

# Introduction to German Law

*Second Edition*

*Edited by*

Mathias Reimann  
*University of Michigan Law School,  
Ann Arbor, Michigan, USA*

*and*

Joachim Zekoll  
*University of Frankfurt am Main, Germany,  
and Tulane Law School,  
New Orleans, Louisiana, USA*

**KLUWER LAW**  
INTERNATIONAL

## Chapter 6

# The Law of Contracts

*Peer Zumbansen\**

### A. INTRODUCTION: CONTRACT LAW BETWEEN STATE AND MARKET

The *Bürgerliches Gesetzbuch* (BGB) [German Civil Code] is anchored in a liberal approach to society, governed by the principles of private property and private autonomy. The principle of freedom of contract, while dramatically altered and qualified through case law and statutory amendments in special contracting areas (in particular sales, lease, employment law), is expressed through the parties' disposition to freely enter binding agreements. For example, the scarcity of provisions in §§ 104–113 BGB addressing the conditions for minors to form contracts is telling of a legal regime that facilitates the participation of minors in contractual exchanges while placing the risk of their involvement on the shoulders of their adult contract parties. The law of obligations, which entered into force in 1900 and has since undergone major developments through adjudication, scholarship, and legislative intervention, is less a coherent closed and uniform set of norms than a constantly evolving system that is best described as 'conditioned freedom' (*Freiheit unter Auflagen*). Critics at the BGB's inception in 1900 contended that it was already outdated because it failed to adequately address the economic realities of a late-coming industrial society with millions of dependent contractors and complex divisions of labor due to a high degree of fragmentation of societal production.

Today's BGB – both in its written form and doctrinal underpinnings – develops through the constant reassessment of the principle of freedom of contract against the background of an ever further identification of protectable interests, groups and activities. The formal right to conclude contracts at will as deduced from the idea of private autonomy and expressed in Art. 2 Basic Law (*Grundgesetz*) some 50 years after the enactment of the BGB has long been overwhelmed by a continuous struggle between competing policies that shift between opposing and complementary conceptions of freedom. This introduction to German contract law will begin with a short account of a series of seminal cases handed down by the Federal Constitutional

\*Prof. Dr. Peer Zumbansen, LL.M. (Harvard), holds the Canada Research Chair in the Transnational and Comparative Law of Corporate Governance, Osgoode Hall Law School, York University, Toronto, Canada. Director, CLPE, <http://www.clpenet.ca>. The author gratefully acknowledges comments by Galf-Peter Calliess, Andreas Maurer, Iain Ramsay, Robert Wai and Joachim Zekoll. E: [Pzumbansen@osgoode.yorku.ca](mailto:Pzumbansen@osgoode.yorku.ca).

Court (FCC) in Karlsruhe over the last twenty years. A few adjudicatory and legislative examples of the policy struggle in contract law are discussed below, in particular with regard to the emergence and development of consumer protection law and a number of unwritten legal institutions.

The FCC played an important role both in the early implementation of contract law in the Federal Republic and in its later development. While the FCC does not have subject matter jurisdiction over substantive private law, it has repeatedly been called upon to review the constitutionality of holdings of the Federal Court of Justice (*Bundesgerichtshof – BGH*) (FCJ), the highest court in questions of private law. This constitutional ‘control’ of private law adjudication merits particular attention because it both underscores the importance of constitutional doctrine in private law and highlights the active role played by the judiciary in shaping the law.

This is clearly emphasized by a landmark decision that was handed down by the FCJ in February 2004<sup>1</sup> that expressly addressed the relevance of constitutional doctrine to the validity of prenuptial agreements. This decision is the culmination of a sequence of cases dating back to the early 1980s. We shall briefly look at this case law in order to gain a better understanding of the deep embeddedness of contract law and contract doctrine in a constantly evolving legal culture. This will provide the necessary background for our ensuing exposition of the structure and core of German contract law before and after the important legislative reform of 2002 (*Schuldrechtsreform*).

### *I. The Collateral Decision of 1993 (BVerfGE 89, 214)*

When the German Federal Constitutional Court (FCC) handed down its so-called *Collateral* judgment (*Bürgschaftsurteil*) on October 19, 1993, it soon became clear that this decision in constitutional law would have a significant impact on the private law of contracts.<sup>2</sup> In its decision, the Court considered a collateral agreement that an adult daughter had signed with the bank from which her father had received a loan to finance a new and risky professional endeavor. The circumstances of the conclusion of the collateral agreement, which were quite ordinary, were complicated by the bank representative’s remark that he needed the daughter’s signature on the agreement ‘merely for his files’. When the father defaulted on the loan, the bank sought to enforce the collateral agreement and was successful up to the Federal Court of Justice (FCJ). Upon petition by the daughter, the case came before the FCC which ruled on the constitutionality of the FCJ holding. In what would soon become to be seen as a landmark ruling for the constitutional control of private contract relations, the FCC declared the agreement between the bank and the daughter void, and recognized that the bank had unlawfully exploited its bargaining position. Pointing to what the FCC called a ‘structural imbalance’ between the parties to the bargain – the bank and the daughter – the FCC found the disputed agreement and the circumstances of its conclusion to be in fundamental opposition

1. BGH, NJW 2004, 930; see also Hahne, DNorZ 2004, 84; Rakete-Dombek, NJW 2004, 1273; Mayer, FPR 2004, 363.

2. BVerfGE 89, 214.

to the constitutionally-protected right to freedom of contract. Stressing the importance of conditions that would make it possible for the bargaining party to exercise her respective contractual freedom, the Court's judgment sent a clear message to the commercial actors in the loan insurance business and to lawyers throughout the country. While the banking sector quickly displayed considerable professionalism in observing the Court's standards, the doctrinal and academic assessment and interpretation of this case had only begun. However, while constitutional scholars expressed little concern with this constitutional control of contract law, many private law scholars reacted with a great deal of opposition to and criticism of the Court's intervention into private ordering processes. Since that decision, an animated debate has unfolded among private and public law scholars regarding the adequacy of the FCC's ruling. It focussed on the ruling's implication for the private law governing collateral and surety agreements and, in the aftermath of decisions rendered in 2001 and 2004, for family law and alimony law in particular.

## II. Horizontal Effect of Constitutional Liberties in Private Law Relationships

The Federal Constitutional Court's (FCC) *Collateral* decision of 1993 must be considered in a long history of constitutional rulings that dates back to 1958, when the Court handed down its widely-acclaimed and internationally-discussed *Lüth* decision (BVerfGE 7, 198). In *Lüth*, the Court ruled on a free speech issue that had arisen in the private sphere. That issue stemmed from Mr. Lüth's call in the early 1950s to boycott movies made by film producer Veit Harlan, who had risen to fame with anti-Semitic propaganda in the Third Reich. The FCC considered the question of whether or not the Basic Law's constitutional rights had any applicability outside of the public law relationship between the state and a private party. The Court recognized that the German Basic Law's fundamental rights not only embody a collection of civil liberties that could be invoked against state actors, but also express an 'objective order of values' (*objektive Wertordnung*). The Court held that these values permeate and inform all other spheres of legal norms. It thereby acknowledged an indirect effect of constitutional norms in private law relationships.<sup>3</sup> In the case at bar, this included the norms of private law through the general clauses such as good faith and good morals/*bona fides* (§ 242 BGB and § 138 BGB, respectively), as well as other clauses (e.g., Section 307). The cases and scholarship addressing §§ 242 and 138 BGB are legendary, and their significance often lies in solving 'everyday' disputes in an appropriate way.<sup>4</sup> Today, this jurisprudence is rightly considered as having had enormous impact on the development of the German legal order, and there is a distinctive series of cases on contract law that spell out the *Lüth*'s decision's lasting impact.

