of Credit and Security, para 7-76 ff for discussion of this complex area. Indeed, great care must be taken in the drafting of multilateral netting regimes to ensure that they do not fall foul of mandatory rules of insolvency set-off and *pari passu* distribution on the liquidation of one of the parties. For an especially tricky example, see *British Eagle International Air Lines Ltd v Compagnie Nationale Air France* [1975] 1 WLR 758 (where the involvement of the International Air Transport Association (IATA) as a clearing house for payments from and credits to member airlines raised difficult issues of netting payments among different airlines when British Eagle went into liquidation, while still holding a claim against Air France. See Goode (above), para 7-76 ff for discussion and critique).

Finally, BGHZ 24, 97, case no 113, provides an interesting illustration of the complex interplay between the rules of civil procedure, set-off and the right of retention. In this case, a surety sought to rely on a set-off declared by the principal debtor. If the set-off had served to extinguish the debt, the surety would (following the accessory nature of the guarantee: § 767 BGB) likewise have been relieved from liability. Furthermore, § 770 II BGB entitles the surety to a defence if the principal debtor could declare a set-off. However, in the case at hand the set-off was invalid under the rules of civil procedure. This was because the principal debtor had not raised the defence of set-off before the conclusion of the legal proceedings against him (§ 767 II ZPO; see also, BGH NJW 1994, 2769). Thus, the surety could not invoke the set-off either. However, since the principal debtor could in respect of the counterclaim have invoked the general right of retention under § 273 BGB (discussed above, section 2), the surety could rely on this defence (§ 768 I BGB).

9

Breach of Contract: General Principles

1. INTRODUCTORY REMARKS

Irregularities of performance or *Leistungsstörungen* are the theme of this and the following chapter. The term 'irregularities' of performance however is not a technical term but a 'collective term' (as Ulrich Huber calls it: *Leistungsstörungen* (vol 1, 1999), p 2) comprising all possible variations on the theme of non-fulfilment of an obligation, much in the same way as the term 'breach of contract' (commonly used in the common law systems) covers all known and imaginable deviations from the regime of contractual obligations. Indeed, with the recent adoption by German law of a unitary notion of 'breach of duty' or *Pflichtverletzung* in § 280 and § 323 BGB as the basis of all irregularities of performance it has become possible to present German law from a remedy-focused (and more Anglicised) perspective without distorting its dogmatic structure. Prior to the reform, which is so fundamental that we need to discuss its ramifications in a separate section below, the approach to irregularities of performance was highly fragmented. (For further details in English, see the first edition of this work.)

The first reason for the abundance of rules for breach was the line of demarcation between the general part of the law of obligations and the special part. Impossibility and delay were clearly given special attention by the drafters of the BGB in the general part, while according to the 'orthodox view' there was no general principle of liability in damages for the breach of a contractual obligation in the Code itself. This, it was said, had to be developed outside the Code under the heading of '*positive Vertragsverletzung*'. In practice however the bulk of the cases was not covered by these rules but was solved by resorting to the 'special part' of the law of obligations dealing with specific types of contract. Thus, the Code established idiosyncratic rules for the phenomenon of non-conforming performance or *Schlechtleistung*. The influence of the *actio*-based Roman law tradition was particularly noticeable in this area of the law. The rules governing the contract of sale, for instance, not only determined the requirements of conformity, but included a special and exclusive regime of remedies such as price reduction or a highly peculiar right to demand termination called '*Wandelung*'. All this has dramatically changed with the new law. The rules in the special part of the BGB no longer lead a life of their own. At least as far as the two important types of contract—the contract of sale and contract for work and materials—are concerned, the remedies available for non-conformity of performance are in essence derived from the general part of the law of obligations (§ 437 and § 634 BGB bring this out very clearly). §§ 280 and 323 BGB thus become the true cornerstones of the German approach to 'breach of contract.' Since most cases in practice concern

non-conforming performance, it seems worthwhile also to discuss the rules contained in the special parts of the law of obligations. Therefore, by way of illustration, in the next chapter certain types of contract are examined in more detail in order to complement the account given here of German law.

The second and closely intertwined reason for the fragmentation of German law in this field was that the remedies for each type of irregularity were largely independent from one another. It was thus necessary to adapt the presentation of German law accordingly and choose as a starting point not the remedy but the irregularity of performance. For instance, under the old law subsequent impossibility for which the debtor was responsible gave rise to not less than seven possible remedies, some of them mutually exclusive. Objective initial impossibility induced the invalidity of the contract. As a result the promisee could recover only his reliance interest. Delay of performance not only made recovery dependent on different requirements but included its own system of legal consequences. It would serve no practical purpose to continue the list of headings appropriate to the old regime. The 'new' BGB no longer proceeds in this way. The desired legal consequence is placed at the forefront of the new approach to breach. Thus, § 323 and § 324 BGB determine the conditions for termination of the contract in the case of a breach (note that § 314 BGB governs the—equivalent—right to give notice in 'continuous' contracts), while § 280 BGB is the general clause for the right to recover damages for a breach of contract. The preconditions for receiving these remedies still depend on the form of the irregularity in question. Here, the traditional categories—impossibility, delay, other breaches—resurface. However, there is nothing surprising about that, as we will show in this chapter. The differentiation at the level of the conditions for recovery or termination is a natural consequence of the preference (in theory at least) in German law for primary performance, ie the performance *in specie* of the contractual obligation.

Before we discuss the rules in more detail, it is necessary to add a few caveats at the outset. The term '*Pflichtverletzung*' in § 280 BGB covers both legal and contractual obligations ('*gesetzliches*' and '*vertragliches Schuldverhältnis*'). This was the reason why the term 'breach of duty' rather than 'breach of contract' (*Vertragsverletzung*) was chosen as the core concept of the reformed law (see Medicus, NJW 1992, 2384). (Note however that duties that sound in tort (regulated in § 823 BGB) are not covered by the term breach of duty in § 280 BGB.) In this work however we are concerned only with the breach of a contractual obligation (although we have previously discussed the breach of a special type of extra—namely pre-contractual—obligation in the context of *culpa in contrahendo*; see chapter 2, p 91 ff). We therefore use the term 'breach of contract' as shorthand for 'breach of (contractual) duty.'

This terminology may suggest a misleading familiarity to the Anglo-American jurist. The reader should be aware from the very beginning that vital differences from the common law idea of liability for breach of contract still remain. It suffices here to mention two.

First is the important difference found in the insistence of German law to find fault as a precondition for liability *in damages*—the 'fault principle' or *Verschuldensprinzip*. History combined with conceptualism account for this. For, unlike 'The Common law [which] treats any failure to perform a duty imposed by a contractual relationship as presumptively a breach of contract and then considers the question whether, under the circumstances, the failure to perform should be excused' (von Mehren), the civil

law systems do not in general regard a failure to perform *simpliciter* as a breach of contract. For contractual liability to ensue, fault on the part of the obligor must also be shown to exist (see §§ 276, 278 BGB). This different approach, described in a masterly way by Rheinstein, *Die Struktur des vertraglichen Schuldverhältnisses im anglo-amerikanischen Recht* (1932); and Rabel, *Das Recht des Warenkaufs*, vol 1 (1936), stems from the different optic historically adopted by the common law and civil law systems towards the concept of contractual bond. For the former systems see contracts essentially in terms of 'guarantees' which result in liability when the guaranteed result is not brought about, while the latter see in the promisor a person who has promised to bring about a certain state of affairs and who thus should not be made liable if the promised result has not come about despite the fact that he has done all he could to conform with his promise.

The second difference with far-reaching implications is the mandatory regime of enforced performance. If, in the words of McKendrick, the rationale of many a rule in English law is that the parties to a contract should in case of breach 'walk away from the deal and seek satisfaction elsewhere' ('Sale of Goods' in Birks (ed), *English Private Law*, vol 2 (2000), para 10.45), the idea behind the German approach may be best encapsulated in this way: before the parties seek satisfaction elsewhere they should at least make one attempt to keep the contract alive. Hence, granting the debtor a period of grace (*Nachfrist*) becomes a *Leitmotiv* of the German approach to 'breach'. This also ties in well with the German (indeed continental European) predilection to protect the debtor.

Before closing this section we should also note that the doctrine of the foundation of the transaction (§ 313 BGB) or 'change of circumstance,' as it is sometimes called, can also be—and frequently is—discussed under the heading of *Leistungsstörung*. The doctrine concerns a number of situations where performance of one contractual obligation is or has become more onerous than anticipated. We have discussed the doctrine (in chapter 7, p 319) separately for two reasons. First, if a change of circumstance occurs in a relevant sense of the concept then the debtor is not in breach of a contractual duty. Rather, the contract terms are adjusted and only if that cannot be achieved may the contract be terminated. Secondly, the doctrine is closely interrelated with the rules on interpretation and mistake. However, this should not detract from the possibility that certain impediments to performance may, although not amounting to 'impossibility' in the strict sense, nevertheless release the debtor from his obligation. We will return to this particular aspect in the section on enforced performance (section 3, below).

2. THE REFORMED SYSTEM OF REMEDIES FOR BREACH OF CONTRACT

Canaris, 'Die Neuregelung des Leistungsstörungs- und des Kaufrechts' in Egon Lorenz (ed), *Karlsruher Forum 2002*, (2003) 5; Canaris (ed), *Schuldrechtsmodernisierung* (2002), (a collection of the preparatory works); Canaris, 'Die Reform des Rechts der Leistungstörungen' JZ 2001, 499; Dauner-Lieb, Konzen and K Schmidt (eds), *Das neue Schuldrecht in der Praxis* (2003); Dauner-Lieb, Heidel and Lepa (eds), *Das neue*

Schuldrecht (2002); Ehmann and Sutschet, *Modernisiertes Schuldrecht* (2002); Ernst and Zimmermann (eds), *Zivilrechtswissenschaft und Schuldrechtsreform* (2001); Haas, Medicus, Rolland, Schäfer and Wendtland (eds), *Das neue Schuldrecht* (2002); Peter Huber and Faust, *Schuldrechtsmodernisierung* (2002); Kohte, Micklitz, Rott, Tonner and Willingmann, *Das neue Schuldrecht* (2003); Stephan Lorenz and Riehm, *Lehrbuch zum neuen Schuldrecht* (2002); Schlechtriem, 'The German Act to Modernize the Law of Obligations in the Context of Common Principles and Structures of the Law of Obligations in Europe' (2002) *Oxford Univ Comparative L Forum* 2; Schmidt-Räntsch, *Das neue Schuldrecht* (2002); Schulze and Schulte-Nölke (eds), *Die Schuldrechtsreform vor dem Hintergrund des Gemeinschaftsrechts* (2001); Westermann (ed.), *Das Schuldrecht 2002* (2002); Zimmer, 'Das neue Recht der Leistungsstörungen' NJW 2002, 1; Zimmermann, *Breach of Contract and Remedies under the New German Law of Obligations* (Sapienza, Rome, 2002). See for more recent overviews that discuss the problems that have occured so far: Stephan Lorenz, *Neues Leistungsstörungs- und Kaufrecht: Eine Zwischenbilanz* (Juristische Gesellschaft Berlin, 2004); Stephan Lorenz, 'Schuldrechtsmodernisierung'—*Karlsruher Forum 2005* (forthcoming); and Schulze and Ebers, 'Streitfragen im neuen Schuldrecht' JuS 2004, 265, 366 and 462. See, for an excellent historical and comparative account though now outdated in parts, Rheinstein, *Die Struktur des vertraglichen Schuldverhältnisses im anglo-amerikanischen Recht* (1932); Treitel, *Remedies for Breach of Contract: A Comparative Account* (1988) based on his contribution 'Remedies for Breach of Contract' to the *International Encyclopedia of Comparative Law*, vol VII, chapter 16 (1976); and Zimmermann, *The Law of Obligations* (1990) chapter 25, p 783 *et seq.* A voluminous collection of essays under the general title *Les Sanctions de l' inexécution des obligations contractulles. Etudes de droit comparé*, edited by Marcel Fontaine and Geneviève Viney was published by Bruylant and the LGDJ in 2001. They cover mainly French and Belgian law but also other legal systems. The account of German law is that of the old regime so the essays will be mainly of interest to those who would like to compare the German law (as expounded in this chapter) with French and Belgian law.

