutions of creditors' participation. The creditors' meeting and the creditors' committee pursuant to the Insolvenzordnung appear to be neat copies of their proposed counterparts in the Guide. As recommended by the Guide, under German law the creditors are involved in the preparing and negotiating of reorganisation plans and in any material actions by the insolvency representative; there are express rules to eligibility to creditors' institutions; the creditors' committee is entitled to supervise the representative and has corresponding investigative powers; members of the creditors' committee are paid and reimbursed for any expenses. One could easily expand this list of similarities among the Guide's recommendations and German Insolvency law. Generally speaking, there is a broad convergence in the field of creditors' participation in insolvency proceedings.

IV. Summary

1. The ongoing technological and socio-political development promotes comparative law work which is becoming a common tool of law making in today's world. This development leads to a convergence of national and supranational law systems.

2. The UNCITRAL Legislative Guide on Insolvency Law is proof for the convergence of insolvency law. There is a convergence within the Guide

("internal convergence") and a convergence in relation to national laws ("external convergence").

3. With respect to the treatment of contracts in insolvency proceedings and the participation of creditors in the proceedings, German insolvency law shows great convergence with the Guide's recommendations.

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The Extent of Judicial Review of Arbitral Awards
A Comparative Analysis of U.S. American and English Law

I. Introduction

No one likes losing. Not surprisingly, when a party is disappointed with an arbitral award, the first question which comes to the mind of this person is: 'How can I get rid of this burdensome award?'[1]. There are two basic ways. First, the party may oppose recognition and enforcement of the award. Second, the party may offensively challenge the award by seeking a judicial review. This is for the losing party. The winning party has different interests and a different question in mind: 'How can a court interfere with the presumed final award?'.

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[1] See Craig, 'Uses and Abuses of Appeal from Awards' (1988), 4 Arbitration Intl 174, 177.

This paper tackles the question by evaluating the extent of judicial review of arbitral awards under U.S. American (federal) and English arbitration law. It presents two arguments. First, judicial review is quite narrow and limited to situations with rather exceptional circumstances. Secondly, U.S. arbitration law is more reluctant to contractual changes on the scope of judicial review rather than English law. The arguments are developed by taking an in-depth look at statute and case law in the U.S.A. (B.) and England (C.). Thereby, the focus is on the extent of the judicial review applied by courts and on the parties' autonomy to decide on the scope of judicial review. Finally, a comparative assessment is made (D.)

II. United States of America

U.S. American arbitration law is governed by statute and case law on the federal level as well as on the state level. This paper focuses on federal arbitration law. Its statutory rules, including provisions to challenge an award, are set out in §10 Federal Arbitration Act (FAA). The act articulates four narrow grounds upon which a arbitration award can be challenged.[2] In addition, courts have shown their willingness to set aside an award upon four non-statutory grounds not contemplated by §10 FAA.

1. Evolution of Judicial Review under U.S. American Law

Early U.S. arbitration law was historically influenced by English arbitration.[3] In the mid 19th century, American courts started to depart from English traditions by expressly stressing the contractual nature of arbitration.[4] In 1920 the first modern arbitration statute was enacted in the State of New York. New Yorker merchants had pressed for the Act, being unsatis-

[2] For an overview see Pluchinsky, 'The Basics of Conforming, Vacating, Modifying and Correcting an Arbitration Award under the Federal Arbitration Act and the Texas Arbitration Act' (2003) 25 The Advoc (Texas), 45-50.

[3] See Sayre, 'Development of Commercial Arbitration Law' (1927) 37 YaleL.J. 596 who also gives an in-depth discussion of the evolution of early English and U.S. arbitration law.

[4] Berger/Sun, 'The Evolution of Judicial Review under the Federal Arbitration Act' (2009) 5 NYU JoL&B 745, 749 with reference to early court decisions, such as *Hobson v McArthur* 41 U.S. 182 , 192 (1842).

fied with the 'expensive, endless law' dispensed by courts.[5] Notably, the Act already provides provisions to have an award set aside. Soon after, in 1924, the Federal Arbitration Act came into force. It had two key features: §2 emphasised the contractual nature of arbitration, §10 set out grounds for setting aside an award. Both features have survived. While in the early years of the FAA courts adhered to a strict textual view of §10,[6] later decisions, such as *Wilkens v Allen*[7] and *Wilko v Swan*[8], expanded judicial review beyond the statutory grounds for challenge set out in the FAA by creating non-statutory grounds like manifest disregard of law.[9] Despite this non-statutory expansion[10], whose existence is uncertain since *Hall Street Associates v Mattel*[11],[12] courts have shown the willingness to keep the scope of judicial review particularly narrow.[13]

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5 Berger/Sun, 'The Evolution of Judicial Review under the Federal Arbitration Act' (2009) 5 NYU JoL&B 745, 750 Fn 25 'See Jerald S Auerbach, Justice without law? Resolving Disputes without Lawyers 32-33 (1984) (explaining that in the mid-18th century arbitration of disputes was favoured by merchants because the courts were slow to develop legal doctrine that facilitated commercial development)'.

6 *James Richardson & Sons, Ltd. v W. E. Hedger Transp. Corp.,* 98 F.2d 55, 57 (2d Cir. 1938) 'This court is without power to amend or overrule merely because of disagreement with matters of law or facts determined by the arbitrators.'; *The Hardbridge North England v Munson Line.*62 F.2d 72, 73 (2d Cir. 1932); see also *Wilkins v Allen 7 Bedell* 494, 62 N.E. 575 N.Y. 1902

7 169 N.Y. 494 (1902).

8 346 U.S. 427 (1953).

9 Some circuits have denied non-statutory grounds, see with further reference Leasure, 'Arbitration after Hall Street v Mattel: What happens next' (2009) 21 UALRLR 273, 283.

10 Critics are expressed by further reference given by Hayford/Kerrigan, ' Vacatur: The non-statutory grounds for judicial review of commercial arbitration awards' (1996) 51 DispResolJ 22.

11 128 S.Ct. 1396 (2008), for further detail on this landmark decision see below.

12 See e.g. Rutledge, 'On the Importance of Institutions: Review of Arbitral Awards for Legal Errors' (2002) 19 JIntArbL 81, 95.

13 Leasure, 'Arbitration after Hall Street v Mattel: What happens next' (2009) 21 UALRLR 273, 277; Rutledge, 'On the Importance of Institutions: Review of Arbitral Awards for Legal Errors' (2002) 19 JIntArbL 81, 81; for an in-depth analysis Hayford, 'Law in Disarray: Judicial Standards for Vavatur of Commercial Arbitration Awards' (1996) 30 Ga.L.Rev. 731.

