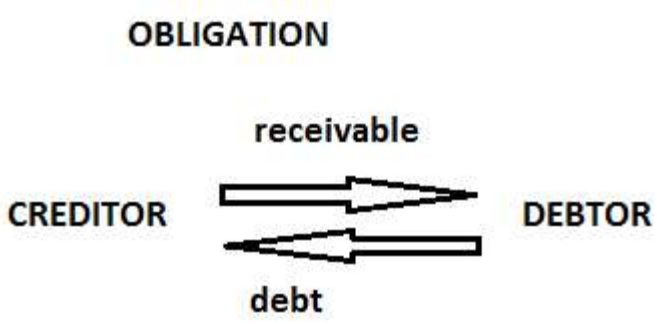
# Chapter 6. Contracts

## 6.1 Obligations

Contracts are the most common title (another one are delicts) for obligations to arise. Obligations are relations between creditors and debtors where a creditor has a receivable and a debtor has a corresponding debt.




Obligations are relative property rights where a relationship between specific subjects arises. Relative property rights thus affect only particular subjects, i.e. creditors and debtors. As an example we can name loan agreement where a creditor has a right to get the lent money returned together with the interest and a debtor has a corresponding duty to return the money together with the interest. No one else is involved in the relationship of the creditor and debtor.

Features of obligations

Any obligation has its subjects, object and its content. Subjects are, in general, a creditor and a debtor. The particular name of subjects depends on the contract in question – in case of a purchase contract, the subjects are a purchaser and a seller, in case of a donation contract, the subjects are a donor and a donee etc. An object of an obligation are goods or performance to which a contract relates. For example, if you intend to buy a house, the house would be an object of such purchase contract. A content of an obligation then comprises rights and duties arising out of a contract. In case of a purchase contract, the content of an obligation would be a **right** of seller for a purchase price and his **duty** to transfer an ownership right to a buyer and the corresponding duty of a buyer to pay a purchase price and his right to acquire an ownership right.

Relative v. absolute property rights

As opposed to obligations (relative property rights), there are absolute property rights such as ownership right which relate to some property rather than to a person. These rights affect all subjects even though they are in no specific relationship to the entitled person. E.g. an owner of a house has (an absolute property) right to use the house for living and everybody must respect such right and not prevent the owner from using the house (by e.g. changing the locks, occupying it etc.). Notice that there is no contract or other reason for creating any special

relationship between those subjects (as opposed in the case with loan agreement). The ownership right applies to all persons who have a corresponding duty not to disturb it.

## 6.2 Principles of contractual law

Contractual law is based on several basic principles such as principle of freedom of contract, *pacta sunt servanda* (see below), principle of the duty to behave honestly and not to harm anyone and also on the protection of the weaker party, especially a consumer.

Freedom of contract means that everybody is, in private law, free to choose whether to enter into a contract or not, choose the contracting partner and determine the content of the contract through negotiations. Nobody can force you to enter into contracts in the first place. There is, however, one exception which is a compulsory motor vehicle third party liability insurance. It is thus obligatory for any motor vehicle operator to conclude the third party liability insurance agreement. The motor vehicle operator is, however, free to choose an insurance company.

*Pacta sunt servanda* principle means that the contracts and their clauses are binding for the parties to the contract and that the failure to fulfil them is a breach of the pact.

## 6.3 Contracts

Contracts are, by their definition, the expression of the will of the parties to create an obligation between each other and to be bound by the content of such contract. Every contract starts with an **offer** which must include essential terms of the contract and such offer must be **accepted** by the other party unconditionally.

E.g. If one party intends to sell a cell phone, he/she must clearly express his/her will to sell it and specify the cell phone. Only such offer is binding and may be subject to an acceptance. If the acceptance is unconditional (no essential changes such as willingness to buy a different cell phone than the one offered), there is a binding purchase contract. If, however, an offeree changes the offered terms significantly, e.g. starts to negotiate about the purchase price, he/she is making a **counteroffer** which is subject to acceptance of the other party (who was an offeror before). