



## Contracts Signed Under Duress: Meeting the Burden of Proof



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# What is Duress?

- Commonly designates a defect in consent caused by external pressure
  - Physical and psychological threat
  - What about economic pressures?
- Energy Disputes:
  - Strong players + critical social importance of energy commodities = Market pressures to enter into/renege contracts
- Can the notion of duress apply to market pressures in the energy sector?
  - Matter of law applicable to the contract:
    - Does the law in question operate with “economic duress”?
    - What are the requirements for a successful plea?





# English Law: The Test for Duress

- Economic duress is well developed in common law:
  - Principle
    - A contract will generally only be valid if it has been entered into freely and voluntarily
    - A contract made under duress is not void but voidable by the injured party against the contracting party
  - Test
    - The economic pressure applied by the contracting party was illegitimate, e.g., a crime, a tort or a breach of contract (including past and threatened breaches)
    - But for the illegitimate economic pressure, the claimant would not have entered into the contract (i.e., causation)



# English Law: Illegitimate Pressure

- In determining whether the pressure was illegitimate, the courts will consider certain factors including:
  - Actions of the victim
    - Did the victim of the alleged coercion protest? (The total absence of protest however does not mean that the act was voluntary)
    - Was there any realistic practical alternative for the victim including an adequate legal remedy?
    - What steps were taken to avoid the contract?
    - Was the victim independently advised?
  - Actions of the contracting party
    - Did the contracting party act in good or bad faith?
  - Nature of the economic threat
    - Was the threat a grave one?
    - Was there an actual or threatened breach of contract?
  - Seriousness of the impropriety
  - Conduct of both parties at the time





# English Law: Evidencing Duress

- Victim:
  - Protest early and often, take tangible steps to set aside the contract (any act of affirmation may validate the contract!), act quickly (lapse of time may extinguish the right to rescind the contract)
  - Documentary evidence:
    - Showing that the victim had no other option but to enter into the contract and/or absence of alternative options
- *Electricity Generation Corporation t/as Verve Energy v Woodside Energy Ltd* [2013] WASCA 36
  - Australian Court held that illegitimate pressure had been applied and was the cause of the victim entering into a short term gas sale agreement (GSA)
  - Fatally for the victim's claim, it failed to take the next step of rescinding the GSA, and it was limited to recovering damages for breach of the GSA



## English Law: Remedies for Duress

- A contract entered into under duress is voidable, not void
  - Although a voidable contract creates rights and obligations, it may in principle be set aside (rescinded) by the victim; the contract would therefore be retrospectively set aside and the parties would be put back in their original position before entering into the contract
- The court can rescind the contract provided there are no equitable bars to rescission such as:
  - The victim has affirmed the contract
  - There has been a lapse of time
  - It is not possible for the parties to be restored to their pre-contractual position
  - If the contract was rescinded, it would adversely affect a bona fide purchaser's interest
- The court can also award damages (which is the only remedy if rescission is not possible)



# French Law





## French Law: Pleas of Economic Duress

- In French law, economic duress may be pleaded in two types of situations:
  - Duress as defect of consent to enter into the contract: high evidentiary threshold
  - Duress in performance of the contract (including renegotiation of existing contracts) may be a more likely avenue to succeed
- Duress as vice of consent to enter into the contract
  - Generally a ground for annulment of a contract and obtaining damages (Article 1111 of the French Civil Code)
  - Since 30 May 2000, the French Supreme Court has developed the concept of “economic duress” as falling under article 1111 of the French Civil Code



# French Law: Duress in Formation of Contract Is Subject to High Evidentiary Threshold

- Claimant must demonstrate:
  - Economic coercion...
    - A contractual inequality resulting from a situation of economic distress, which materializes in an impossibility for a party to negotiate freely or enter into contract freely
  - ...that is illegitimate or abusive...
    - The “dominant party” must have (1) actively and personally participated to the threat which resulted in (2) an abusive exploitation of a situation of an economic dependency
      - » The French Supreme Court has defined economic dependency “as a situation in which a company does not have the possibility to substitute to its supplier(s) other supplier(s) to meet its needs in comparable technical and economic conditions” (French Supreme Court, 3 March 2004)
    - Abuse is appreciated objectively for commercial players, i.e., as professional commercial players for which mere economic power/weakness is insufficient to prove duress
  - ...and that was a decisive element for entering into the contract

# French Law: Duress in Performance of a Contract (1)

- Abusive commercial behavior
  - Liability of a commercial party for
    - “submitting or trying to submit a commercial partner to obligations creating a significant commercial imbalance between the rights and obligations between the parties”, or
    - “obtaining or trying to obtain under the threat of a total or partial abrupt termination of commercial relationships, in conditions manifestly abusive concerning prices, payment periods, sale conditions or services unrelated to the obligations of purchase and sale” (Article L442-6 of the French Commercial Code)
  - Demanding burden of proof for the claimant:
    - Existence of a threat
    - Manifestly abusive nature of action/manifestly derogatory and unilateral advantage for the stronger party
  - Remedies
    - Damages
    - Nullity of the abusive clauses of the contract
    - Restitution
    - Civil fine of a maximum of €2 millions or three times the amounts unduly paid



## French Law: Duress in Performance of a Contract (2)

- The duty of good faith
  - Article 1134 and 1135 of the French Civil Code and case law impose an obligation of loyalty and cooperation on parties
    - A supplier who modified the equilibrium of the contract in such a way that the distributor was unable to face competition breached his obligation of good faith (French Supreme Court, 3 November 1992)
    - Obligation to not render the performance of the contract by the other party more difficult or impossible (French Supreme Court, 18 May 1978)
  - Used to encourage renegotiation of contracts that have become unfair or unsustainable for a party
  - Remedies: Damages and/or freezing of certain rights of the creditor under the contract; termination was admitted by French courts in some cases
- Abuse of the economic dependency under Article L420-2 of the Commercial Code
  - The burden of proof lying on the claimant is high:
    - The abusive exploitation of the state of economic dependency (the importance of the turnover alone is insufficient); and
    - Distort the market/competition
  - Remedies: Nullity of the contract and/or damages





# French Law: Economic Duress in Practice

- Rejection of most claims for failure to meet the burden of proof:
  - Failure to prove the abuse of the situation of economic dependency of real estate investment companies in their relationship with a bank concerning difficulties arising out of the performance of a settlement agreement for the repayment of loans (French Supreme Court, 16 October 2007)
  - Failure to prove that the other party had exercised abusive pressures of any kind over the economically dependent company that would have vitiated its consent (CA Nimes, 10 May 2011; CA Montpellier, 23 April 2013)
    - Successful examples:
      - » In a dispute arising out of a distribution contract between a distributor and his supplier for paint products, the supplier tried to obtain an important revaluation of the price paid by the distributor for the products (+7%) under the threat of brutally terminating the supply (CA Aix en Provence, 7 September 2011, n°2011/319); the Court held that this behavior was manifestly abusive especially considering that a settlement agreement had been concluded by the parties a few month earlier establishing a new price structure
      - » In a dispute arising out of a sales and purchase agreement, the Court considered that the manifestly excessive price conditions and the brutal interruption of the performance of the contract by the seller amounted to abusive commercial behavior and a breach of the duty of good faith (CA Aix en Provence, 15 June 2011, n°11/02547)

# Russian Law



- Economic duress is quite undeveloped under Russian law
  - Duress generally applies to physical and moral violence on natural persons, economic duress per se is unrecognized
  - Russian courts however apply the principle of freedom of contract (Article 421 of the Russian Civil Code) as a general principle of the civil law to a variety of disputes
- Concept close to “economic duress” = one-sided transaction (“enslaving bargain”)
  - Economically stronger party imposes on the weaker party unfavorable conditions:
    - Conditions outside of the subject of the contract (e.g., subjecting conclusion of the contract to conclusion of another contract on commodities that the contractor is not interested in)
    - economically or technologically unsubstantiated conditions, including unconditioned increase of selling price
  - Russian court practice on economic duress cases is silent with respect to application of “economically weaker party” doctrine to energy disputes, no reliable test for an “economically weaker party” has been developed

# Russian Law: One-Sided Transactions

- Test:
  - The contract is disadvantageous for the victim;
  - The complaining party had no choice but to enter into the contract due to a situation of hardship;
  - The other party was aware of the victim's hardship; and
  - The other party took advantage of the victim's hardships in bargaining process
- Remedies:
  - One-sided transaction is voidable and may be rescind upon the claim of the victim (Article 179 of the Russian Civil Code)
  - Restitution
  - Damages





# Russian Law: Burden of Proof

- High threshold for Claimant:
  - The Supreme Commercial Court has recently analyzed a duress claim in its draft court practice review (yet subject to publication):
    - Individual entrepreneur sought a loan agreement rescission under Article 179 of the Russian Civil Code. A loan agreement was entered into due to substantial hardship the entrepreneur was facing and provided for 70% annual interest rate. The contract was rescinded. The rationale of the court was that the defendant failed to prove that an interest rate was reasonable for such sort of transaction and that the hardships on the victim's side were confirmed by evidence presented before the court.
  - High evidentiary threshold:
    - The victim should provide evidence that the conditions of the contract were disadvantageous and uncommon for such sorts of transactions (expert opinion may be needed) and facts evidencing hardship
    - The stronger party on the other hand may disprove the claim by showing the rationale of the disputed conditions (e.g., lack of collateral, contractor's good will, previous breaches)
- Procedural Issue
  - Allegations of duress must be raised before the court/tribunal and not in the enforcement stage of the case where it can rarely influence enforcement and recognition of the award