3. See Gardbaum, *The 'Horizontal Effect' of Constitutional Rights*, Mich L. Rev. 102 (2003), 387, 405-407; Kommers, *The Constitutional Jurisprudence of the Federal Republic of Germany* (2nd ed. 1997), pp. 48-49; Miller, *Lords of Democracy: The Judicialization of 'Pure Politics' in the United States and Germany*, Wash & Lee L. Rev. 61 (2004), 587, 632 n. 237.

4. BVerfGE 90, 27.

After the FCC had added fame and controversy to its 'objective-order-of-values' formula in its first *Abortion* case (BVerfGE 39, 1),<sup>5</sup> a case that interpreted relevant provisions of the German Criminal Code in light of the *Lüth* decision, the Court further extended constitutional review of contractual relations to the field of commercial agent law. In its 1990 *Commercial Agent (Handelsvertreter)* decision (BVerfGE 81, 242), the FCC voided a contract between the principal and a commercial agent on the grounds of duress and unequal bargaining power. The Court explicitly held that contractual freedom in the private sphere was constitutionally protected, and that an excessive limitation of private autonomy constituted a violation of the private party's constitutional rights. The *Collateral* decision of 1993, mentioned above (*supra* A. I), marked the important next step in the Court's manifestation of its constitutional review standards of private law relations. The Court built on both the *Lüth* and the *Commercial Agent* decisions, but went substantially further in establishing a unique review standard with its 'structural imbalance' formula.

While there was a significant academic debate throughout the 1990s over the wisdom of these decisions, the Federal Court of Justice (FCJ), occupied with private law litigation over comparable collateral cases, developed a coherent line of reasoning that would eventually satisfy practitioners' expectations of legal certainty and predictability in this field.<sup>6</sup> The FCJ devised a three-step test by which to assess the contested validity of a collateral agreement. In the first step, the question must be answered whether or not the collateral agreement places such a financial burden on the defendant debtor<sup>7</sup> as to render the agreement economically irrational. The second step requires that the defendant entered into the agreement not out of free will but for reasons of 'emotional ties' to the prime debtor of the loan. Finally, if these two questions are answered in the affirmative, a third inquiry focuses on whether or not particular exceptions nevertheless justify the validation of the collateral agreement. The Court's case law has developed a firm standard for these steps. An unbearable financial burden is established when the defendant is in all likelihood unable to service even the interest portion of the loan within the contracted period. Further, only the financial situation of the defendant for the collateral is taken into account, instead of the financial strength of the primary debtor. In addition, the Court has ruled that even the prospect of an inheritance would not suffice to alter the financial situation of the defendant with respect to the collateral. However, there is an exception if this inheritance was integrated by contract into the financial basis for the loan insurance offered by the bank.<sup>8</sup> Additionally, the FCJ held that the debtor's financial obligations, including obligations such as mortgage payments, count as a further worsening of the debtor's financial situation within the first step of the test.<sup>9</sup> For purposes of the second proof of 'emotional ties', the FCJ introduced a reversal of the burden of proof. Ordinarily, the burden of proof for a violation of good morals (*gute Sitten*) under § 138 BGB lies with the party that wishes to invoke this violation.

5. See also BVerfGE 88, 203.

6. For an overview see Tiedtke, NJW 2003, 407 and Bauer, FuR 2003, 481.

7. Note that throughout this chapter, the term 'debtor' is used to identify a party with a contractual obligation. In contrast, 'creditor' identifies the person towards whom this obligation exists.

8. BGH, NJW 1999, 58.

9. BGHZ 34, 151; affirmed in BGH, NJW 2002, 2230.

However, the Court has held in a series of decisions since 2001 that it is the bank's responsibility to establish the absence of such emotional ties in cases where the collateral has been agreed upon by the marital partner or a close relative of the debtor.<sup>10</sup> The FCJ has also recognized an exception from the rule of the invalidity of the collateral agreement if the defendant had a proper economic interest in the secured loan. Although not all questions have been decided, the case law over the past years has provided much-needed clarification in this complex area. More importantly, the case law illustrates the growing relevance of constitutional standards within private contract law, a development that is not limited to commercial law. Indeed, the FCC now even employs its 'structural imbalance' formula to rectify bargaining asymmetries between husband and wife by invalidating prenuptial agreements in which the woman waives all alimony rights in the case of divorce.<sup>11</sup>

This brief account of the impact of constitutional law on the developments in contemporary contract law is necessary to appreciate the following account of the current state of contract law in Germany. A second step is to consider the impact of the long-standing tradition of consumer protection on private law doctrine. Policy agendas to adapt formal contract law to the pressing needs of an ever-growing market society coincide with a growing trend to replace the state's public control and administration by resorting to private law and, in particular, to contract law schemes.<sup>12</sup> While we will take a closer look at consumer protection law in Section C, it will suffice for this introduction to sketch the relevance of contract law within a changing environment of public services administration.

## B. CONTRACTUAL GOVERNANCE

### I. Materialization of German Contract Law

Contract law has been an important means of structuring large public projects in cooperation between public and private actors, with much responsibility being delegated to private contractors. In the context of complex multilateral and multilevel agreements, contract law is often no longer that of one-time, bilateral agreements for a simple transfer of goods or the performance of well-circumscribed services. Instead, contract law has assumed the structuring and the administration of a growing number of complex social arrangements involving many public and private actors in evolving networks of cooperation.

While traditional public governance has been associated with hierarchical, top-down policy implementation, such patterns have long been rivalled and, in many cases, substituted by varying forms of societal self-regulation. Private ordering has led to the emergence of new, flexible and adjustable legal instruments.<sup>13</sup> Today's

10. BGH, NJW 2001, 2455, 2467; BGH, NJW 2002, 744.

11. BGH, NJW 2001, 2455, 2467; BGH, NJW 2002, 744; see also Röthel, NJW 2001, 1334; Bauer, FuR 2001, 155; Schwab, FamRZ 2001, 349; Zumbansen, *Public Values, Private Contracts and the Colliding Worlds of Family and Market*, Fem. L. Stud. (2003), 71.

12. Zumbansen, *Quod Omnes Tangit*, in: Benvenisti & Nolte (eds.), *The Welfare State, Globalization, and International Law* (2003), pp. 135, 147–153.

13. Esser, *Institutionalizing Industry*, in: Law and Social Inquiry 593 (1996).

national and transnational contractual arrangements dramatically challenge established national legal traditions of contract law. Such arrangements include the financing and running of health care and public services, the sale of natural resources and the multinational construction of a pipeline or power plant in a developing country. As is the case of statutory German contract law, many older private law codifications remain strongly connected to a business and social reality that, according to early critics, had already ceased to exist (if it ever existed at all) at the time the codification came into force. A comparison of the German law of contracts with American contract jurisprudence reveals striking similarities. Both legal regimes have shifted from a formalist approach to a more substantialist interpretation of contractual arrangements,<sup>14</sup> even if recent accounts suggest the beginning of a return to formalism and to 'freedom of contract'.<sup>15</sup> However, in the case law that addresses protection of workers, tenants and consumers, it is possible to see the shortcomings of a law of contract that was traditionally oriented towards commercial actors and the exclusive customs and usages of business exchange. The integration of a large body of case law concerning standard contracts, pre-contractual obligations or good faith standards into an allegedly 'private' contract law has highlighted, for some time now, the inherently public dimension of contract law.<sup>16</sup> In Germany, however, even the long tradition of making landlord-tenant law, employment law, the law of standardized contracts and other areas of consumer protection susceptible to equality and welfare concerns has not eroded the perception that there are and ought to be dividing lines between the private law of contracts and the public law and public welfare values.<sup>17</sup> While this introduction to German contract law cannot exhaustively address the validity of this divide, it should have become clear from the discussion above that issues of 'governance by contract', market failure, and constitutional values forcefully challenge the continued claim of a clear demarcation line between private law and public law.

In addition to the distinction between public and private law, however, another functional distinction has come to the fore, this time running right through private law itself. In recent years, private law, specifically the law of contract and torts has become increasingly concerned with the balancing of interests and the assessment of complex social arrangements that escaped classical contract doctrine and tort law's cause-effect determinations. Actual contractual arrangements have been demonstrating a complexity that often defies the scarce formulations included in the BGB, raising unsolved questions of risk allocation and assignments of burden of proof. It became clear that the contract law of the BGB was hardly compatible with a contract reality that questioned the written law's demarcatory lines between distinct contract types such as sale, service, or work (§§ 433, 611, 631). Consequently, contract

14. See e.g., Macneil & Gudel, *Contracts* (3rd ed. 2001); see also Llewellyn, *What Price Contract? An Essay in Perspective*, Yale L. J. 40 (1931), 704, and Kessler, *Contracts of Adhesion- Some Thoughts About Freedom of Contract*, Colum L Rev 43 (1943), 629; Kronman, *Contract Law and Distributive Justice*, Yale L. J. 89 (1980), 472.

15. Campbell, *Reflexivity and Welfarism in the Modern Law of Contract*, Oxf J Leg Stud 20 (2000), 477; Zöllner, ACP 196 (1996), 1.

16. Zumbansen, *Ordnungsmuster im modernen Wohlfahrtsstaat* (2000), pp. 241–285.

17. Limbach, *Das Rechtsverständnis in der Vertragslehre*, JuS 1985, 10; Zöllner, *Regelungsspielräume im Schuldvertragsrecht*, ACP 196 (1996), 1.

scholars came to admit that this development necessitated a far-reaching complementary assessment of each party's interests, circumstances, and even the social expectations connected to the contractual exchange. While it has been considered acceptable that the BGB failed to provide specific provisions for 'modern' contracts such as leasing or factoring, the Code's silence on more complex contractual arrangements poses problems. There is, for example, very little guidance with respect to mixed contracts, long-term contracts, and fact situations in which the lines between contract and tort, and between contract and business organization, are hardly recognizable.<sup>18</sup>

Now, at the beginning of the 21<sup>st</sup> Century, the historical reform of the German Law of Obligations of 2002 might be forgotten as soon as the doctrinal debates over specific provisions and norm begin to settle down. While this reform, which we will discuss in greater detail below, has brought about considerable changes and improvements, it may be questionable whether it actually transformed the BGB into a considerably more modern code than what it was at the outset over 100 years ago. The reform process defragmented the law by integrating some important extra-BGB provisions into the text and by drastically remodelling the law of obligations in the spirit of greater facility, transparency and coherence with regard to different contract types. This is clear and sound proof that the legislature has effectively undertaken an important and long-overdue step towards reconciling black letter law with legal practice. Indeed, the legislature is to be applauded for the decision to integrate an important part of formerly-uncodified contractual *risk law* into the BGB, including the law of precontractual liability (*culpa in contrahendo* – now in § 311), the law governing frustration ('*Wegfall*' [now '*Störung*'] *der Geschäftsgrundlage* – now in § 313), and the cancellation of long-term contractual relations or recurring obligations (*Kündigung von Dauerschuldverhältnissen* – § 314). However, it remains to be seen whether the changes in sales and construction law (*Kauf- und Werkvertragsrecht*), in the statute of limitations, and with regard to breach of contract will provide a more solid foundation on which contract lawyers and judges may address pressing policy issues and complex contractual arrangements that challenge the delineations between public and private law.<sup>19</sup> Case law on these new provisions is still scarce and largely available only from the lower courts.<sup>20</sup>

## II. Europeanization of German Contract Law

A contemporary assessment of contract (and consumer law) in Germany cannot be discussed without an analysis of the specific background and impact of the European Union's (EU's) legislative and jurisprudential activity. However, a comprehensive treatment of this development would go well beyond this introduction. It must, therefore, suffice to point to the central issues in dispute in order to understand the

18. E.g. Damm, in: *Privatrecht im 'Risikostaat'* (1997), pp. 28–37.

19. See Hart, in: Hart (ed.), *Privatrecht im 'Risikostaat'* (1997), p. 7.

20. Rott, *German Sales Law Two Years After the Implementation of Directive 1999/44/EC*, *German Law Journal* 5, No. 3 (1 March 2004), pp. 237–256, available at <http://www.germanlawjournal.com> (and in: Miller & Zumbansen (eds.), *Annual of German & European Law* Vol. 2, forthcoming 2005).

various influences that EU contract law has had on the Member States' legal cultures and on that of Germany in particular. We will identify the specific influence of EU contract and consumer protection programs on German contract law in more detail below, in particular as they have played out in directing the recent comprehensive reform of the German law of obligations. With regard to the 'greater picture', the institutions of the European Community (EC), notably the Commission and the European Court of Justice (ECJ), initially did not perceive private law as one of the fields central to European integration. Recently, however, the EC has been advancing programs aimed at harmonizing contract law and advancing a consumer protection agenda, both with important ramifications for the Member States' legal orders.<sup>21</sup> The EC's contract law and consumer protection agendas, while subject to significant criticisms, surely speak of the widespread awareness of related concerns for a much-demanded compatibility, if not harmonization of contract law.<sup>22</sup>

There is, however, an important difference between the approximation of different rules and standards by way of EU legislative acts on the one hand and, on the other, a more indirect form of creating compatibility among diverging legal rules in the Member States at a sub-legislative level. The Europeanization of private law has been propelled both by the adoption of Directives and by the work done by groups of legal experts on common standards and principles of European private, in particular, contract law.<sup>23</sup> As to the latter, principles, and other forms of 'soft law' raise pressing issues of the possibility and role of codification of European law on a wider scale.<sup>24</sup> Regarding the former, the frictions between norms developed on the European level and the respective legal cultures of the Member State are relentlessly re-emerging and are presenting a highly problematic aspect of the EC's activity in this field. Because modern private law, and contract law in particular, embody norms and standards of economic efficiency and social distribution that have evolved out of and are embedded in particular national economic and political histories, it is only natural that any attempt at developing European standards meets with varying levels

21. Joerges, *Interactive Adjudication in the Europeanisation Process? A Demanding Perspective and a Modest Example*, *European Review of Private Law* 8 (2000), 1; Schmid, *Pattern of Legislative and Adjudicative Integration of Private Law*, *Colum J. Eur. L.* 8 (2002), 415; Leible, *The Approach to European Law in Domestic Legislation*, *German Law Journal* 4, No. 12 (1 December 2003), 1255 available at <http://www.germanlawjournal.com> (last visited February 17, 2005); Calliess, *The Limits of Eclecticism in Consumer Law: National Struggles and the Hope for a coherent European Contract Law. A Comment on the ECJ's and the FCJ's 'Heininger' – Decisions*, *German Law Journal* 3, No. 8 (1 August 2002) available at <http://www.germanlawjournal.com> (last visited February 17, 2005).
22. Nottage, *Convergence, Divergence, and the Middleway in Unifying or Harmonizing Private Law*, in: Miller & Zumbansen (eds.), *Annual of German & European Law* Vol. 1 (2004), pp. 166–245.
23. Lando *et al.*, *Principles of European Contract Law* (2003); Zimmermann/Whittaker, *Good Faith in European Contract Law* (2000); Schlechtriem, *The Growing Importance of European Law and how it affects teaching and research in the field of the private law of obligations (torts, contracts and restitution)*, *Tx L Rev* 36 (2001), 531.
24. Zimmermann, *Juristenzeitung* 50 (1995), 477, 479; Zekoll, *Symposium: Codification in the Twenty First Century: Foreword*, *U C Davis L Rev* 31 (1998) 655, 656; Berger, *The Principles of European Contract Law and the concept of the 'Creeping Codification' of Law*, *ERPL* 2001, 21.

of resistance by Member States. In short, any program of harmonization is inevitably developed against the background of significant national differences, eventually leading to many diverse forms and speeds of transposing European law into national legal orders. In Section D–II, *infra*, we will examine the implementation of EU contract law directives into German law.

### C. GENERAL STRUCTURE

With this background in mind, we will now look in greater detail at the core institutions in German contract law. We will see that there is hardly an element that has not been affected and influenced by the historical legislative reform that came into force on January 1, 2002, and that has spurred an unprecedented academic and political discussion.

The central codification of contract law in Germany, the BGB, was drafted between 1874 and 1896 and came into force in 1900. This codification remained largely untouched in its substance during dramatically different political regimes of the *Kaiserreich*, the Weimar Republic, the *Third Reich*, and through much of post-World War II West-Germany. The BGB consists of five parts ('Books') which contain the General Provisions (*Allgemeiner Teil* – §§ 1–240), the Law of Obligations (*Recht der Schuldverhältnisse* – §§ 241–853), Possession and Property (*Sachenrecht* – §§ 854–1296), Family Law (*Familienrecht* – §§ 1297–1921), and the Law of Successions (*Erbrecht* – §§ 1922–2385). While the General Provisions precede and predetermine the fundamental decisions within the other parts of the BGB, the following exposition shall draw upon §§ 1–240 only where this is necessary for a better understanding of the relevant contract law discussion. Within the Law of Obligations, our focus shall be exclusively on the law of contracts. This limitation will confine us, for the most part, to §§ 241–811, but we will discuss some secondary law on contracts that can (or rather, *used to*) be found either outside of the BGB or within a very sophisticated, long-standing case law, predominantly that of the Federal Court of Justice (FCJ) (for more detail, see *infra*, under D).

A quick glance at the provisions contained in the First Book (§§ 1–240) and the contract law in §§ 241–811 reveals the legislature's apparent struggle for both a rational, coherent structure and completeness. The General Provisions, in particular §§ 116–240, indicate the lawmakers' willingness to codify most eventualities of the formation of a contract. The ensuing sections follow in this path and attempt to delineate the law of contractual remedies before providing for a long series of individual sections for various types of contracts.

The detailed presentation of the BGB's model of offer and acceptance §§ 145 *et seq.* is preceded by provisions that address error, mistake, rescission (§§ 119–123), and nullity for formal or substantive mistake (e.g., §§ 116–118, 125, 134, and 138). The first part of the second book, containing the Law of Obligations, establishes basic and central norms concerning the good faith standard and the general law of contract law remedies.

Among the first paragraphs of the BGB's Second Book we find § 242 BGB, one of the most important codified provisions of the BGB's Law of Obligations. A provision that has in some cases occupied legal minds for the greater parts of their

lives, § 242 stipulates the principle of good faith, pursuant to which the debtor is obliged to fulfil his duties ('... *verpflichtet, die Leistung so zu bewirken, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern*'). While this BGB provision is strikingly brief, it has received extensive affirmation and differentiation in both case law and academic commentary. Today, § 242 BGB anchors a rule of construction of contractual terms in light of the good faith standard that is both stabilizing and still evolving.

The general law of remedies is set out in §§ 275–432, while the remainder of the BGB's Second Book (§§ 433–853) contains specific regulations for various contracts such as sale, lease, construction or employment as well as the law of unjust enrichment, management of affairs without mandate (*Geschäftsführung ohne Auftrag*), and tort law. The BGB's rules on contract remedies underwent a fundamental reform in 2002 (see *infra*, E).

## D. FORMATION OF CONTRACTS

### I. Offer and Acceptance

The rules for the conclusion of contracts by offer and acceptance are set out in §§ 116 *et seq.*, 145 *et seq.* BGB. The text of these provisions has largely remained unchanged since the enactment of the BGB. A contract is concluded when an identifiable offeree has received a clear and binding offer from the offeror to which the offeree has agreed. In principle, this can be done orally, free of formal requirements, and even implied in fact. However, there are exceptions, e.g., for contracts for the transfer of land, for collateral agreements, timesharing contracts (§ 484), or for consumer credit contracts (§§ 492, 494). The offer must enable the offeree to bring about the conclusion of the contract with a simple 'yes'. In general, any modification of the offer by the offeree is considered a new offer to which the original offeror must consent. The acceptance must be immediate unless a specified period for acceptance has been granted. Furthermore, the acceptance may be express or implied in fact. Mere silence, however, is not sufficient. In contrast, between commercial actors silence can be a means of accepting the terms of a contract. This is the case, for example, if one party sends a confirming letter to the other party summarizing the contents of a previously-discussed contractual agreement and the recipient of the letter does not respond. In these cases, the letter must be sent in timely proximity to the preceding negotiations, and the letter must contain only those conditions that were explicitly agreed upon during the negotiations or must contain such conditions to which the receiver can reasonably be expected to agree.

This elucidation of the requirements for concluding a contract is certainly less developed in ordinary private law relations than in contracts between commercial actors (cf. §§ 1 *et seq.* HGB – *Handelsgesetzbuch*, Commercial Code). Yet, the rather simple provisions for offer and acceptance and for rescission for error and mistake (*Irrtumsanfechtung*, §§ 119 *et seq.*) operate within a framework of a well-developed body of case law that has interpreted the provisions for contractual statements (§§ 133, 157) against the background of an increasingly complex social and economic environment. In this process, courts increasingly relied on objective criteria

in their assessment of offer and acceptance in different social, private, and professional contexts. After decades of competing subjective (will) and objective (customs and social expectations) interpretations, a landmark 1984 judgement by the Federal Court of Justice (*Bundesgerichtshof*) sided with the latter approach. This decision established that the offeror does not necessarily have to act with the intention to bring about a contract if the offeree could reasonably assume under the circumstances that the offeror was making a binding offer (BGHZ 91, 324). This shift towards an objective theory of the contractual offer is somewhat mitigated by the requirement that the offeror have the possibility to recognize her communication as embodying a contractual offer. Initially, this decision caused a storm of academic dispute. However, today it is a largely unchallenged and effective approach to reconciling the principle of private autonomy with a complex contractual reality in which both parties' communications inevitably unfold through the interpretation and assessment of their reasonable expectations.

Various consumer protection statutes, including the Standard Contracts Forms Act (*AGBG*, now §§ 305 *et seq.* BGB), the Doorstep Sales Act (*HausTWG*, now § 312 *et seq.*), and the Consumer Credit Act (*VerbrKrG*, now § 491 *et seq.* BGB – see for more detail *infra*, Section E), complement and modify the rules expressed in §§ 116 *et seq.*, §§ 145 *et seq.* BGB.

## II. Mistake, Misrepresentation, and Revocation (Anfechtung und Widerruf)

A contractual agreement may be unilaterally rescinded in case of mistake (§ 119). The law differentiates between a mistake in the communication itself (§ 119 I) and a mistake regarding the quality of the goods or the persons that would be reasonably expected as being important in a specific context (§ 119 II). Two cases of mistake are addressed in § 119 I, one concerning a mistake with regards to the content of the communication (e.g., a mistake with regard to numbers or meaning), and the other applying to a mistake with regard to the communication act as such (e.g., unintended signal). Under § 123 the contracting party retains the right to rescind (avoid) the agreement if her consent was brought about by fraud or under duress. The rescission for mistake must be declared immediately (in cases under §§ 119, 120) or within one year (for § 123), §§ 121, 124, respectively. Where a contract was rescinded for mistake under § 119 (and § 120, wrongful communication via a third party), the rescinding party must compensate the other party for the investments made towards the anticipated conclusion of the contract.

## E. CONSUMER PROTECTION LAW

The following section briefly describes a number of consumer oriented codifications, such as the law on standard contract forms and the doorstep selling act. Until the reform of the law of obligations in 2002, these legislative acts stood outside the BGB. These enactments resulted in a complex statutory regime in which the BGB was surrounded and complemented by a growing number of special consumer

protection norms (*infra*, I). The reform integrated these norms into the BGB and, in addition, introduced a far-reaching set of rules applicable to contracts between consumers and businesses ('*Verbraucherverträge*' – consumer contracts) (*infra*, II).

### I. Consumer Protection Statutes Outside the BGB (before the Reform of 2002)

#### 1. Standard Contract Forms (*Allgemeine Geschäftsbedingungen*)

Accompanying the growth of the German industrial society was a growing awareness of the importance of adapting contract law doctrine to the conditions of mass commercial interactions based on the good faith standard in § 242 BGB. These conditions prompted courts to formulate and to refine rules for standard form contracts. In 1977, this development led to the adoption of the Standard Contract Forms Act (*Gesetz über Allgemeine Geschäftsbedingungen – AGBG*). The *AGBG* included over two dozen individual provisions and sought to codify a wealth of highly developed case law. This statutory regime spelled out what standard contract forms are, under which circumstances they become part of the contract and which terms or categories of terms are invalid under this law. The 2002 reform integrated the *AGBG* into the BGB and codified its provisions in §§ 305–310 BGB.

#### 2. Doorstep Sales (*Haustürgeschäfte*)

The general rules governing offer and acceptance are set out in §§ 145 *et seq.* BGB. In order to further protect consumers, these provisions were later complemented by the Doorstep Contract Revocation Act (*Haustürwiderrufsgesetz – HaustWG*), which entered into force in 1986 and which implemented the 1985 EC Doorstep Selling Directive (85/577/EEC). This codification established a specific revocation period of seven days for consumers if the contract was concluded away from business premises as specified in the *HausTWG*. The rationale for this legislation was to protect consumers from unwanted contractual obligations by providing them with time to reconsider an agreement entered into under unusual circumstances, e.g., at home, at the workplace, or in a hotel lobby. These provisions, now integrated into the BGB (§§ 312, 312a *new version*), contain specific definitions of door-step contracts which today consumers can revoke within a two week cooling off period. This period only begins to run if the revocation option is clearly communicated to the consumer.

### II. The New Regime: Consumer Contracts

Already two years before the reform of 2002, the Distance Selling Act of 2000 (*Fernabsatzgesetz*) prompted the introduction of legal definitions of both 'consumer' and 'entrepreneur' in, respectively, § 13 and § 14 BGB.<sup>25</sup> This Act also stipulated a

25. For definitions of consumer and entrepreneur, see *infra* G. III.

uniform two-week period within which consumers may revoke a contract (now § 355). Under § 355, the consumer can exercise this right without giving reasons in a number of specifically prescribed contractual settings. These include doorstep selling (§ 312), distance sales (§ 312d), consumer credit contracts (§§ 488, 491, 495), the Distance Education Act (*Fernunterrichtsgesetz* of 2000) as well as a number of other consumer contracts. Contracts entered into under these provisions are effectively concluded, but, upon revocation, are transformed into an obligation to return what was received under the contract (*Rückgewährschuldverhältnis*, §§ 346 *et seq.*). The two-week period begins to run once the consumer is informed by the entrepreneur about the right to revoke in writing. If this information is provided after the conclusion of the contract, the revocation and return period is extended to one month. If the information is not provided correctly (the burden of proof rests with the entrepreneur/seller), the period does not begin to run at all (§ 355 III 3). In a case in which the seller has violated additional information duties, the revocation period expires after six months (§ 355 III 1). The scope of such information duties is set out in a consumer-friendly and detailed fashion in §§ 1 *et seq.* *BGB-InfoV* (*BGB – Informationspflichten-Verordnung* = Regulation governing information and references in private law, as issued on August 5, 2002).

Beyond the enactment of the Distance Selling Act, the German legislature was faced with the challenge of having to transform the EC Consumer Sales Directive<sup>26</sup> into German law by the end of 2001. The legislature chose this opportunity not only to adapt the BGB's sales law to the Directive's requirements, which were mainly aimed at the introduction of a stringent consumer protection system for consumer contracts, but also to overhaul the BGB's general law of obligations on a wider basis. As a result, the legislature revised the law of limitations (§ 194 *et seq.*, 438, 634a) and reformed the law of obligations, particularly with regard to remedies (§§ 275, 280 *et seq.*), the law of contract revocation rights (*Rücktrittsrecht*, §§ 323, 324, 326, 346 *et seq.*), sales law (§§ 433–453), and the law of construction contracts (§§ 631 *et seq.*).

To implement the EC Consumer Sales Directive, the reform legislation introduced specific provisions in §§ 474–479 BGB that further modified the general law of sales (§§ 433–453) for sales contracts between consumers and entrepreneurs. As with other legislative acts that transposed EC Directives into domestic law, the interpretation and application of these provisions by German courts will have to comport with the text and purpose of the Consumer Sales Directive. The specifics of the new law of consumer sales contracts will be addressed below (*infra*, G. III, following the presentation of the general law of sales contracts).

## F. REMEDIES

### I. The Law of Obligations before the Reform of 2002

The following section briefly sketches the main characteristics of the law of remedies as it existed before the legislative reform of 2002, before describing in greater detail the new rules.

26. Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees, 1999 OJ L 171, 12.

### 1. Impossibility and Delay

The general obligations law §§ 241–432 precedes the rules governing particular contract categories such as sales and lease. *Before* the reform of 2002, the general obligations law contained a complex array of remedy provisions. It provided different remedies for impossibility and delay. Whereas the rules governing particular types of contracts (e.g., sales and lease) included specific remedy regimes for deficient performances of such contracts.