(a) History of the Reform and Main Objectives

The recent reform of the law of obligations is the most fundamental reform of the first two books of the BGB since its adoption. The *Gesetz zur Modernisierung des Schuldrechts* of 26 November 2001 (BGBl I-3138) came into force on 1 January 2002. While the impetus for reform stemmed from European (Community) law, the scope of the reform reaches far beyond the narrow field of application of the 1999 Consumer Sales and Guarantees Directive. Five main objectives can be identified.

The first reason for the reform, and for the reform now, was the implementation of the aforementioned Directive 1999/44/EC ([1999] OJ L171/12) on certain aspects of the sale of consumer goods and associated guarantees. (Directives 2000/31/EC ([2000] OJ L178/1) and 2000/35/EC ([2000] OJ L200/35) were also implemented on this occasion; however, both may be neglected for present purposes.) There was no strict necessity to establish more than limited special rules for consumer sales. Indeed, this is how the Directive was implemented in England: see the Sale and Supply of Goods to Consumers Regulations 2002 (SI 2002, No 3045), which have been in force since 31 March 2003. In Germany, this was not regarded as satisfactory

as it would have increased the fragmentary nature of the old law (alluded to above) still further. For, in practice, it would have resulted in yet another layer of rules been added to an already complex regime (sketched out above). (In this sense, the 'official' motivation of the reform: *Bundestags-Drucksache* 14/6040, p 2. Incidentally, the 'isolated' implementation in England can be criticised for this very reason: increasing the complexity of the law and creating uncertainty. Cf Arnold and Unberath, ZEuP 2004, 366.)

There is little doubt however that the sole argument that an isolated implementation would have added another set of rules to an already over-saturated system would not of itself have warranted such a wholesale revision of the law of obligations. A fundamental revision was on the agenda long before the European Community discovered the contract of sale as a target of harmonisation measures. This leads us to the second and third purposes of the reform: improving and simplifying the system of remedies for irregularities of performance and the corresponding periods of limitation (prescription). The remaining two objectives can be classified as being mostly of a 'cosmetic' nature. By this, we mean that in most cases and with very few exceptions, the intention was to change the *form* of the law, while leaving much of its substance intact.

Thus, the aim of the reform was, fourthly, to codify a number of rules already developed by the courts outside the Code. We have already referred to this phenomenon in relation to the existence of contractual 'protective duties' (under § 241 II BGB), the principle of *culpa in contrahendo* (under § 311 II and III BGB) and the doctrine of the foundation of the transaction (§ 313 BGB). Additionally, and fifthly, the legislator integrated into the Code special statutes dealing with certain aspects of contract law. We have already come across this transposition of the legal basis in relation, for example, to: §§ 305–10 BGB, the rules on standard terms of contract; consumer credit, § 491 BGB; dealings away from business premises, § 312 and § 355 BGB; and 'time-share' contracts, § 481 BGB. Most of these provisions aim to protect the consumer and, insofar as they have this aim, they all correspond to a European Community blueprint. They must be read together with the definition of 'consumer' and 'dealer' in the General Part of the BGB in the section on 'Persons' (§§ 13 and 14, included in the year 2000). Thus, roughly one hundred years after the entry into force of the BGB, the consumerist spirit (so often alluded to in various parts of this book) has left its mark on the BGB in an indelible manner. To reiterate the well-known polemic of von Gierke directed against the original version of the Code: the few 'drops of social oil' have been transformed into veritable streams. Thus, sooner or later, any law is forced to catch up with changing societal needs and values.

In the present context, only the first three objectives of the reform will be explored—these are all to some extent related to the simplification of the system of remedies for irregularities of performance (although 'simplification' in German legal literature is something that outsiders will find is a relative term). As suggested, the reform had in fact been long in the making.

The story begins in the late 1970s when the Ministry of Justice commissioned academic reports on the desirability of a reform of the law of obligations. These were published in 1981 and 1983 in three volumes as *Gutachten und Vorschläge zur Überarbeitung des Schuldrechts* and dealt with various aspects of the law of obligations (see for irregularities of performance, Ulrich Huber's report in vol 1, p 647). As a result

of the recommendations, a Law Reform Commission composed of academics and practitioners was appointed in 1984, which in turn presented a final report with detailed recommendations and draft provisions in 1992. (*Abschlußbericht der Kommission zur Überarbeitung des Schuldrechts*; for a summary of the draft concerning irregularities of performance see Medicus's account in NJW 1992, 2384.) The ambitious reform project met with little enthusiasm. It was locked away until the Ministry of Justice somewhat unexpectedly unearthed the draft in 2000 and relaunched the discussion when presenting a so-called 'discussion draft' on the basis of the aforementioned *Abschlußbericht*.

The reason for the sudden interest in the reform was the need to implement the consumer sales Directive. How this could have been the triggering event, ie, the connection between the two projects is not immediately obvious. It turned out that if the system of irregularities of performance as contained in the draft were to be adopted, only a few and marginal further additions were necessary in order to encompass the requirements of the Directive regarding consumer sales. This is not a coincidence. For both drafts were modelled to a considerable extent on the United Nations Convention on the International Sale of Goods (henceforth CISG, in force in Germany since 1 January 1991; its predecessor was the Convention relating to a Uniform Law on the International Sale of Goods of 1973). (On all this see: *Abschlußbericht*, p 19; and for the Directive see, for example, Grundmann, 'Verbraucherrecht, Unternehmensrecht, Privatrecht—warum sind sich UN-Kaufrecht und EU-Kaufrechts-Richtlinie so ähnlich?' AcP 202 (2002) 40. It is perhaps worth recalling that the efforts to develop a uniform sales law go back to an initiative of Ernst Rabel, also regarded as the 'mastermind behind the draft Uniform International Sales Law': see, Schlechtriem, *Internationales UN-Kaufrecht* (2nd edn, 2003), p 2. Rabel's comprehensive comparative studies of the contract of sale as submitted to the International Institute for the Unification of Private Law were published in 1936: *Das Recht des Warenkaufs*, vol 1; vol 2 published posthumously in 1958.)

As already stated, the Directive itself did not warrant such a fundamental revision of the law of obligations. But it did provide a welcome opportunity for the Ministry of Justice to resurrect the draft provisions produced under its auspices eight years earlier, only this time purportedly also furthering the 'Europeanisation' of German law. The rather loose connection between the Directive and the core of German law of obligations gave rise to frequent and strongly voiced objections against combining a fundamental reform of the law of obligations with the need to implement the Directive. The reform project, as embodied in the 'discussion draft' of 2000, came under attack from very different directions. For reasons of space we cannot here reproduce the full 'back and forth' of the discussion (though see, especially, the contributions to Ernst and Zimmermann (cited above)).

The storm of criticism did not leave the Ministry of Justice unaffected. It quickly resurrected the Law Reform Commission, entrusting it with the task of rectifying the perceived or real 'defects' of the 'discussion draft'. One of the working groups dealt with irregularities of performance and also included, along with members of the original Commission (eg, Professors Medicus and Schlechtriem) some of the most prominent critics of the discussion draft. (Notably, Professors Ernst and Canaris, the latter, arguably becoming the most influential member. Much of his account of the deliberations as published in JZ 2001, 499 made it into the 'official' motivation

of the government draft of May 2001.) At this late stage, the concept of impossibility was reintroduced and with it much of the dogmatic structure of the old law.

Another working group introduced last minute changes to the system of limitation periods, which will also be discussed in more detail (see section 6, below). The outcome of this second commission was published as the so-called '*Regierungsentwurf*' of May 2001 (published as *Bundestags-Drucksache* 14/6040). During the legislative process, over one hundred more minor corrections were made before the law was finally adopted as late as November 2001 and came into force on 1 January 2002. The speed of the last phase of the reform process was quite remarkable: the legal community was given little more than a month to get acquainted with the final version of the sweeping reform.

Much of the debate surrounding the reform is now only of historical interest. Two objections however deserve to be mentioned briefly here.

One of its fiercest critics was Ulrich Huber. Ironically, he had initially recommended a far-reaching reform of irregularities of performance in his aforementioned report of 1981, but in the intervening years he had changed his position. In his monumental treatise *Leistungsstörungen* (2 vols, 1999) he had 're-discovered' the 'beauty' of the solutions of the BGB as originally intended. There he laid out how the BGB had been intended to be applied and how it was in fact subsequently misunderstood. Only this 'misconstrued', 'distorted' version of the rules of the BGB (which however it is fair to say represented the firmly established view both in academic writings and court decisions) merited criticism, while the 'original' was both elegant and adequate. Reform was not needed if the BGB were applied as initially intended. (See eg, 'Die Unmöglichkeit der Leistung im Diskussionsentwurf eines Schuldrechtsmodernisierungsgesetzes' ZIP 2000, 2137, and 'Die Pflichtverletzung als Grundtatbestand der Leistungsstörung im Diskussionsentwurf eines Schuldrechtsmodernisierungsgesetzes' ZIP 2000, 2273.) This complex and fascinating argument however came too late to have any significant impact on the final shape of the reform.

Others, including Professor Zimmermann (eg, his *Breach of Contract and Remedies under the New German Law of Obligations* (Sapienza, Rome, 2002), p 8) objected that, despite emphatic assertions that the new law would bring German law in line with 'modern' European standards, by taking up the recommendations of 1992 the draft 'missed out' on significant developments on the European level since then, especially the Dutch *Burgerlijk Wetboek*, the *Principles of European Contract Law* by the Lando Commission (published 1995 and 2003, henceforth PECL) and the *Unidroit Principles of International Commercial Contracts* (1994 and 2004, henceforth PICC). The final draft of the reform proposal attempted to meet this objection by inserting occasional references to those aforementioned Principles. One gets the impression however that these references are somewhat random and the convergence of solutions accidental (eg, *Bundestags-Drucksache* 14/6040, 129). The similarity of solutions is particularly noticeable in those areas in which the CISG has influenced the position of the new law (as it also served as a model for many provisions of the Principles). We will return to some of these aspects in the sections dealing with particular remedies. Lando, who also published a provisional evaluation of the new law, came to the (perhaps unsurprising) conclusion that the PECL were far superior to the 'maze' ('*Irrgarten*') of old and new created by the reform ('Das neue Schuldrecht des Bürgerlichen Gesetzbuchs und die Grundregeln des europäischen Vertragsrechts' RabelsZ 67 (2003), 230, 244).

It is certainly too early to dismiss the reform in this wholesale fashion. At the very least, it strikes one as odd that the high level of abstraction of the new law is criticised, when one could argue that the Principles are even more abstract. As we will attempt to show, the reformed system of irregularities of performance is consistent and draws together the advantages of a unified notion of breach and the finer achievements of the traditional approach, ie, of over one hundred years of experience with specific types of irregularities of performance.