2. Statutory Grounds for Setting aside an Award

a) Corruption, Fraud, Undue Means

An award may be set aside where it was procured by corruption, fraud, or undue means conducted by a party, an advocate, or an arbitrator, §10(a)(1) FAA. The terms 'fraud' and 'undue means' are commonly interpreted together by courts. As stated *in Indocomex Fibres v Cotton Co. Int'l*[14], fraud requires bad faith during the arbitration proceedings, such as bribery, undisclosed bias of an arbitrator, or wilfully destroying or withholding evidence. Similarly, the phrase 'undue means' also refers to any bad faith, especially to any behaviour which is immoral if not illegal.[15] According to a settled line cases, §10(a) FAA require the applicant to show that the alleged improper behaviour (i) caused the tribunal's decision; (ii) was not discoverable by due diligence before or during the arbitration hearing; (iii) materially related to an issue in the arbitration, and (iv) established by clear and convincing evidence.[16]

b) Evident Partiality, Corruption of the Arbitrator

Courts have not yet delivered a precise definition for the terms 'partiality' and 'corruption'. They have rather decided on a case-by-case basis. In *Commonwealth Coatings Corp. v Continental Cas. Co*[17]*.,* the Supreme Court held that since the impartiality of courts is a constitutional principle, there is no basis for refusing to find the same concept in the broad statutory language §10(a)(2) FAA.[18] Accordingly, the Supreme Court[19] opined that (undisclosed) sporadic dealings between the arbitrator and a party may even constitute arbitrator partiality. Furthermore, it held that the amount of relevant

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[14] 916 F.Supp. 721, 728 (W.D.Tenn.1996).

[15] *In re TransChemical Ltd,* 978 F.Supp. 266, 304.

[16] *In re TransChemical Ltd* 978 F.Supp. 266, 304; *Gingiss Int'l, Inc. v Bormet,* 58 F.3d 328, 333 (7th Circ. 1995); *A.G. Edwards & Sons, Inc. v McCollough,* 967 F.2d 1401, 1404; Leasure, 'Arbitration after Hall Street v Mattel: What happens next' (2009) 21 UALRLR 273, 277.

[17] 393 U.S. 145 (1968).

[18] 273 U.S. 510, 47 S.Ct. 437, 71 L.Ed. 749 (1927).

[19] Citing *Tumey v State of Ohio* 748 F.2d 79, 82-84 (2d Cir. 1984).

benefits, even if they were a very small part of (the arbitrator's) income is irrelevant and, therefore, an award should be set aside where there is the slightest pecuniary interest.

Because statutory law provides for 'evident' partiality and corruption, the party must produce specific facts, and the alleged partiality or corruption must be direct, definite, and capable of demonstration to a reasonable man[20]. As stated in *Morelite Construction v New York City District Counsel Carpenter's Benefit Funds*[21] this might require proof of actual bias but suggesting that circumstances being 'powerfully suggestive of bias' might also be sufficient.

c) Arbitrator Misconduct

Any misbehaviour of an arbitrator, such as refusing to postpone the hearing, upon sufficient cause shown, or refusing to hear evidence pertinent and material to the controversy, by which the rights of any party have been prejudiced, gives ground to set aside an award under §10(a)(3) FAA. Courts have stated that only a fundamentally unfair hearing will be open to review. As held in *Bell Aerospace Co. v Local*[22], an arbitrator 'need not follow all the niceties observed by the federal courts'(i.e. fundamental fairness not perfection)[23]. However, an arbitrator must give each of the parties an 'adequate opportunity to present its evidence and argument'[24]. Accordingly, courts have affirmed an arbitrator's misbehaviour where the arbitrator refused to continue the proceeding to hear the testimony of a key witness,[25] or misled the employer's counsel so that he did not submit the testing evidence as a business record[26].

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20 Leasure, 'Arbitration after Hall Street v Mattel: What happens next' (2009) 21 UALRLR 273, 279.

21 748 F.2d 79, 82-84 (2d Cir. 1984), followed by *Mantle v Upper Deck* 956 F.Supp. 719 (N.D. Tex. 1997); *Apperson v Fleet Carrier Corp.* 879 F.2d 1344, 1358 (6th Cir. 1989).

22 *Bell Aerospace Co. Div. of Textron v Local* 516, 500 F.2d 921, 923 (2d Cir.1974).

23 Leasure, 'Arbitration after Hall Street v Mattel: What happens next' (2009) 21 UALRLR 273, 277.

24 *Hoteles Condado Beach v Union De Tronquistas Local* 901, 763 F.2d 34, 39 (1st Cir.1985).

25 *Tempo Shain Corp. v Bertek, Inc.* 120 F.3d 16 (2d Cir. 1997).

26 *Gulf Coast Industrial Workers Union v Exxon Co.* 70 F.3d 847 (5th Cir. 1995).

d) Arbitrator exceeding their Powers

§10(a)(4) FAA provides, that an award may be set aside where the arbitrators (i) exceeded their powers, or (ii) so imperfectly executed them that a mutual, final, and definite was not made.

By far the greater proportion of reported case law concerns the 'exceeded powers' ground. Most courts favour a contractual approach to the 'power' of the arbitrator. In *Eljer Mfg. v Kowin Dev. Corp.*[27], it was held that an arbitrator exceeds his powers when he exceeds the powers delegated to him by the parties. Case law illustrated several examples of an arbitrator exceeding his powers transferred to him by the parties, such as, ruling on issues not put forward by the parties;[28] deciding an issue involving a non-party to the arbitration argument;[29] crafting a remedy not provided by the agreement of the parties;[30] failing to comply with an express requirement as to the form, nature, or content of the award; determining an issue beyond the scope of the arbitration clause[31]. After *Hall Street Associates v Mattel*[32] some courts held that where an arbitrator shows manifest disregard of law, the arbitrator 'exceeds powers'.[33] However, §10(a)(4) doesn't provide for an examination of the merits or facts of an (arbitration) award.[34]

There is very little case law on the 'mutual, final, and definite award' ground set out in the second clause of §10(a)(4) FAA. The cases indicate that attempts to challenge an award on this ground typically concern awards (i) which enormously lack clarity, or (ii) which do not resolve all the

[27] 14 F.3d 1250, 1255-56 (7th Cir. 1994).

[28] *Fahnestock & Co. v Waltman* 935 F.2d 512, 515-16 (2d Cir.); *Dighello v Busconi* 673 F. Supp. 85, 87 (D. Conn. 1987).

[29] *Orion Shipping & Trading Co. v Eastern States Petroleum Corp.* (1963, CA2 NY) 312 F2d 299; *Eljer Mfg. v Kowin Dev. Corp.* 14 F.3d 1250, 1255-56 (7th Cir.).

[30] *American Eagle Airlines, Inc. v Air Line Pilots Ass'n, Intern.* 343 F.3d at 410.

[31] *Folkways Music Publishers, Inc. v Weiss,* 989 F.2d 108, 111 (2d Cir. 1993).

[32] 552 U.S. 576, 128 S. Ct. 1396, 170 L. Ed. 2d 254, 2008 A.M.C. 1058 (2008).