The starting point for the BGB's system of remedies *before* the reform was the actual cause and type of breach, and less the breach itself.<sup>27</sup> The system of remedies was characterized by the predominance of contractual performance with remedies only given in cases of impossibility, delay or specific fault. Although impossibility was, in practice, among the least occurring defaults of contractual performance, the law placed it at the center of its system of remedies. The BGB differentiated between initial and subsequent cases of impossibility, the latter meaning to have arisen after the obligation had been created. While the lawmaker further distinguished between objective causes of impossibility (meaning no one can fulfil the contract) and subjective causes of impossibility (the obligor was unable to perform) (§ 275 old version), the statutory law did not provide a solution to the question of what to do in other cases, for example in those involving extreme economic hardship. As the courts in such cases leaned towards developing and further consolidating the unwritten institution of frustration (*Wegfall der Geschäftsgrundlage*- now codified in § 313 new version), this only highlighted the systematic shortcomings of the codified remedy regime that failed to encompass a great part of contractual reality. Delay, the second recognized ground for remedies in the general law of obligations, served to complement the otherwise limited provisions. However, both impossibility and delay fell short of effectively addressing the manifold cases of breach of contractual duties that still lay outside of the specific provisions in the Law of Obligations, such as cases of involving defective goods or flawed construction work products (§§ 459, 634, 635 BGB, respectively).

### 2. The 'Positive Breach of Contract' Doctrine (*Positive Vertragsverletzung*)

Beyond impossibility and delay, the statutory law *before* the reform of 2002 did not offer a general remedy for substandard performance. Outside the special rules regulating particular contracts, the BGB did not address the situations that resulted from the debtor's imperfect performance or his breach of accompanying contractual duties (*Nebenpflichten*). In order to fill this gap, judges began to apply the doctrine of *positive Vertragsverletzung* (*PVV* – *positive breach of contract*). That doctrine proved very helpful in addressing claims in two different types of cases. It was put to use in cases in which the specific contract provisions did not include a remedy for faulty performance. Alternatively, it was used when the creditor who had suffered a loss resulting from the debtor's breach of collateral

27. Cf. 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*, Oxford Comp. L. Forum (2002), sub III.

duties would otherwise not be compensated. However, PVV also introduced significant systematic problems. In many cases it was not clear whether its remedies and limitations applied, or whether the dispute was governed by the BGB provisions.

## II. The New Concept after the Reform of 2002

After the reform of 2002 and its comprehensive reformulation of §§ 275 *et seq.*, the greatest importance of the otherwise superseded doctrine of PVV is its influence on the now-codified, central remedy in German contract law – the cause of action for damages due to the debtor’s breach of a contractual duty (*Pflichtverletzung*) (§ 280 I). ‘Duty’, the central element of this new provision encompasses both primary and collateral obligations, including those that arise in the precontractual negotiation phase. The scope of application of this remedy will be discussed in more detail in the following Section.

### 1. Breach of Duty, §§ 280–284, § 286 BGB

The system of contractual remedies that came into force with the reform of the German law of obligations in 2002 constituted a dramatic change.<sup>28</sup> At the center of the reformed remedy system are compensatory damages for the breach of a duty in §§ 280 *et seq.* BGB new version. Sections 280–284 and § 286 constitute the core provisions of this system of remedies. According to § 280, a breach of duty (in a contractual obligation or in an obligation imposed by law – ‘*vertragliches oder gesetzliches Schuldverhältnis*’), for which the debtor is responsible, gives rise to the creditor’s claim for compensation. Section 280, paragraphs II and III spell out the conditions under which the creditor may demand compensation for specific types of damages. In principle, the law differentiates between compensation instead of performance (§§ 281–283) on the one hand and compensation for delay (§ 286), on the other. All remaining forms of damages are considered so-called simple damages (*einfacher Schadensersatz*) and can result in compensation under § 280 BGB.

If there is delay in the debtor’s performance, the creditor can claim compensation if he has put the debtor on notice about the delay (*Mahnung*). Under certain circumstances, the remedy for delay is available without prior notice. Such is the case, for example, when the creditor filed suit, or when the debtor sincerely and definitely (*ernsthaft und endgültig*) refused to perform §§ 286 I, 2, II, III. The claim must be vested (*wirksam*) and enforceable (*durchsetzbar*). In that case, the debtor’s delay in bringing about the performance constitutes a breach of duty. The creditor can claim compensation for all damages resulting from this delay, such as lost profits or substitution costs. The claim for delay damages does not affect claims for specific performance (*Erfüllungsansprüche*).

28. Schulte-Nölke, *The New German Law of Obligation*, available at <http://www.iuscomp.org/gla/literature/schulte-noelke.htm> (last visited February 17, 2005), intro: ‘... most important reform of the German BGB since it was originally enacted in 1900’.

The creditor can demand compensation instead of performance in the following three cases:

- (a) The creditor can demand compensatory damages instead of performance if the prerequisites of §§ 280 III, 281, 283 are met (the debtor is at fault of breaching a contractual or legal obligation) and if performance is impossible (§ 275, see *infra*, 2).
- (b) The second case in which the creditor can demand damages instead of performance arises when the debtor did perform, but in the course of doing so violated certain ancillary duties (§ 241 II). For example, a carpenter painted the walls in a home as demanded but, against the explicit orders by the creditor not to smoke did so repeatedly. In this case, the creditor could terminate the contract (§ 324) and demand damages in lieu of performance (§ 282). For example, the damages would be seen in the additional costs incurred by the creditor in having to hire another carpenter to do the paint job.
- (c) Finally, the most important and most common case for a claim for damages instead of performance is expressed in § 281. The provision addresses both cases of faulty performance and cases in which the debtor does not perform at all although he is still able to do so. For this claim, it is necessary that the obligation was due (*'fällig'*) and performance of primary obligations is still possible. In addition, the creditor must have provided the debtor with a time limit for (his late) performance (*'Frist zur Nacherfüllung'*) and that time limit must have expired without the debtor's performance. Only under these circumstances, can the creditor claim damages instead of performance. Accordingly, if the creditor claims damages, the debtor is relieved of his duty to perform. These limitations underscore the legislator's basic preference for specific performance over the award of compensatory damages.

Section 281 I differentiates between a claim for so-called 'full-scale' compensatory damages and one for 'limited' compensatory damages (*'großer und kleiner Schadensersatz'*). The need for this differentiation arises from situations in which the debtor performs only a part of his obligation. The creditor can claim full scale damages only if she has no interest in partial performance. Otherwise the creditor is bound to keep what the partial performance yielded but can claim partial damages for the missing part.

In principle, the claim for compensation over specific performance encompasses all damages resulting from faulty performance or non-performance. The law aims at putting the creditor in as good a position as she would be if the debtor had performed correctly and fully. Alternatively, the creditor may make a claim for expenses reasonably incurred in reliance on the debtor's performance (§ 284). If successful, she would be placed in a position as if she and the debtor had never met. The creditor will calculate whether the damages for faulty performance or non-performance exceed her incurred costs and will choose her remedy accordingly.

Finally, the new system of remedies in the German BGB as it was just described operates in a parallel fashion to the rules for rescission of the contract (*'Rücktritt vom Vertrag'*, §§ 323–326, 346 *et seq.*). For the most part, both sets of remedies are built on identical requirements. In principle, under the rules for rescission, each party has to return what it received or provide compensation for its value if a return is

not possible. Invoking the right to rescind a contract does not deprive the creditor of her claim for damages. She can demand both, if all the elements for such a claim are met (see also *infra* F. II. 5).

## 2. Impossibility, §§ 275, 311a

The new provisions concerning impossibility can be found in § 275 I-III and in § 311a BGB new version. Section 275 addresses cases in which impossibility occurs *after* conclusion of the contract. Impossibility is not limited to those cases in which performance is not (or no longer) possible. The debtor also may refuse performance if his efforts stand in gross disparity to the creditor's interest in the performance (§ 275 II), or if the debtor must personally perform and an obstacle to performance that outweighs the creditor's interests has arisen (§ 275 III). An illustration of the first example might be the recovery of a sold ring lying inside a safe on the bottom of the ocean. Although the recovery of the ring and its delivery to the creditor might still be possible, the debtor could not reasonably be expected to perform from an economic point of view. Of course, if the debtor wished to perform, he remains free to do so. An illustration of the latter case of personal impediments to perform is the case of the opera singer whose performance cannot (or no longer) be reasonably expected at the night at which she learns of a death in her family.