(b) Outline of the Reform

What then are the key features of the new system of remedies for irregularities of performance?

Three main types of '*remedy*' are recognised: enforced performance (§ 241 I BGB and numerous other provisions); termination (§§ 314, 323–5, 326 V, 346–54 BGB); and damages (§§ 249–55, 276–8, 280–4 BGB). Only as far as the specific requirements are concerned do the traditional categories of irregularities of performance resurface. The reason for maintaining them (although in a modified form) was not to perpetuate historical coincidence, but rather the insight that, if the protection of the interest in the performance of the contract is the guiding principle, then the traditional categorisation becomes a logical necessity. To give just one example: the central notion of *Nachfrist*, ie an additional period of grace for performance, would amount to a meaningless formality if performance were impossible. It is therefore sensible to waive this requirement in cases of impossibility (eg, § 283 BGB).

Three main types of *irregularity of performance* are acknowledged in German law. The first two types concern the duty of performance or *Leistungspflicht*, ie, the duty of the debtor to do what he promised to do or refrain from doing in the contract. The corresponding right to demand performance is laid down in § 241 I BGB. The first type of failure of performance is this: the debtor does not perform on time although he is capable of performing—ie, performance is delayed (§§ 280 II, 281, 286–92, 323 BGB). The second type arises in the following situation: the debtor does not perform because he cannot perform—ie, performance is impossible (§§ 275, 283, 311a, 326 BGB).

The third category of irregularities of performance involves a duty of a different kind, namely the so-called 'protective duties' or *Schutzpflichten*. Here, the debtor does perform but he also violates an auxiliary protective duty (for instance not to physically injure the promisee while carrying out performance). These duties are collateral, in fact entirely auxiliary, because they never provide a reason in themselves to enter into the contract. From a comparative perspective this is a peculiar category. In order to understand it, it must be recalled that in German law most delictual duties of care tend to be transposed into contract law (mainly because of structural deficiencies or limitations of the tort provisions of the Code). This was established by consistent case law before the new reform came into force and has now been codified in § 241 II BGB. The contractual explanation of these protective duties not to harm another person (in this case the other contracting party) is particularly attractive in German law because of the existence of vicarious liability in contract law absent from tort law (contrast § 278 with § 831 BGB: liability in delict only if servant was negligently selected or supervised). From a comparative perspective, most of these breaches are not interesting because they do not give rise to genuine contract law problems. However, in some cases the breach of such a collateral duty may affect the performance of the contract itself. This is where German law provides some interesting answers (§§ 282, 324 BGB). (For a fuller discussion of some of these issues from the angle of tort law, see *The German Law of Torts*, chapters 2 and 3.)

As already pointed out in the introduction, one of the major goals of the reform was to dissolve the special regime of remedies concerning *non-conformity of performance*. This was achieved (as far as the contract of sale is concerned) by applying the analysis of delay and impossibility to the seller's duty to perform. The seller promised to deliver conforming goods. If he delivers non-conforming goods, he is given a second chance to perform. If he fails to do so, this is either because he did not bring the goods into conformity with the contract even though he could have done so (this is a case of partial delay of performance) *or* he was unable to cure the defect or deliver substitutes (this is a case of partial impossibility of performance). It accordingly becomes possible to define the remedies of the buyer by simply referring back to the rules of the general part of the law of obligations with only a few qualifications (§ 437 BGB). The same approach was adopted in relation to the contract for work (§ 634 BGB). The economising effect of this way of proceeding is considerable. It suffices here to note further that the scope of reform was limited to these two types of contract. The contract of services (§ 611 BGB) was however already traditionally governed by the rules of the general part of the law of obligations. Only leases are still subject to a special—and complex—regime of liability (§ 535 BGB). Nevertheless, the general part of the law of obligations is now treated as a basic 'model' for the special parts of the law of contract, to which we will turn in the next chapter.

As a result, the present system of irregularities of performance is much leaner than before the reform. The fragmentation of the old law has been diminished considerably (even though an outside observer can often only understand the new law by knowing something of the old). This is also reflected by the adoption of a *unitary notion of breach*. Delay, impossibility and non-conformity of performance are all rationalised as a breach of duty (*Pflichtverletzung*) or, more precisely, as breach of a contractual duty of performance—in short, as breach of contract.

It is worth pausing to consider some of the implications of this concept, as well as to add a few words of caution. In particular, it is important to distinguish 'breach' from 'liability for breach.' A unitary notion of breach does not imply a unitary approach to liability. Once a breach is identified, the debtor may still be able to raise defences against liability. The defence will depend on the type of remedy to which the claimant has resorted. 'Breach of contract' in German law is defined as the absence of due performance or part thereof. If performance has not been effected then the defaulting promisor (or guilty party) has breached the contract. As a result, the promisee (or innocent party) may resort to the three main remedies already mentioned.

First, he may demand performance *in specie*. The 'guilty' party may by way of defence prove that performance is impossible. As a result, he is released from the primary duty of performance *regardless* of whether he is responsible for the impossibility (§ 275 I-III BGB). This does *not* however prejudice the innocent party's other rights (§ 275 IV BGB, *cf* Article 9:103 PECL). Even if the performance is impossible due to an Act of God this still constitutes a breach of duty. However, whether liability in

damages follows from this 'breach' is a different matter. This is referred to as the 'dualistic' approach of the new law (Ernst in *Münchener Kommentar*, vol 2a, § 275 Rn. 1). The exclusion of the *duty* of performance and the exclusion of *liability* for non-performance of that duty are not the same. There are breaches of contract giving rise to liability in damages even though the duty of performance is excluded. It must be admitted that it is somewhat peculiar that a duty of performance is 'breached' even though at the same time § 275 BGB releases the debtor from that duty. (Huber even regards this as 'illogical', ZIP 2000, 2276.) The obvious answer to this criticism is that the rights arising from a breach must be distinguished from the breach as such. § 275 BGB releases the debtor not from the breach as such, but only in respect of the duty to performance *in specie*, as sub-section 4 of that provision expressly clarifies. (The problem of initial impossibility regulated in § 311a BGB raises special considerations, discussed below in section 5(d).) In the common law the issue is simply non-existent due to the fact that specific performance as a remedy is very much the exception rather than the rule. An order of specific performance is difficult to imagine where the performance is impossible. A court will not order specific performance if an order is difficult to enforce or if performance entails an undue burden (see for a discussion of the approach of the common law section 3(a) below). However, other systems recognising primary enforcement of the contract do not exclude the duty of performance in cases of impossibility (see eg, Article 79(5) CISG, but cf also Article 28 CISG). An alternative solution would be retain the right to the performance but limit the actual enforcement of the judgment requesting performance (some of these rules are examined below, section 3(d)).

Secondly, the innocent party may seek to *terminate* the contract. The (old) incompatibility between termination of contract and damages is removed (§ 325 BGB). However, while liability in damages is (as we shall see shortly) still fault-dependent, *fault is not a pre-requisite to a claim to terminate the contract* (this was a requirement under Directive 1999/44/EC but had already been part of the *Abschlußbericht* of 1992). Furthermore, according to § 326 V BGB the right to termination is also available where the right to performance is excluded under § 275 BGB. The CISG excuses the debtor for a failure to perform under certain circumstances. However, this does not affect the right to terminate the contract (Article 79(5) CISG and the analogous Article 7.1.7(4) PICC; contrast Article 9:303(4) PECL: contract comes to an end *ex lege*). Unlike French law but like the common law, German law does not require that the termination be pronounced by a court of law but will be effected by the innocent party—provided that (in most cases) additional time has been given to the guilty party to perform (§ 323 I BGB). If the breach committed by the guilty party concerns non-conformity of performance, it must be (when objectively measured) a serious one (or, in the words of the original text in § 323 V 2 BGB, it must not be *unerheblich*—ie, not insignificant, negligible or slight). It should be noted that the right to a reduction in the price payable will normally follow the same pattern as the right to terminate the contract, except that the breach must not be serious or fundamental (§§ 441 I 2, 638 I 2 BGB; Article 50 CISG).

This insistence that the guilty party be given 'one more chance'—which we will also encounter in relation to the right to recover damages—is in keeping with the Germanic preference (where possible) for *specific performance* and the desire to keep the contract alive. (Interestingly, American law seems to be moving in the same

direction. This is analogous to the concept of cure in American sales law, UCC 2-508. Restatement Second of Contracts §§ 241 and 242 make the likelihood a defaulter will cure a relevant factor in determining if a breach is total and so grounds for discharge.) The CISG, by contrast, while in principle allowing the debtor to remedy any failure of performance of his obligations, grants the innocent party a right to *immediate* termination if the breach is 'fundamental', see Article 25, 49 (cf Article 7.3.1 PICC and Article 9:301 PECL). It should be noted that § 323 BGB does not require (as however Article 25 CISG *does*) that the detriment substantially deprives the innocent party of what he is entitled to expect; a much lesser breach suffices, provided that as explained the debtor has been accorded 'a second chance.' According to Article 3 of Directive 1999/44/EC, the seller is likewise granted a second chance to bring the goods into conformity with the contract before the consumer may exercise any further rights. In this regard, the implementation of the Directive thus presented a much greater challenge for English law than for German law. The challenge was in fact avoided by the 2002 Regulations, by granting the rights of the Directive alongside the traditional right of a buyer to immediate termination if a 'condition' has been breached (this is discussed further in chapter 10, p 494 ff).

The reform also dealt with the *effects* of termination through *Rücktritt* (§ 346 BGB). *Rücktritt*, as understood in German law, will be discussed in greater detail below (p 419 ff), so here we shall only mention the outline of the reform. Restitution for termination aims to achieve, as far as humanly possible, the principle of *restitutio in integrum*. The parties are thus expected to return to each other whatever they may have already received from the other (§ 346 I BGB); and this rule also applies to all cases of statutory termination (*gesetzliches Rücktrittsrecht*) and those cases where one of the parties has reserved the right of termination (*vertragliches Rücktrittsrecht*). Difficulties arise however where it has become impossible to return the performance received. According to § 346 II BGB, the debtor must compensate the creditor for the value of the performance. Certain exceptions to this general rule are laid down in § 346 III BGB. In practice, the greatest difficulty arises where goods delivered to the buyer are destroyed while in his possession, even though the buyer has exercised normal care (*diligentia quam in suis*). The new § 346 III Nr. 3 BGB excludes the duty to compensate. It cannot be doubted that the new law has simplified the effects of termination. Whether one agrees with the actual results thus effected is a different matter. (Cf Lorenz, *Zwischenbilanz*, above, p 14.) (American law is more liberal on this point. Restatement, Third, Restitution and Unjust Enrichment § 37 requires restoring value received but doesn't require return of performance in kind or specie.)

The third remedy that may be available is the right to claim substitute compensation, in short, *damages*. The first central aspect of the right to claim damages for breach of contract is that as a general rule the guilty party is once again given a second chance to perform, § 281 I BGB. The second aspect concerns the standard of liability. 'Breach of duty' or 'breach of contract' used to have the connotation in German law of a fault-based standard of liability. This is no longer the case. Breach of duty is defined objectively as the absence of performance or a part thereof. However, a fault-based standard of liability is retained in relation to the remedy damages. Breach of duty will lead to liability in damages if the debtor is at fault (§ 280 I in conjunction with § 276 BGB). In practice however the fault principle is considerably attenuated by four countervailing factors, which will be discussed in more detail

below (p 444; and to this extent minimising the differences in practice with the common law). First, fault is presumed. This is expressed by the negative formulation of § 280 I 2 BGB. The debtor will have to rebut the presumption of fault if he wishes to avoid liability. Secondly, the standard of fault is an objective one. Thirdly, the emphasis on enforced performance further tightens liability. This point will be examined more fully below. Finally, certain categories of 'strict' liability are recognised, such as the promise to deliver generic goods.

Paradigmatically, the common law does not associate fault with liability for 'breach of contract.' However, a variety of doctrines excuse non-performance in the face of mistake, impracticability, impossibility, frustration of purpose, or failure of a condition. The approach of the CISG is analogous. One notes that 'breach of contract' does not presuppose the existence of fault to give rise to liability (Articles 74, 45(1) and 61(1) CISG use the term 'failure of performance' synonymously). Liability (in damages), however, is excluded where an impediment to performance is beyond the control of the debtor: Article 79(1) CISG. (For competing views as to the differences between the 'guarantee' liability of the common law and the fault principle of German law, compare: Stoll, in Schlechtriem (ed), *Kommentar zum Einheitlichen UN-Kaufrecht-CISG* (4th edn, 2004), Article 79 CISG, Rn. 9; and Tallon, in Bianca-Bonell (ed), *Commentary on the International Sales Law* (1987), 572.) Article 7.1.1 PICC and Article 8:101 PECL use 'non-performance' as the basic concept covering all irregularities of performance. Both proceed on the assumption that fault is not required to establish liability, but both also exclude liability for certain events beyond the control of the debtor (cf Article 7.1.7 PICC, which refers to this as '*force majeure*'; and Article 8:108 PECL). Ulrich Huber, in his recommendations of 1981, also followed the CISG model of liability. (He there preferred the term 'non-performance' or *Nichterfüllung* to 'breach'. In any event, the difference between the two terms is negligible. What matters is whether liability for 'breach' or 'non-performance' depends on fault or is strict.)

If one were to reduce the difference between the reformed remedy of damages in German law and the approach of the CISG (and the Principles) to a simple pattern, one could conclude that in German law liability requires that the promisor can be held responsible for the breach of contract (§ 276 BGB), while according to the CISG a breach entails liability unless the promisor cannot be held responsible for it (Article 79 CISG). The difference is not only one in drafting technique since the conditions for establishing respectively excluding responsibility are not the same.

Our brief overview of the system of remedies for breach has shown that a unitary notion of 'breach of contract' does not pre-determine the conditions for liability. Breach of contract in all systems must be distinguished from liability for that breach. A 'breach' may be excused in relation to the duty of primary performance but may not be excused so far as secondary rights are concerned. The right to terminate the contract is independent of fault but (unlike price reduction) presupposes a certain objective quality of the breach. The right to recover damages (liability for breach in a stricter sense) depends in German law on whether fault can be imputed to the guilty party in relation to the breach. The difference between the new German approach and the model of the CISG (excuse for certain impediments 'beyond the control' of the guilty party) does not seem dramatic and is further attenuated by other factors.

This introduction to the new system of remedies for failure of performance would be incomplete without a brief coverage of the reformed *periods of limitation.*

The law prior to the reform was highly unsatisfactory (see *Bundestags-Drucksache* 14/6040, 90–1). Prescription was perhaps the area of the law where the pressure for reform was most obvious. The great variety of periods of prescription had led to discrepancies in some areas of private law, particularly with regard to the special rules governing warranties in the fields of sales law and contracts for work and labour. A good example is provided by former § 477 BGB, dealing with the prescription of claims on sales warranties. There the claims of the buyer were barred by prescription six months after delivery if the object of sale was a movable thing. By contrast, the normal period of prescription used to be 30 years. There was widespread agreement among lawyers in Germany that, while six months was too short a time, the 30-year period was too long. A promisee who had discovered the non-conformity of performance after the six-month period had expired invariably sought to rely on the remedies of the general part of the law of obligations and to avoid the special regime of rules dealing with non-conformity. The courts were thus frequently forced to differentiate between the scope of application of the General and Special Parts of the law of obligations. The outrageous difference in length between these periods of limitation applicable to actions for breach of contract led to artificial distinctions being drawn in cases which lacked any real differences in substance.

This observation forms a neat parallel to those cases in English law where the incidental rules in one area of the law led to pressure to expand other related areas to accommodate what were perceived to be deserving cases by developing concurrent liability on different and overlapping grounds. See eg, the expansion of tort law to deal with various three-party situations that many systems would treat as problems of contract law (such as *Henderson v Merrett Syndicates (No 1)* [1995] 2 AC 145, especially at 174 (*per* Lord Goff of Chieveley): more favourable limitation rules would apply if a tort duty could be shown, which their Lordships held that it could) and the complex discussions in the law of restitution concerning liability under common law rules on failure (or indeed absence) of consideration and equitable principles relating to resulting trusts (in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, especially at 684 (*per* Lord Goff of Chievely) and 700–2 (*per* Lord Browne-Wilkinson: more favourable rules as to the availability of compound interest applied if the claim could be made out in equity (which their Lordships held that it could not)).

To abolish these inconsistencies in German law and to remove the pressure on the rules of substantive law, the reform project initially favoured a uniform period of prescription for all claims based on contract, which was to be three years. In the case of sale of movables this period would have begun to run from the moment of delivery (see *Abschlußbericht* (1992) 283). (A uniform regime of prescription is now adopted by Article 14:201 *et seq* PECL.)

The final draft moved away from the idea of a single rule for all contractual claims. Instead, it adopted a two-stage approach. The general period of limitation is three years and commences at the end of the year in which the creditor had or could have had knowledge of the claim and the person of the debtor (§§ 195, 199 I BGB). The general rule however is supplemented by a number of special periods of limitation in respect of claims for non-conforming performance. These were regarded to be necessary in the interest of commercial convenience. They commence irrespective of whether the debtor could have had knowledge of the claim. For instance, the remedies of the buyer in respect of non-conforming goods are subject to an objective period of

limitation of two years commencing with the delivery of the thing (§ 438 I Nr. 3 BGB; this was also the minimum period under Article 5 of Directive 1999/44/EC). Despite the move away from a single rule for all claims, the reform has considerably simplified the previous proliferation of limitation periods, and by adjusting the length of the two sets of periods, has minimised (although unfortunately not completely removed) the incentive to bring oneself within the application of the general rules of breach of contract. The details of this aspect of the reforms are discussed below (p 486).

3. ENFORCED PERFORMANCE

Canaris, 'Die Behandlung nicht zu vertretender Leistungshindernisse nach § 275 Abs. 2 BGB beim Stückkauf' JZ 2004, 214; Canaris, 'Die Reform des Rechts der Leistungsstörungen' JZ 2001, 499; Canaris, 'Schadensersatz wegen Pflichtverletzung, anfängliche Unmöglichkeit und Aufwendungsersatz im Entwurf des Schuldrechtsmodernisierungsgesetzes' DB 2001, 1815; Canaris, 'Grundlagen und Rechtsfolgen der Haftung für anfängliche Unmöglichkeit nach § 311a Abs. 2 BGB' in *Festschrift für Andreas Heldrich* (2005) 11; Emmerich, *Recht der Leistungsstörungen* (5th edn, 2003); Grunewald, 'Neuregelung der anfänglichen Unmöglichkeit' JZ 2001, 433; P Huber, 'Der Nacherfüllungsanspruch im neuen Kaufrecht' NJW 2002, 1004; U Huber, 'Die Schadensersatzhaftung des Verkäufers wegen Nichterfüllung der Nacherfüllungspflicht und die Haftungsbegrenzung des § 275 Abs. 2 BGB neuer Fassung' in *Festschrift für Peter Schlechtriem* (2003), p 521; Jones and Goodhart, *Specific Performance* (2nd edn, 1996); Jones and Schlechtriem, 'Breach of Contract' in *International Encyclopedia of Comparative Law*, vol VII, chapter 15 (1999), para 157 *et seq*; McGhee (ed), *Snell's Equity* (31st edn, 2004), chapter 15; Meagher, Heydon and Leeming, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (4th edn, 2002), chapter 20; Medicus, 'Die Leistungsstörungen im neuen Schuldrecht' JuS 2003, 521; S Meier, 'Neues Leistungsstörungsrecht' Jura 2002, 118 and 187; Neufang, *Erfüllungszwang als* ‚remedy' *bei Nichterfüllung* (1998); Picker, 'Schuldrechtsreform und Privatautonomie' JZ 2003, 1035; Schwarze, 'Unmöglichkeit, Unvermögen und ähnliche Leistungshindernisse im neuen Leistungsstörungsrecht' Jura 2002, 73; Spry, *Equitable Remedies* (6th edn, 2001), chapter 3; Treitel, 'Remedies for Breach of Contract' in *International Encyclopedia of Comparative Law*, vol VII, chapter 16 (1976), para 7 *et seq*.

(a) Preliminary Observations

The idea of specific enforcement of an obligation is much narrower in the common law than in the civil law. In accordance with its equitable origins, the remedy is discretionary in nature. Its enforcement presupposes a court decree, which is directed at the defendant personally. The use of specific performance has traditionally not been regarded as generally desirable because it places a strain on the machinery of law and interferes with the personal freedom of the contractual debtor (or defendant). In English law, the remedy has thus been confined to exceptional cases in which an award of damages would not afford sufficient protection to the contractual creditor

(or claimant): in the classic terminology, where damages are not an 'adequate' remedy. (See the various references in the bibliography above, particularly: *Snell's Equity*, chapter 15; Jones and Goodhart, *Specific Performance*; see also, Treitel, *The Law of Contract*, p 1019 ff; McKendrick, *Contract Law*, chapter 26; and as to the law in the US, Dobbs, *Law of Remedies* (2nd edn, 1993), § 12.8.) Where it concerns an obligation to forbear from doing something, the order is known as a prohibitory injunction. An important exception to the rule that the obligation of performance is not enforced *in specie* arises in relation to an obligation to pay a certain amount of money, which even the common law (as opposed to equity) was prepared to enforce. Here, an action 'for an agreed sum' is available that is neither a suit for specific performance nor damages.

In providing a basis from which to make a comparative assessment of the German law on enforced performance, it is necessary to consider an outline of the English law of specific performance. First, when will an award of specific performance be made—what are the major relevant factors in the exercise of the court's discretion to make such an order? Secondly, are there signs that English law is moving towards a more liberal interpretation of the availability of the use of this remedy? In dealing with these questions, we must also consider the impact of the significant recent decision of the House of Lords in the *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] AC 1, which is the leading modern authority on specific performance in English law.

As noted above, a key element in the court's analysis in this area is whether damages would provide an adequate remedy for the breach suffered by the claimant. Thus, in the typical case, where the subject matter of the contract is readily available on the market (ie, its specificity is not of the essence of the contract), damages *will* be an adequate remedy. Indeed, for the claimant to fulfil his 'duty' to mitigate his loss, it will usually be necessary for him to attempt to procure just such a substitute (on which see below, p 475 ff): to order specific performance would cut across this 'duty' (see eg, *Buxton v Lister* (1746) 3 Atk 383 at 384) and in such cases there is a clear and ready means of assessing the measure of damages for breach. By contrast, where the contract is for the sale of a specific thing with unique characteristics, it is clear that such an order is likely to be made (see the reasoning of Sir Richard Kindersley V-C in *Falcke v Gray* (1859) 4 Drew 651 and the similar position under section 52 of the Sale of Goods Act 1979 ('the 1979 Act'); the latter is discussed in Treitel, *The Law of Contract,* pp 1022–5). Whether this includes what McKendrick has termed 'commercial uniqueness' (in the sense of market availability at the relevant time) is dependent on the possibility of alternative performance and a claim for damages to cover the extra cost of that alternative: compare *Behnke v Bede Shipping Co Ltd* [1927] 1 KB 649 with *Société des Industries Metallurgiques SA v The Bronx Engineering Co Ltd* [1975] 1 Lloyd's Rep 465. In the former, Wright J held that the ship's characteristics (cheap, yet recently refitted to satisfy German regulations) meant that she was 'of peculiar and practically unique value to the plaintiff' (at 661), while in the latter the mere fact that the plaintiffs would have had to wait a further nine to twelve months for delivery of replacement machinery was not such as to 'remove . . . this case from the ordinary run of cases arising out of commercial contracts where damages are claimed' (*per* Lord Edmund Davies, at 468). In the *Bronx Engineering* case, it was clear that the defendants could have met any subsequent damages claim brought by the plaintiffs and the court assumed that such machinery was readily available in the market and so refused

the clear wording and unequivocal intention of the legislator. (Such attempts to restrict § 346 III BGB are opposed on this ground by, among others, Lorenz and Riehm, *Lehrbuch zum neuen Schuldrecht* (2002) Rn. 434; *Palandt*-Heinrichs, § 346 Rn. 13.)

The English regime that follows rescission does bear some similarities to the German approach set out above. Thus, if the innocent buyer wishes to claim the return of his purchase price, he must return what he has acquired under the contract so as to effect a total failure of consideration and make good his restitutionary claim (see eg, *Baldry v Marshall* [1925] 1 QB 260; and generally, Treitel, *The Law of Contract*, pp 1049–57). Further, if it proves impossible to return the benefit received due to the defect that gave rise to the right to rescind (eg, non-conforming goods or goods to which the seller did not have title to sell: see *Rowland v Divall* [1923] 2 KB 500) or due to a cause beyond the control of either party (*Head v Tattersall* (1871) LR 7 Ex 7) then there is no duty to return that which was acquired as a precondition for the recovery of the purchase price. However, the major difference is that the basic remedy even on termination is a claim for damages; although it should be noted that the innocent party can elect not to rescind the contract and can instead continue to press for performance, this will most commonly end up in a subsequent action for damages for breach in any case. See generally, Treitel, *The Law of Contract*, pp 850–5 and chapter 21, section one on 'Damages'; the instructive judgments of Lord Diplock in both *Lep Air Services v Rolloswin Investments Ltd* [1973] AC 331 (especially 350–5) and *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 will repay careful reading on these matters. Such damages liability can cover both loss suffered due to breaches prior to rescission and due to the repudiation of subsequent primary obligations, even though those primary obligations of performance are no longer due once rescission has been effected by the innocent party. (An interesting problem that has risen in America is whether an insured may recover premiums on breach (failure to pay a claim) by the insurer without a deduction for the value of insurance coverage received; cf *Bollenback v Continental Cas*, 243 Or 498, 414 P 2d 806 (1966). The Restatement, Third, Restitution and Unjust Enrichment § 37 permits a restitution claim when performance cannot be returned in kind and even if there is a benefit of inestimable value that cannot be restored.)

(e) Continuing Contracts (*Dauerschuldverhältnisse*)

A final word must be said regarding so-called 'continuing contracts' (*Dauerschuldverhältnisse*), ie contracts which are not fulfilled by single acts of performance on each side, but which require continuing acts of performance over a period of time, such as leases (*Miete*), usufructuary leases (*Pacht*), contracts of partnership (*Gesellschaft*) and contracts of labour (*Dienstvertrag*). It is important to observe that these contracts are not subjected to the regime of restitution described in the previous section.

Such long-term relationships may run for a stipulated period of time or for an indeterminate period of time. In the latter case, both parties may terminate the contract with effects for the future by giving notice, provided that certain time limits are observed in providing notice in advance. These time periods for advance notice vary according to the nature of the contract and the party seeking termination. Thus, for

instance, employer and employee must respect different time limits (cf § 622 BGB, the postponement of the effect of the termination by the employer depends on for how many years the employee was employed). This right to give notice is commonly referred to as the ordinary right to terminate such continuing contracts (*ordentliche Kündigung*). It does not presuppose a breach of contract by the other party.

Termination however is also a remedy for breach in relation to this type of contract. A special right of termination may arise because of a breach of contract in relation to continuing contracts. It is referred to as an 'extra-ordinary right to give notice' (*außerordentliche Kündigung*). In these legal relationships, the legislator in § 314 I BGB has envisaged situations in which, for serious cause, notice may be given to terminate the contract without observing any term of notice. The pre-requisite of the right to give notice is a serious breach of contract (*wichtiger Grund*). It should be noted that this is more difficult to establish than meeting the requirement of seriousness in relation to non-conforming performance under § 323 V 2 BGB. According to § 314 I 2 BGB, all the circumstances of the individual case must be taken into consideration and, in balancing the interests of both sides, the continuation of the contractual relationship until the agreed termination date or until the expiry of a notice period cannot be expected of the party giving notice. The general right to give notice in § 314 BGB is supplemented and to a considerable extent replaced by special rules in relation to specific instances of continuing contracts: eg, §§ 543, 569, 581 II, 626, 723–4 BGB (some of which have been discussed in chapter 3). (See as to the remaining scope of application, Looschelders, *Schuldrecht Allgemeiner Teil*, Rn. 794 *et seq*.)

In these cases of 'termination by notice' (*Kündigung*), the legal relationship ends when notice is received by the other party (§ 130 BGB; see chapter 2 for the problem of when a declaration of will takes effect). It operates only in respect of performances not yet due at the time of termination (Larenz, *Schuldrecht I, Allgemeiner Teil*, 415–17). It follows that performance which was due, but had not yet been rendered, must still be made (as under English law: see the comments in section 4(d), above). The reason why *Kündigung* of a continuing contract has no retrospective effect must be sought in the fact that, for all practical purposes, the many acts of performance on each side which have taken place in the past cannot be ignored because this has happened within the framework of a functioning legal relationship. The termination of such continuing contract, therefore, does not as a general rule lead to restitution of past performance. It simply brings to an end the duties of performance from the moment of termination onwards.

5. DAMAGES

Altmeppen, 'Schadensersatz wegen Pflichtverletzung- Ein Beispiel für die Überhastung der Schuldrechtsreform' DB 2001, 1131; Canaris, 'Begriff und Tatbestand des Verzögerungsschadens im neuen Leistungsstörungsrecht' ZIP 2003, 321; Deutsch, 'Die Fahrlässigkeit im neuen Schuldrecht' AcP 202 (2002) 889; Gsell, 'Aufwendungsersatz nach § 284 BGB' in Dauner-Lieb, Konzen and Karsten Schmidt (eds), *Das neue Schuldrecht in der Praxis* (2003) 312; Grigoleit and Riehm, 'Die

Kategorien des Schadensersatzes im Leistungsstörungsrecht' AcP 203 (2003) 727; Hirsch, 'Schadensersatz statt der Leistung' Jura 2003, 289; Honsell, 'Herkunft und Kritik des Interessebegriffs im Schadensersatzrecht' JuS 1973, 69; U Huber, 'Die Pflichtverletzung als Grundtatbestand der Leistungsstörung im Diskussionsentwurf eines Schuldrechtsmodernisierungsgesetzes' ZIP 2000, 2273; U Huber, 'Normzwecktheorie und Adäquanztheorie' JZ 1969, 677; Jones and Schlechtriem, 'Breach of Contract' in *International Encyclopedia of Comparative Law*, vol VII, chapter 15 (1999), para 203 *et seq*; Kohler, 'Das Vertretenmüssen beim verzugsrechtlichen Schadensersatz' JZ 2004, 961; Lange and Schiemann, *Schadensersatz* (2nd edn, 2003); Larenz, 'Die Prinzipien der Schadenszurechnung' JuS 1965, 373; Looschelders, *Die Mitverantwortlichkeit des Geschädigten im Privatrecht* (1999); S Lorenz, 'Schadensersatz statt der Leistung, Rentabilitätsvermutung und Aufwendungsersatz im Gewährleistungsrecht' NJW 2004, 26; E Lorenz, 'Die Haftung für Erfüllungsgehilfen' in *50 Jahre Bundesgerichtshof*, vol I (2000) 329; Medicus, 'Normativer Schaden' JuS 1979, 233; Medicus, 'Naturalrestitution und Geldersatz' JuS 1969, 449; Medicus, 'Geld muß man haben. Unvermögen und Schuldnerverzug beim Geldmangel' AcP 188 (1988) 489; Schlechtriem, 'Schadensersatz und Schadensbegriff' ZEuP 1997, 322; Stoppel, 'Der Ersatz frustrierter Aufwendungen nach § 284 BGB' AcP 204 (2004) 81; Treitel, 'Remedies for Breach of Contract' in *International Encyclopedia of Comparative Law*, vol VII, chapter 16 (1976) para 40 *et seq*; Wagner, 'Das Zweite Schadensersatzrechtsänderungsgesetz' NJW 2002, 2049.

(a) Preliminary Observations

The recent reform has completely reshaped the right of a promisee to recover damages. Whatever may have been the merits of the previous fragmented approach, the present system is concise and reduces the number of rules needed considerably. This has been achieved by adopting a general rule with a limited number of qualifications in the general part of the law of contract, which also applies in relation to non-conforming performance. In order to enhance consistency between the remedies for breach of contract, the conditions for the application of the right to claim damages have been adjusted—with one notable exception (namely fault)—to align them with those of the remedies of termination and price reduction. The result can, with some measure of justification, now be regarded as a model approach for a legal system that adheres to the fault principle in respect of liability in damages and at the same time recognises the primacy of the right to demand performance *in specie*.

From a theoretical perspective, the combination of these two elements places German law in a diametrically opposed position to Anglo-American law. However, this different starting position may make comparison with the common law interesting and perhaps instructive. Given these differences in 'starting points,' the discovery of convergences between the systems may prove particularly rewarding, reinforcing a point often made in this book, namely that things are not always what they appear to be at first sight. But, where they persist, differences of structure, result or methodology also have the merit of challenging the outside observer to understand their rational and compare it to his own.

A few words may be appropriate to explain the unsatisfactory state of affairs *before the reform*. The Code as it was originally conceived devoted special attention to two

types of irregularities of performance—namely, delay by the debtor and impossibility—and arguably neglected other types of irregularity of performance. This had already given rise, just a few years after the enactment of the Code, to a misunderstanding of far-reaching effects. The misconception was that other types of irregularities of performance were not provided for in the Code, or at least not in a principled fashion. The Code was said to have a 'gap' (Staub first made this contention in his highly influential *Die positiven Vertragsverletzungen* in 1902 (2nd edn, 1904). The courts responded to this academic criticism of the BGB and recognised a third category, purportedly not regulated in the Code, usually referred to as 'positive breach of contract.' The hypothesis that the drafters of the BGB had overlooked the irregularity of performance, later to be coined *positive Vertragsverletzung*, was peculiar, considering the dimensions of the apparent gap. Is it realistic to claim that the drafters of the BGB did not cater for instance for the possibility that a contract of service is badly performed? It is therefore somewhat surprising that it was not until Ulrich Huber's treatise *Leistungsstörungen* in 1999 that a fully fledged attempt was made to show that the BGB did indeed include rules for dealing with other categories of irregularity of performance (see chapter 3 of vol 1). His central thesis was that the old § 276 included not only the fault principle, but the general rule that a breach of contract entailed liability *in damages* (now codified in § 280). Huber claimed (at p 80) that this was self-evident to the drafters of the BGB and therefore they did not consider it necessary to use express words to that effect in the final version. There is something of a Gothic drama in this story of a collective and massive misunderstanding put right by an erudite academic just as the whole world of yesterday was brought to a close. But to most common law readers it will, at most, bring a wry smile to their lips. If it proves anything, it is that much though legal rules may converge, national temperaments remain solidly immutable!