[33] *Comedy Club, Inc. v Improv West Associates* 553 F.3d 1277, 1290, 2009-1 Trade Cas. (CCH) 76482 (9th Cir. 2009), *Stolt-Nielsen SA v AnimalFeeds Intern. Corp.,* 548 F.3d 85, 93-95, 2008-2 Trade Cas. (CCH) ¶ 76355, 2008 A.M.C. 2722 (2d Cir. 2008), cert. granted, 129 S. Ct. 2793, 174 L. Ed. 2d 289 (2009).

[34] *Coast Trading Co. v Pacific Molasses Co.* 681 F.2d 1195, 1198 (9th Cir. 1982).

issues submitted to arbitration.[35] In *Lummus Global v Aguaytia Energy.[36],* it was held that an award providing a formula that leaves disputes and is likely to require further proceedings regarding future damages is not a 'final, and definite award'.

3. Non-Statutory Grounds for Setting aside an Award

a) Public Policy

According to an established line of cases, an award may also be set aside where it is contrary to public policy.[37] In *W.R. Grace & Co. v Rubber Workers*[38] and *United Paperworkers Int'l Union v Misco. Inc.,*[39] the Supreme Court held that to vacate an award on public policy grounds, there must be (i) an explicit, well defined and dominant policy which must be clearly shown to exist and (ii) it must be shown that the policy is one that specifically contradicts the relief ordered by the arbitrator. Case law stresses the narrow scope of this non-statutory ground.[40]

b) Essence of the agreement

In the past, very few courts set aside an award on the ground that the arbitrator's decision didn't draw its 'essence' from the parties' agreement. In

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[35] *Rocket Jewelry Box, Inc. v Noble Gift Packaging, Inc.*157 F.3d 174 C.A.2 (2nd Cir., 1998); Fradella v Petricca 183 F.3d 17 C.A.1 (1st Cir., 1999).

[36] 256 F.Supp.2d 594, 641-43 (award not final).

[37] This ground roots in the common law doctrine of court's power to refuse to enforce a contract that violates public policy or law, Hayford/Kerrigan, 'Vacatur: The non-statutory grounds for judicial review of commercial arbitration awards' (1996) 51 DispResolJ 22, 27 citing *Seymour v Blue Cross/Blue Shield*, 988. F.2d 1020, 1023 (10th Cir.1993).

[38] 461 U.S. 757, 766, 103 S.Ct. 2177, 2183, 76 L.Ed.2d 298 (1983).

[39] 484 U.S. 29, 108 S.Ct. 364, 98 L.Ed.2d 286 (1987).

[40] *Prestige Ford v Ford Dealer Computer Services, Inc.* 324 F.3d 391 (5th Circ, 2003); *United Paperworkers Int'l Union v Misco, Inc.* 484 U.S. 29, 108 S.Ct. 364, 98 L.Ed.2d 286 (1987); *Gulf Coast Industrial Workers Union v Exxon Co.,* U.S.A., 991 F.2d 244 (5th Cir.1993); further reference given by Hayford/Kerrigan, 'Vacatur: The non-statutory grounds for judicial review of commercial arbitration awards' (1996) 51 DispResolJ 22, 27.

Executone Information Systems v Davis[41], the court stated that an award 'must have a basis that is at least rationally inferable, if not obviously drawn, from the letter or purpose of the contract. Apparently, this ground is closely linked to the ground provided by s.10(a)(4) FAA (arbitrator exceeding their power).

c) Arbitrary and Capricious

The Eleventh Circuit, which apparently doesn't follow the manifest disregard of law doctrine[42], has recognized yet another ground for challenge, not expressed in the FAA, where it is irrational, arbitrary or capricious.[43] As held in *Ainsworth v Skurnick*[44], an award is arbitrary and capricious only if 'a ground for the arbitrator's decision cannot be inferred from the facts of the case'. While the Fifth Circuit has held that arbitrariness and capriciousness are not an accepted non-statutory ground for challenging an award, other circuits are in a muddle on this question.[45]

d) Manifest Disregard of Law

Manifest disregard had generally been accepted by case law as a non-statutory ground for setting aside an award since the Supreme Court's decision in *Wilko v Swan*[46]. A manifest disregard of law is, generally speaking, where an arbitrator (i) knew of a clear, unambiguous, and plainly applicable legal principle, (ii) appreciated that this principle controlled the outcome of the disputed issue, in the way that no judge ever conceivably would disregarded it, (iii) and nonetheless willfully refused to apply it. Corresponding-

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[41] 26 F.3d 1314 (5th Circ., 1994) citing *Anderman/Smith Operating Co. v Tennessee Gas Pipeline Co.*918 F.2d 1215 (5th Circ., 1990) and *United Steelworkers v Enterprise Wheel & Car Corp.,* 363 U.S. 593, 597, 80 S.Ct. 1358, 1361, 4 L.Ed.2d 1424 (1960).

[42] For this non-statutory ground for challenge see below.

[43] *Lifecare Intern., Inc. v CD Medical, Inc.,* 68 F.3d 429, 435 (11th Cir. 1995), opinion modified and supplemented, 85 F.3d 519 (11th Cir. 1996).

[44] 960 F.2d 939 (11 Circ., 1992) citing *Raiford v Merrill Lynch, Pierce, Fenner & Smith, Inc.* 903 F.2d at 1410, 1413 and *Drummond Coal Co. v United Mine Workers of America* 748 F.2d 1495, 1497 (award may be vacated if irrational).

[45] Further reference given by Hayford/Kerrigan, 'Vacatur: The non-statutory grounds for judicial review of commercial arbitration awards' (1996) 51 DispResolJ 22, 28.

[46] 346 U.S. 427 (1953).

ly, manifest disregard of law has been seen more than legal error or misunderstanding. That is, a court would not set aside an award because of an arguable difference regarding the meaning or applicability of laws.[47] Specifically, setting aside an award has been unjustified simply because a reviewing judge disagrees with the award or believes the arbitrator made a serious legal or factual error.[48]

After many deliberations and dissenting opinions among Circuit Courts, the Supreme Court has apparently discredited manifest disregard of the law as an independent, non-statutory ground. In *Hall Street Associates v Mattel*[49] the Supreme Court was confronted with an alleged manifest disregard of law. Referring to the statutory language of §10(a) FAA, the courts held that the statutory grounds for setting aside an award are exclusive.[50] However, the Supreme Court that manifests disregard of law can be read as merely referring to the §10(a) grounds collectively.[51] In the aftermath of *Hall Street Associates v Mattel*[52] some Circuit Courts[53] seem to have departed from the doctrine of manifest disregard, while others[54] held that manifest disregard survives, but only when recast as shorthand for §10(a)(4) FAA.[55]

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[47] *New York Telephone Co. v Communications Workers of America Local 1100,* AFLCIO Dist. One, 256 F.3d 89 (2d Cir. 2001) (per curiam).