# Ukrainian Law



- Notions close to “economic duress”
  - Invalidity of contracts or other arrangements entered as a result of coercion (Article 231 of the Civil Code):
    - Pressure includes psychological pressure and thus may apply to economic pressure
    - The Supreme Court, however, requires pressure to be a result of an unlawful act which is problematic in the context of pressure as a result of commercial inequality
  - Invalidity of commercial contracts that breach rights and lawful interests of other parties or third persons (Article 207 of the Commercial Code)
    - Primarily designed as a rule of consumer protection (e.g., provisions on exclusion or limitation of product liability, provisions allowing unilateral termination of a contract, high contractual penalties
    - Application to economic pressures on commodities market is possible but untested before Ukrainian courts
  - Arrangements entered into in adverse circumstances (Article 233 of the Civil Code) – a more realistic option



# Ukrainian Law: Plea of Adverse Circumstances

- Invalidity of arrangements entered into in adverse circumstances: a more realistic option
  - Requirements:
    - A contract entered into as a result of the existence of adverse (difficult) circumstances (assessed in the specific situation of the victim)
    - List of adverse circumstances is not exhaustive and includes, for example, a threat of insolvency for a company
    - The result of the coercion is that terms/conditions of the contract are disadvantageous for the victim
    - The victim had no other choice but to enter into a contract to prevent the occurrence of such adverse circumstances or to mitigate their effect
  - Burden of proof is high:
    - Coercion as well as abuse of adverse circumstances must be established
    - The victim must also prove that but for adverse circumstances, it would not have entered into the contract or would have entered into the contract on different terms and conditions.
  - Remedies:
    - Invalidity of a contract or part thereof
    - Restitution
    - Compensatory pecuniary and emotional distress damages





# UNIDROIT Principles



## Duress Under UNIDROIT Principles

- Application of UNIDROIT Principles of International Commercial Contracts 2010:
  - UNIDROIT Principles shall be applicable in case the parties have agreed that their contract be governed by them
  - UNIDROIT Principles may be applicable when the parties have agreed that their contracts be governed by general principles of law, the lex mercatoria or the like or when the parties have not chosen any law to govern their contract
  - UNIDROIT Principles may be used to interpret or supplement international uniform law instruments, domestic law and may serve as a model for national and international legislators
  - Application of UNIDROIT Principles may not restrict application of mandatory rules, whether of national, international or supranational origin, which are applicable in accordance with the relevant rules of private international law
- UNIDROIT Principles include two notions close to economic duress:
  - Threat
  - Gross Disparity



# UNIDROIT Principles: Threat

- Threat:
  - A party may avoid the contract when it has been led to conclude the contract by the other party's unjustified threat which, having regard to the circumstances is so imminent and serious as to leave the first party no reasonable alternative. In particular, a threat is unjustified if the act or omission with which a party has been threatened is wrongful in itself, or it is wrongful to use it as a means to obtain the conclusion of the contract. (Article 3.2.6)
- Requirements:
  - Imminent and serious – the threat must be of so imminent and serious character that the threatened person has no reasonable alternative but to conclude the contract on the terms proposed by the other party
    - The imminence and seriousness of the threat must be evaluated by an objective standard, taking into account the circumstances of the individual case
  - Unjustified – the definition of threat under UNIDROIT Principles involves examples of unjustified threat, i.e., the act or omission considered as threat is wrongful in itself or the purpose to be achieved is wrongful
- Remedies: Avoidance of the contract



# UNIDROIT Principles: Gross Disparity

- Threat:
  - A party may avoid the contract or an individual term of it if, at the time of the conclusion of the contract, the contract or term unjustifiably gave the other party an excessive advantage. Regard is to be had, among other factors, to:
    - (a) the fact that the other party has taken unfair advantage of the first party's dependence, economic distress or urgent needs, or of its improvidence, ignorance, inexperience or lack of bargaining skill; and
    - (b) the nature and purpose of the contract (Article 3.2.7)
- Requirements:
  - Excessive advantage – i.e., disequilibrium in the circumstances so great as to shock the conscience of a reasonable person; and
  - Unjustifiable advantage – shall be considered on case-by-case bases, however two factors deserve special attention, namely unequal bargaining position (e.g., economic distress, urgent needs, etc.) and nature and purpose of the contract
- Remedies:
  - Avoidance
  - Substantial revision of the provisions of the contract in accordance with reasonable commercial standards of fair dealing







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