It may be useful to give at this stage a brief overview of the central aspects of the *new* approach to liability (see Figure 3).

Paragraph 280 I BGB now contains the general rule that a breach of duty gives rise to liability in damages if the guilty party was answerable for it (fault principle). As already emphasised, the provision is of wider application than breach of contract, since it also covers non-contractual breaches of duty. For instance, it applies to liability derived from *culpa in contrahendo* (§ 311 II BGB, on which see chapter 2, p 91 ff) and it also comes into play if the obligations resulting from *negotiorum gesto* (§ 677 BGB) are breached. (On *negotiorum gestio*, see Dawson, 'Negotiorum Gestio: The Altruistic Intermeddler' (1960–61) 74 *Harvard LR* 817 and 1073; Stoljar, 'Unjust Enrichment and Negotiorum Gestio' in *International Encyclopedia of Comparative Law*, vol X, chapter 17 (1984) and Muir, 'Unjust Sacrifice and the Officious Intervener' 297 ff in Finn (ed), *Essays on Restitution* (1990).) Note however that tort liability is regulated separately in §§ 823 *et seq* BGB. In this chapter, we will focus on liability for breach of contract.

The general principle of liability in damages in § 280 I BGB is qualified in six respects:

(1) If damages instead of performance are sought, the innocent party must set a period for performance and only if the guilty party fails to perform by the end of that period, ie, the breach persists, does the guilty part become liable, §§ 280 III, 281 BGB.

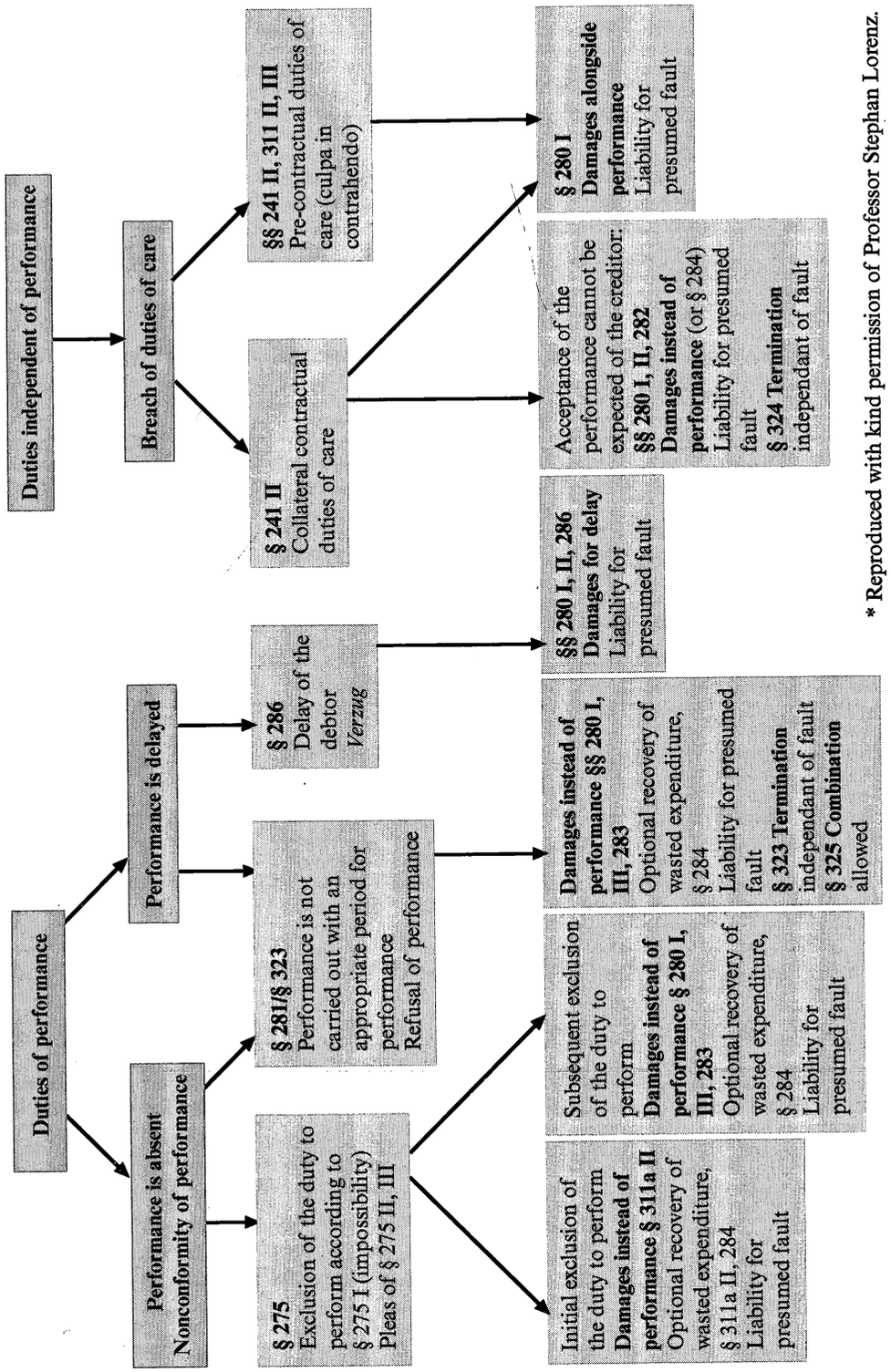

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FIG. 3: Liability for breach of duty (*Pflichtverletzung*) (§ 280)*

(2) Any damages flowing from the delay of performance may be claimed separately according to §§ 280 II and 286 BGB once the debtor is in default (*mora debitoris*).
(3) If performance is impossible, to request it would be futile. So, the combined effect of §§ 280 III and 283 BGB, grants the innocent party an immediate right to recover damages calculated on his expectation interest.
(4) §§ 280 III, in conjunction with 282 BGB, extends this right to cases in which certain ancillary duties of protection have been infringed.
(5) § 311a II BGB contains a separate set of rules dealing with liability for initial impossibility.
(6) Finally, alternatively to damages instead of performance any expenditure made in reliance on the contract may be recovered: § 284 BGB.

It is already apparent from this brief survey that the right to recover damages is to the fore and the different categories of irregularities of performance only affect the conditions of recovery in order to maintain the prevalence of enforced performance. As a result, the Code now recognises three main different types of damages, namely: damages *instead* of performance in § 280 III, damages for *delay* in § 280 II and damages *alongside* performance or 'simple' damages according to § 280 I. (For an overview, see eg, *Staudinger*-Otto, (2004), § 280 Rn. E1 *et seq.*) Understanding the differences between these different heads of damages is also 'the key' to the new system of liability (Zimmermann, *Breach of Contract and Remedies* (Sapienza, Rome, 2002), p 20; Grigoleit and Riehm, AcP 203 (2003) 730, who rightly warn against interpreting the new in the light of the old).

Before we turn to the specific requirements of liability it is necessary to make two further preliminary observations in order to avoid misunderstandings.

First, the question must be addressed whether the German idea of *Schadensersatz* with which we are here concerned is in fact an equivalent of the Anglo-American notion of 'damages', ie, *monetary compensation* for breach of contract. §§ 280 *et seq.* BGB simply state that the creditor may claim *Schadensersatz* but they do not define the term. What the concept of damages in German law signifies can be discovered by looking at §§ 249–54 BGB.

The starting point and general rule is the principle of *Naturalherstellung*, now contained in § 249 I BGB. According to this principle, the debtor is under an obligation to bring about the state of affairs that would have existed had the circumstance giving rise to liability not occurred. (See, eg, Treitel, *Encyclopedia*, para 12, who discusses the principle in the context of enforced performance.) Three exceptions are made. First, if a person has been injured or physical damage to things has occurred § 249 II BGB entitles the aggrieved party to a substitutionary relief in money. Apart from that, it seems that the Code grants the right to claim *Schadensersatz in Geld* ('monetary compensation') only and in an exceptional fashion if a period for actual restoration has been set in vain (§ 250 BGB) or if actual restoration is impossible or insufficient (§ 251 BGB).

At first sight this could give the impression that 'damages' in German law are not primarily monetary relief, but rather are another variant of specific performance. In relation to breach of contract, this impression would be entirely wrong. It must be conceded, however, that the expression *Schadensersatz* in German law covers more than monetary compensation and if an exact equivalent of the English technical term

'damages' is sought, the term *Schadensersatz in Geld* is to be preferred. However, damages awarded for a failure of performance and as a substitute for performance are to all intents and purposes *Schadensersatz in Geld*. The apparent exception is the general rule so far as breach of contract is concerned. We have therefore used the term 'damages' throughout, although the reader should be aware that differences as to the actual consequences of the remedy damages in English law might exist in particular circumstances.

It is not difficult to see why monetary compensation is the form of relief for breach of contract so far as the right to claim *Schadensersatz* is concerned. If the principle of *Naturalrestitution* were to be applied to breach of contract, this would mean that the regime of enforced performance (the 'primary' right or *Leistungsanspruch*, § 241 I BGB) examined above would be duplicated. This would be contrary to the very essence of the remedy of damages. A claim for damages is the exercise of a 'secondary' right, which awards the aggrieved party a *substitute* for performance. It is therefore common ground that the remedy of damages in place of performance (*Schadensersatz statt der Leistung*; previously called *Schadensersatz wegen Nichterfüllung*) as well as damages for delay (*Verzögerungsschaden*) entitles the claimant to the protection of his expectation interest in monetary terms. (See Treitel, *Encylopedia*, para 12; Lorenz and Riehm, *Lehrbuch zum neuen Schuldrecht* (2002), Rn. 206. See however Lange and Schiemann, *Schadensersatz* (3rd edn, 2003), p 220; *Staudinger*-Otto, § 280 Rn. E81, who wish to retain exceptions to the general rule. In the past, these exceptions concerned primarily the interest of the creditor to be actually provided with what he bargained for during periods of crises in which goods were in short supply. Whether it is still necessary to retain this exception in addition to the remedy of enforced performance is doubtful.) If one were to pin this self-evident result on a provision in the Code, one could in cases of impossibility derive it from § 275 BGB and in all other cases from § 281 IV BGB: claiming damages instead of performance excludes the right to claim performance. In other words, if the promisee claims the performance and not monetary compensation he is not enforcing the remedy of damages.

We can therefore conclude that the aim of the remedy of damages for breach of contract is to protect the expectation interest (*Erfüllungsinteresse*) by the means of a substitutionary relief in money; that is 'to put the aggrieved party into as good a *financial* position as that in which he would have been if the contract had been duly performed' (Treitel, *Encyclopedia*, para 49, emphasis added; for details, see below). In this sense, the positions of German law and of the common law converge: 'the rule of the common law is, that where a party sustains a loss by reason of a breach of contract, he is, in so far as money can do it, to be placed in the same position, with respect to damages, as if the contract had been performed' (*Robinson v Harman* (1848) 1 Ex 850, 855 *per* Parke, B).