[48] *Beacon Journal Pub. Co. v Akron Newspaper Guild, Local Number 7,* 114 F.3d 596 (6th Cir. 1997).

[49] 128 S.Ct. 1396 (2008).

[50] Suporting this vie see e.g. Rutledge, 'On the Importance of Institutions: Review of Arbitral Awards for Legal Errors' (2002) 19 JIntArbL 81, 95.

[51] 128 S.Ct. 1396, 1406 (2008).

[52] 128 S.Ct. 1396 (2008).

[53] *Citigroup Global Markets, Inc. v Bacon,* 562 F.3d 349 (5th Cir. 2009).

[54] *Comedy Club, Inc. v Improv West Associates* 553 F.3d 1277, 1290 (9th Cir. 2009); *Stolt-Nielsen SA v AnimalFeeds Intern. Corp.* 548 F.3d 85, 93-95 (2d Cir. 2008); *Ramos-Santiago v United Parcel Service* 524 F.3d 120, 124 (1st Cir. 2008); *Grain v Trinity Health, Mercy Health Services Inc.*, 551 F.3d 374, 380 (6th Cir. 2008).

[55] For an in depth analysis Berger/Sun, 'The Evolution of Judicial Review under the Federal Arbitration Act' (2009) 5 NYU JoL&B 745.

4. Procedural Matters

In terms of procedure is shall be mentioned, that notice of a motion to set aside an award must be served upon the adverse party or his attorney within 3 months after the award is filed or delivered; §12 FAA. This leaves the parties considerably long in uncertainty.

5. Conclusion: Court Interference

Under the federal arbitration law, courts may interfere with awards on statutory grounds set out in §10(a)(1) FAA, but also on non-statutory grounds developed by case law. The statutory grounds FAA are constructed in plain and simple language making easy for the parties to ascertain under which conditions they may challenge an award. Despite the first-sight simplicity of the language, all of the grounds stated in §10(a)(1)-(4) are compiled of vague phrases, such as 'undue means', 'evident partiality', or 'any other misbehaviour', which allow theoretically for a quite wide interpretation of it by courts. However, courts not only have stressed that a judicial review of an award is exceptionally narrow and severely limited is an essential, and inherent, feature of contractually agreed binding arbitration.[56] Courts have lived up to this perception. They have construed the vague phrases of §10(a)(1) FAA in a narrow way.[57] In addition they have established high standards of evidence, putting a heavy burden of proof on the party who challenges the award.[58] Because of its wide wording ('where the arbitrators exceed their powers'), §10(a)(4) is the loophole or gateway when going for a review of an award. Construing the phrase in a broad way it may absorb all other statutory grounds.[59] When an arbitrator acts

[56] *Lummus Global Amazonas S.A. v Aguaytia Energy del Peru S.R. Ltda.* 256 F.Supp.2d 594, 605; citing *In re TransChemical Ltd,* 978 F.Supp. 266, 303.

[57] Leasure, 'Arbitration after Hall Street v Mattel: What happens next' (2009) 21 UALRLR 273, 277.

[58] Leasure, 'Arbitration after Hall Street v Mattel: What happens next' (2009) 21 UALRLR 273, 277.

[59] See e.g. Mungioli, 'The Manifest Disregard of the Law Standard: A Vehicle for Modernization of the Federal Arbitration Act' (2000) 31 St. Mary's L.J. 1079, 1099-1002 (collected cases); Rutledge, 'On the Importance of Institutions: Review of Arbitral Awards for Legal Errors' (2002) 19 JIntArbL 81, 89; *Watts & Sons v Tiffany and Co* No 00-3231 (CA7 April 16, 2001); for a discussion see also Hayford, 'Law in Disarray: Judicial Standards for Vavatur of Commercial Arbitration Awards' (1996) 30 Ga.L.Rev. 731.

fraudulently, he certainly exceeds his powers which the parties have assigned to him by contract. Not surprisingly, almost 60% of all the applications for a judicial review are based on §10(a)(4) FAA.[60] Nevertheless, a recent study shows that courts take a non-interventionist approach when reviewing awards. Only 10% of applications brought in the federal courts were successful in setting aside an award.[61] The willingness not to intervene with awards manifests in the field of the non-statutory grounds. Indeed, courts have developed non-statutory grounds for setting aside an award. However, they have narrowed exceptionally the scope of theses grounds. It remains to be seen if *Hall Street Associates v Mattel*[62] will further limit this scope.

6. Party Autonomy

Courts have, in a few cases, addressed the issue, whether parties can lower or raise the scope of judicial review compared to statutory provisions. The overall picture is blurry. Some courts have stressed that minimal standards must exist for arbitration awards to be enforced. In *Hoeft v MVL Group, Inc.*[63], the Court of Appeals found that the FAA created 'critical safeguards' for the arbitration process that represented a 'floor for judicial review of arbitration awards below which the parties cannot require courts to go.'[64] Other courts have, however, been more sympathetic with lowering the scope of review by way of contractual agreement. In *Bowen v Amoco Pipeline*[65], the court stated that 'the parties to an arbitration agreement may eliminate judicial review by contract, [but] their intention to do so must be clear and unambiguous.'[66] In *Kyocera Corp. v Prudential-Bache Trade Services*

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[60] Mills et.al., 'Vacating Arbitration Awards', (2005) 11 No 4 Disp.Resol.Mag 23, 25.

[61] Mills et.al., 'Vacating Arbitration Awards', (2005) 11 No 4 Disp.Resol.Mag 23, 25.

[62] 128 S.Ct. 1396 (2008).

[63] 343 F.3d 57 (2d Cir. 2003).

[64] Some courts have taken a "blue-pencil" approach and upheld the award so long as it meets traditional FAA review standards; *Bowen v Amoco Pipeline,* 254 F.3d 925 (10th Circ. 2001); *Kyocera Corp. v Prudential-Bache Trade Services Inc.* 341 F3d., 987, 994 (9thCirc 2003).

[65] *Bowen v Amoco Pipeline,* 254 F.3d 925 (10th Circ. 2001).

[66] See also *Aerojet-Gen'l Corp. v Am. Arbitration Ass'n,* 478 F.2d 248, 251 (9th Cir. 1973).

Inc.[67] the court stated 'the decision to contract for a narrower standard of review than the courts generally apply in the absence of a statutory command is a decision that may be less troublesome than the attempt to contract for a broader standard of review than that authorized by Congress'.