In contrast, § 275 I addresses cases of impossibility of performance for the debtor as for anyone else. The most important cases under this category concern *de facto* and *de jure* impossibility. Regarding the latter, for example, under German law, the transfer of stolen property is not possible (§ 935). With respect to *de facto* impossibility, the core case is the destruction of the owed individualized item.

In as much as impossibility relieves the debtor of his obligation to perform, the creditor is then, too, free not to perform his part of the contract. The creditor may claim compensatory damages or rescind the contract (on rescission see *infra* F. II. 5).

Finally, § 311a addresses those cases in which performance had already become impossible (in the meaning of § 275) at the time when the contract was concluded. In contrast to the law before the reform of 2002 (§ 306 old version), the new regime (§ 311a new version) considers the contract as being effectively concluded and existing. However, the debtor is entitled to the above mentioned remedies (compensatory damages and rescission of the contract).

## 3. *Culpa in Contrahendo*

A notable expansion of the sphere of recognized contractual duties is the now-codified area of pre-contractual liabilities (*culpa in contrahendo* [c.i.c.], §§ 311 II, 241 II). This area had a very long history of development and sophistication, first in the Prussian General Law of the Land of 1794 (*Preussisches Allgemeines Landrecht*, Art. 284), and then by way of scholarly reassessment, notably by Rudolph von Ihering,<sup>29</sup> and by the ensuing consolidation through the 19th and 20th centuries.

29. Ihering, *Culpa in contrahendo oder Schadensersatz bei nichtigen oder nicht zur Perfektion gelangten Verträgen*, Iheringsche Jahrbücher 4 (1861), pp. 1–112.

The liability for breach of protective duties during the negotiations preceding a contract (whether or not the contract actually is concluded) is re-cognized because this period is deemed to be governed by fiduciary duties growing out of both parties' particular preparations for a later contract. Before the reform of 2002, at which time c.i.c. was codified in § 311 II, III BGB new version, courts had elaborated on the suggestions of Ihering that the beginning of contractual negotiations or the initiation of commercial contact led to the creation of a contract-like relationship of trust (*vertragsähnliches Vertrauensverhältnis*), out of which grew mutual protective obligations owed by each party towards the other. While the new codification of the grounds for compensation in § 280 I, § 311 II, III BGB does not contain all the details and requirements that have been developed in the case law, these provisions provide the normative basis both for the recognition of pre-contractual duties as well as for the compensation claim regarding the breach of such duties. *Culpa in contrahendo* was designed to acknowledge the exposure of potential contract partners to risks arising in pre-contractual, commercial or other specialized settings. Mere social contact, however, is not sufficient.

#### 4. Frustration (*Störung der Geschäftsgrundlage*)

Since the reform of 2002, §§ 313, 314 BGB contain provisions concerning frustration of the inherent purpose of a contract ('*Störung der Geschäftsgrundlage*' § 313) and the cancellation of long-term contracts for cause ('*Kündigung von Dauerschuldverhältnissen aus wichtigem Grund*' § 314). Section 313 BGB codifies a well-established case law doctrine of contractual adaptation in cases in which the circumstances forming the basis of the contract have changed dramatically after its conclusion. Section 313 I BGB now clearly delineates the principles that were developed in legal scholarship and jurisprudence. If adaptation of the contract proves impossible or if it would constitute an undue hardship for one of the parties that party is entitled to rescind the contract (§ 313 III).

#### 5. Rescission (*Rücktritt*)

The provisions in §§ 323–326, 346 BGB address requirements for the rescission of a contract (*Rücktritt*) and its consequences. Section 323 BGB deviates from the principle adopted, for example, by the CISG,<sup>30</sup> UNIDROIT<sup>31</sup> and the PECL,<sup>32</sup> that only a fundamental breach justifies rescission or avoidance (thereby giving much discretion to the adjudicating body regarding the interpretation of this formula). It follows from the revised provisions in the BGB that the contracting parties themselves must define a period of time after which late performance will give rise to a right of rescission. The provisions regulate but do not exhaustively list the conditions under which

30. The United Nations Convention on Contracts for the International Sale of Goods (1980).

31. International Institute for the Unification of Private Law, *Principles of International Commercial Contracts* (1994).

32. Commission on European Contract Law, *Principles of European Contract Law* (revised 1999).

one party may rescind a contract because of faulty or non-performance by the other party. For example, under § 323 the creditor may rescind a contract if the debtor did not perform, or if he failed to perform adequately under the contract and failed to cure this defect within a reasonable additional period of time fixed by the creditor. However, the creditor need not establish an additional period if it follows from the debtor's communications or from the circumstances that the debtor will not perform. Section 325 BGB states that the termination of a contract does not prejudice the creditor's right to claim compensation, while § 326 BGB regulates in great detail the conditions under which the creditor is released from her duty to perform if the debtor failed to perform according to § 275 I-III BGB (see, *supra*, F. II 2).

In the following Sections (G – H), we shall describe in greater detail two of the BGB's most prominent codifications of specific types of contract, sales and construction contracts.

## G. SALES CONTRACTS

### I. Seller's and Buyer's Obligations

The central provision for sales contracts under German law is § 433 BGB. Under this provision, a seller is obligated to hand over the sales object to the buyer and to transfer ownership (§ 433 I 1). The buyer is under the obligation to pay the seller the contract price and to take delivery of the sales object (§ 433 II).

In the 2002 reform of the law of obligations and of sales law, the legislature chose to go further than would have been required by the EC Consumer Sales Directive. Instead of limiting the reform to consumer sales contracts, the legislature expanded it to all sales transactions. This has a number of important consequences. Drawing on the principles laid out in the Consumer Sales Directive, the legislature implemented the principle whereby the seller is under an obligation to deliver goods free of physical or legal deficiencies (*frei von Sach- und Rechtsmängeln*, § 433 I 2).

### II. Defective Goods

Under § 434, the object of sale is free from defects if it is of the quality as stipulated in the contract at the time the risk passes to the buyer. In the absence of such contractual stipulations, § 434 sets out additional criteria to determine the status of the sales object. According to one standard, goods are free from defects if they are fit for the purpose that can be inferred from the contract. Alternatively, goods are of the requisite quality if they are fit for ordinary purposes, are of a quality common to comparable items, and the buyer could reasonably expect such quality. Public statements and advertisements by the seller, the manufacturer or its agent count as factors in this regard. They can trigger reasonable expectations on the part of the buyer unless the seller did not actually or constructively know about the promotion (§ 434 I 3). Such a situation can occur when the seller is caught unaware of a promotion by the manufacturer or by his wholesale agent. Furthermore 434 II BGB establishes the seller's liability for the defective assembly of the sales item or for faulty instructions

(e.g., improper translation). Finally, under § 434 III BGB a product is considered as defective if the seller has delivered different goods or too small a quantity of the specified goods.

In case of delivery of a defective product, § 437 BGB provides for three options: The buyer may (1) primarily, demand additional performance (*Nacherfüllung*) which may either consist of the repair or the replacement of the defective article. The buyer also has the secondary option to (2) rescind the contract (*Rücktritt*) or reduce the sales price (*Minderung des Kaufpreises*), generally if the debtor failed to cure the defect within a reasonable additional period fixed by the buyer. Finally, (3) the buyer may, under certain circumstances, demand compensatory damages for the breach (*Schadensersatz*) or for expenses incurred in reasonable reliance on performance (*Ersatz vergeblicher Aufwendungen*).