Insofar as a breach of contract causes damage to interests or rights other than the expectation interest (referred to as the interest in the integrity of these rights and interests, *Integritätsinteresse*), § 249 II BGB will often apply and this will also result in monetary compensation (see section 5(h)(iii), p 471, for details).

This situation must be distinguished from others in which a disappointed party may only recover wasted expenditure (*negatives Interesse* or *Vertrauensschaden*). Where such 'reliance loss' may be claimed, generally speaking the plaintiff is put into the position in which he would have been if the intended contract had never been concluded. In German law, as we have seen in chapter 6, the *Vertrauensschaden* may be remedied by a right to set the contract aside (*culpa in contrahendo*, explained on the basis of *Naturalrestitution*). However, insofar as wasted expenditure for breach of contract is claimed, the award will invariably take the form of monetary compensation (§ 284 BGB: *Aufwendungsersatz*). It should be observed at the outset, however, that § 284 BGB protects not the reliance on the contract, but reliance on its *performance*—it is therefore not to be equated with the protection of the reliance interest (details below). (In English law see, eg, *Cullinane v British 'REMA' Manufacturing Co Ltd* [1954] 1 QB 292, 303, *per* Lord Evershed MR. In *Anglia Television Ltd. v Reed* [1972] 1 QB 60, the damages awarded were the expense lost as a result of the breach. Thus they included pre-contractual expenditures made worthless by the breach.)

The second general comment concerns the *nature and purpose* of a monetary award.

Damages are first and foremost compensatory (Lange and Schiemann, *Schadensersatz* , p 9: '*Ausgleichsprinzip*'; the same is true for English law; see Treitel, *Encylopedia*, para 42 *et seq*). Damages are based on the loss of the promisee and do not exceed that loss. This excludes, firstly, damages calculated by reference to the loss of a third party. (There is a limited exception to this rule, which has been discussed in chapter 4, section 4, p 216; whether a similar principle of 'transferred loss' operates in English law is uncertain: see Unberath, *Transferred Loss* (2003).)

Secondly, damages are calculated by reference to the loss of the promisee and not by looking at what the promisor gained from the breach. In other words, damages are not awarded on a *restitutionary* basis. 'Restitution' aims at depriving the defendant of a benefit obtained at the expense of the plaintiff (although some would distinguish between 'restitution' and 'disgorgement', with the former covering subtraction of wealth from the claimant, but only the latter depriving the recipient of the benefit of profits made: see LD Smith, 'The Province of the Law of Restitution' [1992] *Canadian Bar Rev* 672; see further McInnes, " 'At the Plaintiff's Expense": Quantifying Restitutionary Relief' [1998] *CLJ* 472 and Burrows, *The Law of Restitution* (2nd edn, 2002), pp 25–31; Restatement, Third, Restitution and Unjust Enrichment draws this distinction in §§ 37 and 38 (restoration remedy) and § 39 (disgorgement of profits from opportunistic breach).) English contract law has not generally recognised this restitutionary purpose of an award of damages either (see eg, *Surrey CC and Mole DC v Bredero Homes Ltd* [1993] 1 WLR 1361), but has shown some (albeit limited and guarded) signs of change in recent times (see *Jaggard v Sawyer* [1995] 1 WLR 269, and in particular, *Attorney-General v Blake* [2001] 1 AC 268. The last of these has recently been considered and applied in *Experience Hendrix LLC v PPX Enterprises Inc* [2003] Fleet Street Reports 46; EWCA Civ 323 (noted by Graham (2004) 120 LQR 26) and *Severn Trent Water Ltd v Barnes* [2004] 2 EGLR 95; EWCA Civ 570). For discussion, see generally, Treitel, *The Law of Contract*, pp 928–32 and Edelman, *Gain-Based Damages* (2002). If the breach occasioned a profit to the guilty party, this profit will not be considered in calculating damages. It should be noted, however, that the *commodum ex negotiatione* may be recoverable under § 285 BGB (see p 407). If performance is impossible due to a transaction with a third party the price paid by that party to the promisor may then be claimed by the promisee. (The issue is controversial, see *Münchener Kommentar* § 285 Rn. 19.)

Finally, damages are not awarded to *penalise* the contract breaker (cf *Motive*, vol 2, at p 17 ff). Punitive or exemplary damages are not awarded. (German courts are remarkably hostile even towards the mere *execution* of *foreign* (typically US)

judgments containing an award of punitive damages, eg, BGHZ 118, 312 = JZ 1993, 261.) It should be noted however that German law has no difficulty in giving full effect to *penalty clauses*. §§ 336–345 BGB contain the applicable rules. Particularly noteworthy in this regard is § 343 BGB, which entitles the guilty party to have the penalty reduced by the court to a 'reasonable' amount if it is found to be disproportionate. Penalty clauses in standard term contracts between dealer and consumer must meet the further requirements of § 309 Nr. 6 BGB (see the general discussion on assessing the fairness of standard terms in chapter 3, section 5(d), p 175. On this particular issue, see the UK's Unfair Terms in Consumer Contracts Regulations 1999, reg 5(2) and Schedule 2, para 1(e): a clause is prima facie unfair if it requires 'any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation'). The common law has in principle been wary of so-called 'penalty clauses' that allow recovery by the claimant of a sum far in excess of his actual loss: the courts will not tolerate a clause providing for 'a payment of money stipulated as *in terrorem* of the offending party' (*Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 79, at 86). However, clauses that have made a genuine advance attempt to estimate the loss that breach might cause will be enforced, even if the actual loss that has eventuated does not correspond exactly to the value thus estimated (see eg, *Robophone Facilities Ltd v Blank* [1966] 1 WLR 1428). Further, the courts have made it clear that they are reluctant to second-guess agreements reached by the parties on this issue: the burden of showing the penal nature of such a clause agreeing a sum to be paid on breach is most definitely on the party seeking to avoid the application of that clause, and where the parties are of equal bargaining power that burden will not be easy to discharge (*Philips Hong Kong Ltd v Attorney General of Hong Kong* (1993) 61 BLR 41 (especially at 55 and 61, *per* Lord Woolf)). Thus, once these caveats in English law are borne in mind, and once the proportionality criterion of German law is applied, it may well be that the apparently substantial difference in starting points between English and German law is in practice significantly reduced. (For further discussion of this issue, see Treitel, *The Law of Contract*, pp 999–1007; McKendrick, *Contract Law*, pp 1096–1104 and the Law Commission, *Penalty Clauses and Forfeiture of Monies Paid* (Working Paper No 61, 1975).)

(b) The 'Fault Principle'

Paragraph 280 I 2 BGB presupposes that, for the right to claim damages to be exercised by the creditor, the debtor is *answerable* for the breach (see also § 311a II 2 BGB for initial impossibility and § 286 IV BGB for damages for delay). The fault principle is of axiomatic character for German law. Its codal ramification is § 276 BGB. The debtor is answerable for *intention* and *negligence*, provided that no stricter or more lenient liability is either expressly determined or to be inferred from the content of the obligation, in particular from the adoption of a guarantee or the assumption of a risk of procurement. In a nutshell: in the absence of any provision to the contrary, in the individual case liability in damages is fault-dependent. As noted previously in this chapter, the main difference between the conditions for the application of the remedy of termination (and price reduction) and that of damages is that the latter presupposes fault—ie, that the debtor is answerable for the breach—whereas the former does not require that the 'guilty' party is answerable for the breach.

There are other significant inroads into the fault principle, but neither the first (*Abschlußbericht* (1992), p 123) nor the second Law Reform Commission (*Bundestags-Drucksache* 14/6040, p 131) went so far as to recommend abolishing it altogether. Yet both commissions stressed that the differences from the common law 'guarantee'-type of liability were 'not great' (making reference to Zweigert and Kötz, *Comparative Law* (3rd edn, 1998, translated by Weir), p 510). An influential member of the second commission subsequently emphasised repeatedly the 'obvious ethical superiority' of the fault principle (Canaris, eg, *Festschrift* (2005), 1, 22; similarly: *Bundestags-Drucksache* 14/6040, p 165). It would be self-evident that a promisor could be held liable for a breach for which he was 'responsible', whereas it would require justification holding him (strictly) liable for a guarantee. Huber also argued that the 'principle of fairness' requires that the promisor does not undertake a guarantee for performance whatever the nature of the impediment; hence the fault principle was the better approach (*Leistungsstörungen*, vol 1 (1999), p 31; though in his original report of 1981 he had suggested departing from it: *Gutachten*, p 673). With all respect, this argument proceeds on a very narrow view of the common law type of 'guarantee' liability. The days where, in the interest of the protection of the public against fraud, the liability of certain promisors (like 'common carriers') was considered to be absolute are long gone. (See, for the early approaches, Ibbetson, 'Absolute Liability in Contract' in Rose (ed), *Essays in the Honour of Guenter Treitel* (1996), p 1.) 'Strict' or 'guarantee' liability does not impose liability on the promisor whatever the circumstances of the breach. A variety of 'excuses' are recognised (for instance, frustration). Article 79 CISG is a paradigm example of this approach, which allows the debtor to object to liability because an impediment to performance occurred which was beyond his control. The common law thus also presupposes that the guilty party is 'responsible' for the breach (see generally, Treitel, *The Law of Contract*, pp 838–42). The difference merely lies in the definition of 'those impediments to performance for which the obligor will be held legally responsible and those for which he will be excused,' while in practical terms it is immaterial whether the prerequisites for liability are part of the content of the promisor's obligation or as a negative condition of liability (Jones and Schlechtriem, *Encyclopaedia*, para 203).

Further, there are many instances where liability for breach of contract under the common law requires a measure of fault: these occur where the nature of the contract itself presupposes that a standard of reasonable care must be met. Thus, under section 13 of the Sale and Supply of Goods Act 1982 it is provided that in 'a contract for the supply of a service where the supplier is acting in the course of business, there is an implied term that the supplier will carry out the service with reasonable care and skill.' However, section 16(3)(a) of the same Act makes clear that the Act does not exclude 'any rule of law which imposes on a supplier a stricter duty.' Thus, the final standard of care to be satisfied will depend on whether any pre-existing and stricter common law duty might apply to the provision of such services: hence, section 13 provides a default standard. See Treitel, *The Law of Contract*, pp 840–2 and Powell and Stewart (gen eds), *Jackson & Powell on Professional Negligence* (5th edn, 2001), paras 2-116–2-124 for further details. According to *Jackson & Powell*, the test of the standard of 'reasonable care and skill' (whether expressed under the law tort, the law of contract or under statute) is: 'that degree of skill and care which is ordinarily exercised by reasonably competent members of the profession, who have the same rank and profess the

The second consequence of delay arises in relation to money debts. § 288 I BGB stipulates that during 'delay' in the technical sense of the word (*Verzug*), the debtor of a money debt is required to pay interest. This is not phrased as a right to claim damages, thus the creditor does not need to show that he incurred a loss as a result of late payments and the debtor is not entitled to object that the creditor did not suffer loss (see eg, Looschelders, *Schuldrecht Allgemeiner Teil*, Rn. 597). However, § 288 IV BGB clarifies that the creditor is not precluded from recovering damages for delay under § 280 II BGB, provided that he shows that he has suffered a loss that exceeds the interest that can be claimed under § 288 I BGB (for instance, because he was compelled to take a loan and his creditor charges interest beyond the level stipulated for in § 288 BGB: for details, see *Staudinger*-Löwisch, § 288 Rn. 31 *et seq*). The right to recover interest under § 288 BGB is fault-dependent (this follows from § 286 IV BGB). However, it will be recalled that in relation to money debts generally speaking the law imposes what could be regarded as 'guarantee liability': 'one has to have money' (Medicus, AcP 188 (1988), 449). The amount of interest depends on whether a consumer was involved. If a consumer was involved on either side, then according to § 288 I 2 BGB the interest awarded is five per cent per annum above the 'basic level of interest' as defined in § 247 BGB (which fluctuates, since it is determined by reference to the interest rates set by the European Central Bank). In all other cases, the rate is eight per cent above the basic rate (§ 288 II BGB). The parties are free to set a higher rate in the contract (§ 288 II BGB). It should also be noted that, independently of 'delay', a money debt is subject to interest once legal proceedings are commenced (§ 291 BGB: *Prozeßzinsen*).