Today, after the Supreme Court decision in *Hall Street Associates v Mattel*[68], it seems unclear which way the law will develop. The Supreme Court denies any party autonomy in contracting a judicial review under the FAA. The court didn't explicitly spell out whether and to which extent the parties can contract themselves entirely out of §10 FAA. In recent decision, the Supreme Court of California held that arbitration agreements providing for expanded judicial review of the award are enforceable under California Arbitration Act. It seems that the question is still open for arguments.[69]

III. England

Arbitration, as a method of dispute resolution, has existed in England for a long time. Its development was mainly caused by the inability of the royal court systems to provide merchants with an efficient system for dispute resolution. Inherently linked with the evolution of arbitration, the rules governing the judicial review of awards developed accordingly. The evolution of judicial review under English law is outlined below (1.). It lays ground for a look into the present legal landscape in this field of law, which is dominated in statutory terms by the Arbitration Act 1996 (AA 1996). The act provides, in a sophisticated manner, three grounds upon which an award is likely to be challenged: defects of substantive jurisdiction (2.), serious irregularities (3.), and serious defects on the point of law (4).

[67] *Kyocera Corp. v Prudential-Bache Trade Services Inc.* 341 F3d., 987, 994 (9thCirc. 2003).

[68] 128 S.Ct. 1396 (2008).

[69] *Cable Connection, Inc. v DIRECTV, Inc.* 44 Cal.4th 1334, 190 P.3d 586 Cal., 2008.

1. Evolution of Judicial Review under English Law

By the middle of the 17th century principles of arbitration law could be found in a small set of case law and in the text on *lex mercatoria*. One of these principles suggests that there was a reluctance regarding any review of an award once it was issued, but also a willingness to accept party autonomy on this question: '[...] that they [awards] make an final end [...] by specification or otherwise, if they [awards] be required so to do and authorised thereunto.'.[70] In *Sergeant Hards*[71] the court opined that, although natural justice prevents a party to be his own judge in ordinary litigation procedures, this rule doesn't apply to arbitration proceedings: If the parties deliberately choose one of them as arbitrator then they are bound to this choice. Subsequent court rulings departed to some extent from this strict approach. However, the extent of the court's power to review awards remained limited to acts of arbitrators, which were beyond their powers, acts of arbitrators which were contrary to natural justice, and acts of arbitrators which were of corruptive nature.[72]

The Common Law Procedure Act 1854 roughly transferred this practice into statutory form. Various Arbitration Acts were passed since then. The latest one was introduced in 1996.[73] The so called Arbitration Act 1996 (AA 1996) was prepared by the Departmental Advisory Committee on Arbitration Law ('DAC') and was inspired by the UNICTRAL Model Law on arbitration[74]. It hosts a body of rules incorporated within ss.67-71 AA 1996. Ss.67-69 deal with grounds upon which an award may be challenged. Ss.70-71 provide supplemental procedural rules.

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[70] For in-depth discussion of the evolution of early English and U.S. arbitration law see Sayre, 'Development of Commercial Arbitration Law' (1927) 37 YaleL.J. 596.

[71] Referred to in *Matthew v Ollerton* (1693) 4 Mod 226.

[72] See *Morgan v Mather* (1792) 2 Ves Jr 15 per Wilson LC cited by Tweeddale, *Arbitration of Commercial Disputes* (Oxford University Press, Oxford 2007) 484.

[73] For an review of some principals of the AA 1996 see Yu, ‚Five Years On: A Review of the English Arbitration Act 1996' (2002) 19 JInt.Arb. 209.

[74] Davidson, 'The new Arbitration Act - a model law?' (1997) JBL 101 identifies the key areas where AA 1996 borrowed from the UNCITAL Model Law.

2. Grounds for Setting Aside an Award

a) Lack of Substantive Jurisdiction

aa) General. Under s.67 AA 1996 a party may challenge an award on the ground that there is a lack of substantive jurisdiction. The essential phrase 'substantive jurisdiction' is defined in a narrow sense in ss.30(1), 82(1)(a) AA 1996: invalid valid arbitration agreement, improper tribunal's constitution; award outside the matters submitted. In *Vee Networks Ltd v Econet Wireless International Ltd*[75], Colman J stressed that s.67 is not intended to challenge matters of substantive law (waiver, estoppel, res judicata) or procedural matters. As held in *Peterson Farms Inc v C&M Farming Ltd*[76], challenges to the jurisdiction of an arbitral tribunal under s.67 AA 1996 Act are in the character of a *de novo* rehearing.[77].

bb) Conclusion: Court Interference and Party Autonomy. S.67 AA is structured in a plain way providing little conditions for challenging an award than the lack of substantive jurisdiction. Courts seem to favour a non-interventionist approach to the statute. In *Vee Networks Ltd v Econet Wireless International Ltd*[78] a non-interventionist approach was taken by referring matters of substantive law and procedural matters to other statutory ground for challenge, which in some regard feature higher demanding prerequisites. In terms of party autonomy, there is no statutory provision dealing with the question whether parties can agree on the exclusion of section 67 within their arbitration agreement. Neither there is case law on the issue. However, *Tweeddale* opined that section 67 AA 1996 is mandatory and, hence, cannot be excluded by the parties.[79]

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[75] [2004] EWHC 2909 (Comm.).

[76] [2004] EWHC 121 (Comm).

[77] *Ranko Group v Antarctic Maritime SA* [1998] LMLN 492 suggested a mere review of the tribunal's decision.

[78] [2004] EWHC 2909 (Comm.).

[79] Tweeddale, *Arbitration of Commercial Disputes* (Oxford University Press, Oxford 2007) 761.

b) Serious Irregularities (Sec. 68 AA 1996)

A set of grounds for challenging an award is pooled under the term "serious irregularity" in section 68 AA 1996.[80]

aa) Defining Serious Irregularities. Serious irregularity refers to substantial defects in the arbitral proceedings and in the award itself. These defects are narrowly defined and listed in s.68(2) AA 1996. There is a well established line of case dealing with the terms and phrases incorporated within the statutory definition of serious irregularities.81 The cases show that courts tend to construe the statutory terms and phrases in a narrow way.

bb) Causation of substantive injustice. The court will set aside the award, only if the serious irregularity 'has caused or will cause substantial injustice to the applicant'; s.68(2) AA 1996. In Mohsin v Commonwealth Secretariat82 the court denied a substantial injustice because setting aside the award would not have given the applicant any financial benefit, considering also costs of a new tribunal hearing. Today, courts use this economic or monetary approach to determine if the serious irregularity, once it is established, is likely to affect the award in terms of any loss. However, in *Groundshire Ltd v VHE Construction plc*[83] Bowsher J held that injustice is not only assessed by pecuniary means saying that it is measure of proportionality of different considerations. In *Egmatra AG v Marco Trading Corp*[84] Tucky J stressed that "substantial' injustice was interpreted according to the Roman rule *de minimis non curat lex (*the law doesn't concern itself with trifles).

[80] For an overiew of this ground for challenge see e.g. Serek, 'Serious Irregularities and the Arbitration Act 1996: Lesotho Highlands Development Authority v Impregilo SpA' (2005) JBL 745.