Defective products that also cause damages to other possessions of the buyer give rise to a claim for compensation (§ 437 Nr. 3, § 280 I BGB) without the requirement of fixing an additional period for the seller to discharge his main obligation first, i.e., to repair or replace the goods sold. Setting a time period in such cases obviously would not make sense, as the damage to other possessions of the buyer has already occurred.

The reform of 2002 also modified and clarified the limitation periods for claims under sales law. In the original sales law, the prescriptive period for claims in connection with defective products was six months. This period was often criticized as being too short and prompted numerous attempts to circumvent this undesired limit. This was done by either importing the three year period applicable to tort claims or by invoking the thirty year default period under general obligations law. The new sales law now provides for periods of thirty, five or two years, depending on the nature of the claim (§ 438 BGB). Of greatest practical relevance is the two-year period applicable to claims for compensatory damages against the seller of defective goods (including consumer goods).

### III. Consumer Sales Contracts

A 'consumer sale' is defined in § 474 BGB as a sales contract concluded between a consumer (§ 13) who buys a tangible movable item (consumer goods – *Verbrauchsgüter*) from an entrepreneur (§ 14). A consumer is defined as a natural person who is acting for purposes which are not related to his trade, business or profession. An entrepreneur is a natural or legal person who, under a contract, sells consumer goods in the course of his trade, business or profession. The consumer sales provisions (§§ 475–479 BGB) contain a set of specific rules that implement the EC Consumer Sales Directive<sup>33</sup> and complement the general law governing sales contracts. These specific consumer rules apply to the sale of new goods and, generally, to used things as well (§ 474 I 2). If the purchased item serves both commercial/professional and private purposes of the buyer, the decision of whether the transaction is to be classified as a consumer sales contract may depend on which purpose constitutes the preponderant part. The burden of proof lies with the buyer who claims protection under these specific rules.

33. See *supra* note 26.

In contrast to the reform of the general sales law which emphasizes private autonomy, the regulation of consumer sales contracts in §§ 474–479 BGB considerably restricts the parties' freedom of contract. These consumer protection rules prohibit most derogations from the performance and remedy provisions (§§ 433 et. seq.) which largely can be waived or modified under the general sales law. Under the consumer rules, such derogations are invalid if they are to the disadvantage of the consumer, and if they are agreed upon *before* the consumer notified the entrepreneur about the product defect (§ 475 I 1). Conversely, derogations are effective if they are advantageous for the consumer or were stipulated after the consumer put the entrepreneur on notice about the defect.

The new rules reverse the burden of proof concerning the existence of a product defect. Under ordinary sales law, it is for the buyer to prove that a defect existed at the time the risk passed to him. According to § 476 BGB, any defect which becomes apparent within six months of delivery of consumer goods shall be presumed to have existed at the time of delivery unless this presumption is incompatible with the nature of the goods or the nature of the defect. This reversal of the burden of proof which is mandated by the EC Consumer Sales Directive marks the most radical departure from the general law on sales and considerably strengthens the position of the consumer.

The provisions specific to consumer sales contracts also introduce remarkable remedies for the entrepreneur (retailer) against his seller (§ 478 BGB – *Unternehmerrückgriff*). The retailer may seek redress if he – in his relation to the buyer – had to accept the return of defective goods, suffered a reduction of the purchase price or incurred expenses in repairing or replacing the goods. Provided the goods were already defective at the time the risk passed to the retailer and certain additional requirements are met, the retailer may return the defective goods to his supplier or demand compensation. These indemnity rights reflect the overall objective of the Consumer Sales Directive, which sought to improve the buyer's position, particularly in light of increasingly aggressive marketing and distribution methods.

## H. CONSTRUCTION CONTRACTS (*WERKVERTRÄGE*)

Under § 631 I BGB the contractor is obligated to produce the chattel ordered, while the customer is obligated to pay the contracted price. Section 640 I 1 BGB specifies the obligation of the customer to take delivery of the chattel that meets the contract specifications (*Annahme*).

The EC Consumer Sales Directive did not require a legislative reform of the law of construction contracts (*Werkvertragsrecht*). It was undertaken nonetheless, primarily to adapt that body of law to the new rules governing general obligations and sales law. The reform mainly brought about three changes. First, it reduced the scope of applicable construction law provisions. Under the old law, courts frequently faced the problem of adequately classifying contracts involving movable goods that the contractor agreed to both produce and deliver, i.e., sell to the customer. After the reform of 2002, such contracts are governed by the law of sales (§ 651 I 1). Second, the reform harmonized the rules defining defective construction and prescribing remedies with those embodied in the BGB's sales law and general law of obligations

(§§ 275 *et seq.*). Third, the legislature revised the limitation periods for construction contracts. Subject to exceptions, a two-year period applies to movable products and a five-year period to claims relating to buildings (§ 634a BGB).

The provision defining what constitutes a defect that gives rise to remedies under construction contracts (§ 633) largely replicates the new sales law (§ 434). As in sales law (§ 437, see *supra*, G. II), moreover, the remedies available for breach of a construction contract now derive primarily from the general law of obligations. Among other things, therefore, the customer is entitled to additional performance, rescission, and damages. In recognizing the particular nature of construction contracts, the legislator maintained the customer's right to repair the defective article himself and claim compensation for related expenses (§ 637 I). This remedy generally requires that the constructor be given a reasonable period of time to fix the problem and failed to do so. The reform also codified case law which entitled the customer to demand an advance for the expenses that he will incur in repairing the defect. (§ 637 III).

## I. OUTLOOK

The reform of 2002 was accompanied by a heated debate over the merits of reforming national (and admittedly old and complex) legislation while at the same time a Europe-wide search had begun for universal contract principles and, possibly, a Europe-wide private law codification. The German legislature chose a middle way.

By reforming a central part of the BGB, but not the law's underlying principles, the legislature sought to address a long-standing situation in which the BGB was torn between the aspirations of private law scholarship rooted in the Roman legal tradition which sought coherence and displayed great reluctance to amend its text on the one hand, and the continuing pressure on the BGB through case law and a growing body of conflicting international codification and policy forces on the other hand. The integration of different elements of contracts doctrine (such as *culpa in contrahendo* and frustration) that previously existed either in separate statutes or in case law, must thus be seen as the attempt to upgrade the status of the BGB and to bring it into an era in which the Pan-European comparison of national private law codifications will be instrumental in shaping the future development of private law harmonization in Europe. Given the continuing struggle over unification and harmonization of European contract law, the different values of mutual learning, reflexive harmonization or system competition are again coming to the fore.

At the same time, the reality of an ever-increasing Europeanization of national legal doctrines, calls for an assessment of national path-dependencies in another fashion. Considering, for example, the European origins of consumer protection policies at the end of the 1970s,<sup>34</sup> one must acknowledge the complex task that the EC actors, particularly the Court and the Commission, faced in their attempts to introduce substantive policy agendas to private law. That field had long been viewed as relevant only for purposes of market functioning, with little or no implications for other policy concerns. The 'transformation of Europe',<sup>35</sup> which has been characterized by

34. Reich/Micklitz, *Consumer Legislation in the EC Countries* (1980), p. 185.

35. Weiler, *The Transformation of Europe*, Yale L. J. 100 (1991), 2403.