Under English law, one general analogy to this issue is likely to be found in express contractual provisions that lay down 'penalty' (in the non-technical sense) payments for every day (or other period of time) after the stipulated deadline that performance is not forthcoming (or completed, depending on the nature of the contract and its terms). Such payments can operate in a functionally similar way to a demand under German law for interest for delay. Further, under the Late Payments of Commercial Debts (Interest) Act 1998, where the parties are both acting in the course of a business and enter into a contract for the supply of goods and services (thus excluding a wide range of contracts, eg, consumer credit agreements: section 2(5)), there is a statutory right to interest by means of implying a term into the contract (section 1(1) and (2)). This interest starts to run (section 4) from the agreed payment date or (if not provided for in the contract) 30 days after *either* the promisee has supplied the goods or services *or* after the promisee has given notice of the debt to the promisor. The parties may contract out of the Act to an extent: once the debt has been created, the Act does not restrict the parties' power to make their own provisions as to interest (sections 7(2) and 8(5)). However, prior to the creation of the debt, the Act's implied term can be ousted only if the parties provide for a 'substantial remedy' for late payment of the debt (sections 8(1), (3) and (4), and 9) and, of course, the 'reasonableness' requirement of section 3(2)(b) of the Unfair Contract Terms Act 1977 must also be satisfied (see section 14 of the 1998 Act). Equally, if failure to perform led the promisee to decide to accept the breach of contract and sue for damages, then such questions of interest can also be taken into account in the assessment of damages for breach (although the statutory provisions only provide for a discretionary power of the court to award interest: see now, section 35A of the Supreme Court Act 1981). (On the topic of interest generally, see Treitel, *The Law of Contract*, pp 994–8.)

Finally, and this is the third consequence of *Verzug*, the debtor who has formally been placed 'in delay' will find himself in a position of enhanced responsibility (*Haftungsverschärfung*). According to § 287 BGB, this means that he is liable even for slight negligence (*jede Fahrlässigkeit*), even if normally he would have only been liable for a more severe form of carelessness; and it also means that he will assume, during the period of the delay, the risk that the performance due will become impossible—ie, he is answerable for the impossibility even if the impossibility is accidental. (We have already discussed this consequence of delay (see section 5(b), p 450) in the context of the fault principle.)

(h) Damages Alongside Performance, 'Simple' Damages (§ 280 I 1 BGB)

'Damages alongside performance' (*Schadensersatz neben der Leistung*) or 'simple' damages are awarded on the basis of § 280 I BGB. Liability in damages is imposed if the debtor was answerable for the breach of duty that caused the loss. The fault principle, including all of the qualifications to it, applies (§ 276 BGB); fault is presumed (§ 280 I 2 BGB). No further conditions must be met. In our context, we may safely replace the term 'breach of duty' with that of 'breach of contract,' although note that the rule in § 280 BGB also applies to certain statutory relationships of obligation. 'Simple' damages fulfil a residuary purpose and must be distinguished from 'damages instead of performance' and 'damages for delay.' The theoretical explanation of 'simple' damages is somewhat uncertain. It may therefore be useful to clarify the meaning of some basic principles of liability in which they are used here (noting, of course, that other definitions are conceivable).

(i) Theoretical Explanations

Imposing liability in damages may serve the protection of the 'negative' or 'reliance' interest (*Vertrauensschaden*). The aggrieved party is put in as good a position as he was in before the promise was made. Alternatively, the object of liability may be to put the promisee in as good a position as he would have occupied had the defendant performed his promise. This is the 'positive' or 'expectation' interest (*Erfüllungsinteresse*). Finally, awarding damages may aim to protect the interest of one of the parties in the integrity of his other rights and interests: in this scenario, the aggrieved party is put into a position in which he would now have been had the violation of the interest not occurred (*Integritätsinteresse*). We may neglect the restitution interest for it is not protected in German law by an award of damages (see however, the rules on termination, discussed in section 4, above).

The reliance interest cannot be recovered as damages for breach of contract under § 280 I BGB. The situation is fundamentally different outside the ambit of contract law and here § 280 I BGB regularly serves to protect reliance. For instance, a claim based on *culpa in contrahendo* (§ 311 II BGB) may entitle the creditor to recover any loss that he has made in relying on an invalid contract (as explained in chapter 2, this was the origin of the doctrine). So far as liability for breach of contract is concerned, the Second Commission rejected the idea of awarding the negative interest as an alternative to protecting the positive interest and came down in favour of an 'amputated' version of the right to claim for the negative interest in § 284 BGB.

It is important to emphasise that § 280 BGB cannot be restricted to the protection of either of the two remaining basic elements of liability (expectation and integrity). § 280 I BGB is a fallback provision, which applies if the special requirements of § 280 II BGB (delay) and § 280 III BGB (damages instead of performance) are not appropriate. Damages instead of performance (§§ 280 I, III, 281–283 BGB) cover loss that results out of the ultimate failure of performance. Performance ultimately fails if it is impossible (§ 275 BGB) or if the promisor is no longer allowed to perform against the will of the promisee (that is when the latter actually claims damages instead of performance, § 281 IV BGB). Loss that has arisen before that point falls outside this category. If the loss is due to delay, the special requirements of § 280 II BGB must be met (in particular, a *Mahnung* must be given) in addition to those of § 280 I BGB. If the loss is not due to delay, the basis of recovery is exclusively § 280 I BGB. This will normally be the case with any violation of the *Integritätsinteresse*, but may also include what can be regarded as the protection of the expectation interest. (For this approach, see Stephan Lorenz, NJW 2002, 2497, 2500 and *Karlsruher Forum 2005*, section III.1.b); Ernst in *Münchener Kommentar*, vol 2a, § 280 Rn. 67.)

It should not be concealed however that some writers argue in favour of limiting 'simple' damages to the protection of the interest in the 'integrity' of the promisee's sphere (eg, Grigoleit and Riehm, AcP 203 (2003), 751; *Staudinger*-Otto, § 280 Rn. E11). The difference of approach should not be overemphasised, however. What is important is whether the additional requirements of § 280 II (*Mahnung*) and § 280 III BGB (period of grace) are considered necessary preconditions for the imposition of liability: there is widespread agreement on this practical question, whatever the arguments concerning the 'correct' legal basis. The advantage of the approach followed here is that it becomes possible to focus on the *purpose* of the additional requirements, without having to rely on vague and abstract delimitations of the different interests protected. In what follows, we will endeavour to illustrate the main areas of application of 'simple' damages under § 280 I BGB.

(ii) 'Expectation Interest' (Erfüllungsinteresse)

The expectation interest is as a general rule protected by §§ 281–3 BGB, that is the right to claim damages instead of performance. As explained, the rationale of these provisions is to afford priority to enforced performance.

One aspect of the expectation interest is the interest in being able to put the subject matter of the contract to a *certain use*. As we have seen in the previous section, a temporary halt in production caused by the failure to deliver a piece of machinery may give rise to liability if the promisor has been put on notice (moratory damages for *Verzug*, § 280 II BGB). However, where the halt in production is due to the non-conformity of the (delivered) goods, liability does not depend on whether the promisor has been put on notice, as the requirement of *Mahnung* would serve no real purpose (we discussed this point in section 5(g)(ii), p 467, when examining *Betriebsausfallschaden*). At the same time, subsequent performance would not eliminate the loss caused by having to bring production to a stop. The loss has accrued irreversibly. Hence, the loss can be claimed on the basis of 'simple' damages. It follows that § 280 I BGB may on occasion serve to protect the expectation interest. This will be the case if the particular head of damages can be claimed alongside the performance or where subsequent performance would extinguish the loss (then § 281 BGB is to be applied).

(iii) Interest in the Integrity (Integritätsinteresse)

Finally, non-conforming performance may cause loss to the promisee over and above the loss of the value of the performance or the loss of the use he intends to make of it. This type of loss is an obvious candidate for § 280 I BGB. For instance, defective goods may explode and cause injury to the promisor. Or the contractor may do a bad job of repairing a roof, after which rain leaks through the roof and causes considerable damage to furniture and carpets on the upper floor(s) of the building. Since the interest in the integrity of the promisee's other rights and interests is affected (other than his expectation under the contract), the interest protected is also referred to as the *Integritätsinteresse*. We have stated on previous occasions (both in this book and in *The German Law of Torts*) that the contractual explanation of liability is due to certain advantages of framing a claim in contract in German law. Equally, a tort explanation would be both possible and plausible. This type of loss is usually referred to as 'consequential loss' in German law. The loss is a consequence of the non-conforming performance. This is important for the regime of prescription applicable (see section 6, p 486). This type of loss cannot be reversed by subsequent performance. Hence, it is invariably recovered alongside performance as 'simple' damages under § 280 I BGB. (See, for an illustration of a claim that now would be based on §§ 437 Nr. 3, 280 I BGB and in which such consequential loss was at stake: BGH NJW 1968, 2238, case no 116. The claim failed because the seller was not regarded as answerable for the defect in the goods (§§ 280 I 2, 276 BGB).) (See for a useful discussion of the concept in American law *Reynolds Metal Co v Westinghouse Elec Corp*, 758 F 2d 1073 (5th Cir 1985).)

'Simple' damages may further be awarded to compensate the promisee for any violation of auxiliary duties of protection (*Schutzpflichten*, § 241 II BGB). If the performance of the contract is not causally linked to the loss, but merely affords the promisor an opportunity to enter the sphere of the promisee, the promisee may recover any loss thereby caused as 'simple' damages. If for instance the contractor who was supposed to repair the roof, negligently drops a roof tile on the employer's car parked nearby, he violates a duty of protection and can be held liable in damages on the basis of § 280 I BGB (as also § 823 I BGB: delict). This loss at the occasion of performance clearly arises independently from the fact of performance. (See, for an overview of such collateral contractual duties of care and protection: *Münchener Kommentar*- Ernst § 280 Rn. 89 *et seq*; for an illustration see BGHZ 8, 239, case no 117.)

(i) Limiting Damages

A breach of contract may cause loss that is far greater than the value of performance. While the value of performance can normally be claimed, so far as other or 'consequential' losses are concerned further limiting factors often come into play. Civil and common law systems share the view the right to recover damages must be subjected to further limitations as regards the amount of loss recoverable. They disagree to some extent as to the methods of limiting damages. Several methods of limiting damages are