[81] *Lesotho Highlands Development Authority v Impregilo SpA* [2005] UKHL 43 the House of Lords held that if arbitrators err in choosing the wrong currency in which to express their award, this error is not an error involving an excess of power under s.68 of the Arbitration Act 1996 but one under s.69 of that Act. For a brief discussion of this decision Serek, 'Serious Irregularities and the Arbitration Act 1996: Lesotho Highlands Development Authority v Impregilo SpA' (2005) JBL 745.

[82] [2002] EWHC 377 (Comm.).

[83] [2001] BLR 395.

[84] [1999] 1 Lloyd's Rep 862.

cc) Conclusion: Court Interference and Party Autonomy. The legislative history suggests, that these grounds under para. 2 are exclusive and should be construed in very narrow way. The Departmental Advisory Committee on Arbitration Law ('DAC') noted in his Report: 'Clause 68 is really designed as a long stop, only available in extreme cases where the tribunal has gone so wrong in its conduct of the arbitration that justice calls out for it to be corrected.'.[85] This approach has been demonstrated by case law not only by interpreting the terms under para. 2 tightly, but also the phrase 'substantive injustice'. The majority of applications under s.68 AA 1996 showed to be unsuccessful supporting the non-interventionist-approach of AA 1996.

According to *Tweeddale*[86] the serious irregularities stated in (2) are mandatory, meaning there is no party autonomy to explicitly excluding these grounds from judicial review. This approach seems reasonable in terms of systematic interpretation. Unlike s.69 of the Arbitration Act which reads: 'Unless otherwise agreed by the parties, a party to arbitral proceedings may [...] appeal to court', does s.68 not refer to any agreement of the parties. However, the ratio legis of s.68 is not a compelling reason to overturn a consent of the parties not rely on s.68 AA 1996. It neither seems persuasive that the parties should not be able to define the relevant phrases likes by providing examples for serious irregularities.

c) Question of Law (Sec. 69 AA 1996)

Section 69 AA 1996 allows for an appeal from an award on the point of law. Prior to the enactment AA 1996 there were calls to eliminate the possibility to challenge an award on a question of law. The Departmental Advisory Committee on Arbitration Law ('DAC') overturned the criticism. It argued by starting that a limited right of appeal is perfectly coherent with the parties' agreement to arbitrate. The arbitration agreement implied the consensus that the arbitral tribunal properly applies the relevant law. If the

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[85] DAC (Departmental Advisory Committee on Arbitration Law), *Report on the Arbitration Bill* (1996; reprinted in 13 Arbitration International 275-316) para. 280; this view is supported e.g. Serek, 'Serious Irregularities and the Arbitration Act 1996: Lesotho Highlands Development Authority v Impregilo SpA' (2005) JBL 745, 746.

[86] Tweeddale, *Arbitration of Commercial Disputes* (Oxford University Press, Oxford 2007) 765.

tribunal does not, the award does not meet the agreement's intent. However, s.69 is quite narrowly constructed providing several requirements upon which the award is only set aside.

aa) Question of Law. A party may apply to a court under s.69 AA 1996 to have determined a question of law of England and Wales[87], not of facts. Whether an event has occurred or not, or whether a contention is proven or not, it is generally a question of fact and therefore, cannot be a subject to an appeal under s.69 AA 1996.[88] The same holds generally true for substantive[89] and procedural (s.4(5) AA 1996)[90] foreign law.[91]

The question of law must arise from an arbitration award, excluding any interim measures by the tribunal. A question of law, generally spoken, concerns the interpretation of legal principles, like whether the exercised pressure amounts to economic duress or the construction of terms used by the parties.[92] A number of cases deal with the question whether matters of evidence are a matter of law and, therefore, appealable to a court. The Departmental Advisory Committee on Arbitration Law held that under the AA1996 any evidence related error by the arbitrator cannot be challenged as a question of law.[93] This view was backed by court rulings in the pre-1996-era[94] and is now applied in cases under the AA 1996.[95] In *Fence Gate*

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87 According to s.82(2) AA 1996 a question of law refers only to the law of England and Wales.

88 See *Athenian Tankers Management SA v Pyrena Shipping Inc, The Arianna* [1987] 2 Lloyd's Rep 376; *General Feeds Inc v Panama Slobodna Plovidba Yugoslavia* [1999] 1 Lloyd's Rep 688; *Hallamshire Construction Plc v South Holland DC* [2003] EWHC 8 (TCC).

89 For an exception see *Hussmann (Europe) Ltd v Al Ameen Development and Trade Co* [2000] 2 Lloyd's Rep 83, 94 per Thomas J.

90 Tweeddale, *Arbitration of Commercial Disputes* (Oxford University Press, Oxford 2007) 801.

91 For a discussion see Davidson, 'The new Arbitration Act - a model law?' (1997) JBL 101, 122 seq.

92 *Lesotho Highlands Development Authority v Impregilo SpA* [2005] UKHL 43.

93 DAC (Departmental Advisory Committee on Arbitration Law), *Report on the Arbitration Bill* (1996; reprinted in 13 Arbitration International 275-316) para. 170; Tweeddale, *Arbitration of Commercial Disputes* (Oxford University Press, Oxford 2007) 804.

94 *Blexen Ltd v G Percy Trentham Ltd* [1990] 21 Con LR 61, 65; *Geogas SA v Trammo Gas Ltd, The Baleares* [1993] 1 Lloyds's Rep 215, 232 CA.

Ltd v NEL Construction Ltd[96], Thornton J departed from this strict view. He distinguished insufficient evidence and nonexistent evidence and concluded that the latter concerns a question of law.

bb) Additional Statutory Conditions for Appeal. Section 69(2) AA 1996 states that an appeal shall only be brought if (i) the parties to the proceedings agree or (ii) the court grants leave to appeal. The parties consent must be in clear terms and may be made at any time before the appeal. It may also be made within the general terms of a contract.[97] If the is no consent among the parties regarding any appeal, the party who wants to appeal under s.69 AA 1996 must ask the court to grant leave to appeal. According to s.69(3) AA 1996 the court shall leave to appeal only if it is satisfied.

Notably, the stated conditions upon which a court may grant leave to appeal are apparently 'high-standard-phrases' implying big hurdles for any applicant: 'substantially affect the rights', 'obviously wrong', 'of general public importance', 'open to serious doubt'.[98] Furthermore, all of these conditions need to be satisfied. Not surprisingly, the number of cases dealing with the interpretation of the wording of s.69(3) AA 1996 are quite large.[99]

cc) Court Interference and Party Autonomy. Section 69(1) AA 1996 is non-mandatory. It reads as follows: 'Unless otherwise agreed by the parties, a party to arbitral proceedings may [...] appeal to the court on a question of law'. The phrase 'otherwise agreed' allows the parties to opt-out of a judicial review on the point of law. Therefore, if the parties include a clause[100] limiting the parties' right to challenge in their arbitration agreement, a court will not review the award.

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95 *How Engineering Services Ltd v Lindner Ceilings Floor Partitions plc (No 2)* [1999] 2 AllER (Comm) 374.

96 [200] AllER (D) 214.

97 See *Vascroft (Contractors) Ltd v Seaboard plc* (1996) 78 BLR 132.

98 For an detailed review of these conditions see Tweeddale, *Arbitration of Commercial Disputes* (Oxford University Press, Oxford 2007) 808 seq.

99 See Dedezade, 'Are you in? Are you out?' (2006) IALR 56; Tweeddale, *Arbitration of Commercial Disputes* (Oxford University Press, Oxford 2007) 808 seq.

100 For an example for such clause Dedezade, 'Are you in? Are you out?' (2006) IALR 56, 60.

Recent court rulings suggest that parties have to state their decision not to allow for a judicial review by using unequivocal language. In *Shell Egypt West Manzala GmbH v Dana Gas Egypt Ltd (formerly Centurion Petroleum Corp)*[101], Gloster J held that the words 'final, conclusive and binding' in the arbitration clause relating to the effects of an award don' demonstrate that the parties have agreed in to exclude the jurisdiction of a court under the s.69 AA 1996.[102] According to the ruling in *Sumukan Ltd v Commonwealth Secretariat*[103], the agreement to opt-out from a judicial review doesn't have to take explicit reference to the AA 1996.[104] Obviously, there is no case law on the question whether parties can agree on judicial review beyond the conditions set out in s.69 AA 1996.[105] Section 4(2) AA 1996 dealing with non-mandatory provisions like s.69 'allows the parties to make their own arrangements' without limiting this autonomy in any direction. Therefore, it is arguable that parties may agree on judicial review exceeding the border of s.69 AA 1996.

The construction of s.69 AA 1996 implies little interference by courts with arbitral awards. First, it allows appeals only on questions of law excluding other matters like evidence. Secondly, it provides for a number of elements in para. 3 which all must be met for granting leave to appeal. However, s.69 AA 1996 is contains several terms and phrases which are vague, such as question of law, and, therefore, give room for an extensive interpretation by courts. Insofar, courts have shown a tendency to be quite reluctant. Most notably, Lord Tucky held in *North Range Shipping Ltd v Seatrans Ship-*

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[101] [2009] EWHC 2097 (Comm), *Essex CC v Premier Recycling* [2006] EWHC 3594 (TCC) applied.

[102] Critical to this interventionist approach Capper, 'Section 69 and the "Interventionism" English Courts' (2009) Kluwer Arbitration Blog, 23.09.2009, http://kluwerarbitrationblog.com/blog/2009/09/23/section-69-and-the-%E2%80%9Cinterventionism%E2%80%9D-of-english-courts/ (05-02-2010).

[103] [2007] EWCA Civ 243.

[104] For a case comment see Friel, ' Excluding the Right to Appeal under section 69 of the Arbitration Act 1996 by Reference to the Rules of an Arbitral Institution' (2006) Int.Arb.L.Rev. N26.

[105] The same perception Samuel, 'The U.S. Supreme Court on the Federal Pre-Emption and Appeals on Questions of Law by Consent - A Case Not', (2009) 5 Arb. Int. 455-460.

ping Corp (The Western Triumph)[106], that there is no appeal from the judge's refusal to give permission on the merits. This is also implied by s.69(8) AA 1996.

3. Supplemental Aspects

There are two supplemental aspects to notice. First, s.70(2) requires an applicant to exhaust any alternative remedy to set the award aside (e.g. any available arbitral process of appeal or review) or any available recourse under the AA 1996 (e.g. correction of an award).[107] Second, s.70(3) AA 1996 requires that any application to challenge an award must be brought within 28 days of the date of the award.[108] [109] If the applicant doesn't meet these conditions, the application will not be considered by court.

IV. Comparative Assessment

The survey of U.S. and English arbitration law has shown similarities, but also differences, in the way arbitration awards can be set aside and, hence, in the way courts can interfere with arbitration awards.

1. Statutory Scope of Judicial Review

Both legal systems follow a non-interventionist approach. The Federal Arbitration Act as well as the AA 1996 provides for a sophisticated body of rules which is intended to narrow judicial review of arbitration awards. This may be best illustrated by ('exclusive') enumeration of grounds for

[106] [2002] EWCA Civ 405.

[107] Blackaby et.al., Redfern and Hunter on International Arbitration (Oxford University Press, Oxford 2009), 586; Tweeddale, Arbitration of Commercial Disputes (Oxford University Press, Oxford 2007), 783; see *Torch Offshore v Cable Shipping* [2004] EWHC 787 (Comm) where the court refused an application under s.68 AA 1996 for this reason.

[108] Or if there has been any arbitral process of appeal or review, of the date when the applicant or appellant was notified of the result of that process. The court may extend the time period.

[109] For an overview on time limits while challenging an award see Tweeddale, Arbitration of Commercial Disputes (Oxford University Press, Oxford 2007), 784 seq.

challenge in the statute, additional cumulative requirements (see s.69(3) AA 1996, causation of irregularities), and the strict languages, such as 'serious irregularities' or 'evident partiality'.

The construction of the relevant is partly different. While the FAA pursues a one-stop-ground, incorporating all different grounds for setting aside an award in one section and treating all of them in the same way, the AA 1996 distinguishes systematically between three grounds: lack of substantive jurisdiction, serious (procedural) irregularities, substantive grounds. Despite this difference in statutory construction, there is apparently not much difference in substance. The grounds set out in s.10 FAA also cover lack of substantive jurisdiction, serious (procedural) irregularities, and substantive grounds. Furthermore, the FAA as well as the AA 1996, uses broad terms and phrases which are open for an extensive interpretation. This is why there is no fundamental difference in the scope of judicial review under the FAA and the AA 1996. The same holds true for the non-statutory grounds for challenge under U.S. arbitration law. As suggested above, these grounds can arguably be interpreted as special cases of the statutory grounds set out in the FAA. This may not be true for the public policy ground. The AA 1996 covers this ground to some extent in s.69(3)(c)(ii) ('the question is one of public importance').

The broad terms and phrases used by the statute would seem to give way for an extensive judicial review of arbitral awards. However, the survey of American and English case law shows a rather strict judicial interpretation of statute law. A recent American study supports this assessment. Only 10% of applications for review in federal courts were successful.

Notably, there is one difference between U.S. and English law which has considerable practical implications. While under the AA 1996, an application for judicial review has to be brought to court within 28 days, while the FAA provides for much longer period of three months. Parties to arbitration under the FAA are much longer uncertain about the definite finality of an award. In commercial terms this is unsatisfactory.

2. Freedom to Contract for the Extent of Judicial Review

The freedom to contract for the extent of judicial review is not paid very much attention by statutory law and case law as well. Also, there is little scholarly work on the topic. Not surprisingly, this results in legal uncertainty. Taking freedom to contract seriously, there are two questions to be answered: (1) Can the parties agree on judicial review above the standards of statute law? (2) Can the parties agree on judicial review below the standards of statute law?

a) Review above the standards of statute law

In *Hall Street Associates v Mattel*[110] the Supreme Court denied any party autonomy in contracting a judicial review under the FAA. The Supreme Court argues, inter alia, one of the rationales of the FAA in general and of §10 FAA especially is to limit time-consuming judicial review of arbitration awards.[111] As pointed out before, in *Hall Street Associates v Mattel*[112] the Supreme Court didn't answer the question whether parties can explicitly and entirely opt-out of the FAA in order to broaden the scope of review. Before *Hall Street Associates v Mattel*[113] some courts Court Appeals have explicitly enforced agreements which broadened the scope of judicial review.[114] It seems that the question is still undecided and open for arguments. Taking the arguments in *Hall Street Associates v Mattel*[115] seriously, parties may opt-out of a judicial review under the FAA. The waiver of a judicial review would without doubt lead to a rapid final end of arbitration. Finally, it has to be distinguished between a broadened review of awards by (federal) courts and by another (review) tribunal. Parties might be allowed to agree on a review entirely outside the FAA (see below).

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[110] 128 S.Ct. 1396 (2008).

[111] 128 S.Ct. 1396, 1404 seq. (2008)..

[112] 128 S.Ct. 1396 (2008).

[113] 128 S.Ct. 1396 (2008).

[114] LaPine Technology Corp. v Kyocera Corp. 130 F.3d 884 (9th Circ., 1997); *Roadway Package System, Inc. v Kayser* 257 F.3d 287 (3rd Circ. 2001).

[115] 128 S.Ct. 1396 (2008).

The English AA 1996 appears to allow for a broadened scope of judicial review of an award. S.69 AA 1996, which provides for a review on questions of law, reads: 'unless otherwise agreed by the parties'. This leaves for the argument that parties can opt for a review beyond the grounds for challenge under AA 1996. The survey of case law didn't reveal whether courts accept an agreement to raise the standard of review.

b) Review below the standards of statute law

There are just a few U.S. cases dealing with agreements to lower the standard of judicial review. These cases show an ambiguous picture. In *Hoeft v MVL Group Inc*[116], the court found that the FAA created 'critical safeguards' for the arbitration process that represented a 'floor for judicial review of arbitration awards below which the parties cannot require courts to go.' Other courts held that 'the parties to an arbitration agreement may eliminate judicial review by contract, [but] their intention to do so must be clear and unambiguous.'[117]

The great party autonomy by the English Arbitration Act 1996 has been stressed before. S.69 AA 1996 reads 'Unless otherwise agreed by the parties, a party [..] may [...] appeal to the court on a question of law'. Hence, parties can opt-out from a judicial review regarding questions of law. The other two grounds for challenge provided by AA 1996, i.e. lack of substantive jurisdiction, serious irregularities, are not governed by an 'unless-otherwise-agreed-rule'. Consequently, parties cannot contractually opt-out from these two grounds.

3. Excursus: Freely Contracting for the Scope of Review

As already indicated, there is much legal uncertainty about the legitimacy of contracting for a review above or below statutory standards.[118] It is argua-

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[116] 343 F.3d 57 (2d Cir. 2003), but see also *Kyocera Corp. v Prudential-Bache Trade Services Inc.* 341 F3d., 987, 994 (9th Circ. 2003).

[117] *Bowen v Amoco Pipeline,* 254 F.3d 925 (10th Circ. 2001).

[118] For U.S. American law Samuel, 'The U.S. Supreme Court on the Federal Pre-Emption and Appeals on Questions of Law by Consent - A Case Not', (2009) 5 Arb. Int. 455, 460.

ble that the parties are generally allowed to contract for review of an award outside the judicial system and, furthermore, contract on the standard of review (e.g. Appeal Procedure for the CPR IDR[119], ICSID Rules[120]).[121] It is said that when the parties agree to arbitrate, they accept 'whatever reasonable uncertainties might arise from the process'[122] and thereby "trade [...] the procedures and opportunity for review of the courtroom for the [...] simplicity, informality, and expedition of arbitration.'[123] So why not let parties freely choose the way they may challenge an award? It's their freedom to arbitrate. It's their freedom to decide how to arbitrate.

V. Final Observations

1. U.S. and English arbitration law provide grounds for challenging an arbitral award. Those grounds are quite narrowly drafted in order to severely limit court interference with arbitral awards.

2. Even though statutory law uses terms and phrases open to an extensive interpretation, U.S. and English courts have been severely reluctant in construing these terms and phrases in a broad way. Instead, they appear to follow a rather strong, non-interventionist approach.

3. The survey on the parties' autonomy with regard to raising or lowering the standards of judicial review revealed an ambiguous picture. While there appears to be a tendency in U.S. arbitration law to restrict the parties' au-

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[119] www.cpradr.org/ClausesRules/ArbitrationAppealProcedure/tabid/79/Default.aspx (05-02-2010).

[120] For a brief discussion see Blackaby et.al., *Redfern and Hunter on International Arbitration* (Oxford University Press, Oxford 2009) 588 seq.

[121] Tyler/Parasharami, 'Finality ofer Choice: Hall Street Associates, LL.C. v Mattel, Inc. (U.S. Supreme Court)' (2008) 25 JInt.Arb.Law 613, 619; Rutledge, 'On the Importance of Institutions: Review of Arbitral Awards for Legal Errors' (2002) 19 JIntArbL 81, 114.

[122] *Raiford v Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 903 F.2d 1410, 1413 (11th Cir. 1990), quoted in *Robbins v Day, 954 F.2d 679, 683* (11th Cir.), cert. denied, 506 U.S. 870 (1992).

[123] *Bowles Financial Group, Inc. v Stifel, Nicolaus & Co. 22 F.3d 1010, 1011 (10th Circ. 1994); Gilmer v Interstate/Johnson Lane Corp., 500 U.S. 20, 29-33, 111 S.Ct. 1647, 1654-55 (1991); Mitsubishi Motors Corp. v Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628, 105 S.Ct. 3346, (1985).*

tonomy, the AA 1996 give the parties the opportunity to opt-out from the review regime provided by the Act.

4. It has been said that the key goal of the FAA is 'making arbitration a swift, inexpensive, and effective substitute for judicial dispute resolution.'. U.S. and English arbitration law do in fact provide a swift, inexpensive, and effective substitute for judicial dispute resolution in terms of challenging an award.

5. Arbitration is not about a swift, inexpensive, and effective substitute for judicial dispute resolution. Arbitration is about the autonomy of the parties to agree on an alternative dispute resolution and, subsequently its rules. Taking this seriously, parties should have greatest autonomy on deciding which standard of review, judicial or otherwise, applies.

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The ongoing technological evolution has brought people closer together. They exchange goods in great numbers across the world — numbers which nobody could have imagined a decade ago. This development has moved comparative law right into the spotlight. The essays collected in this book intend to focus the reader's comparative view by looking at a few very interesting aspects of commercial law.

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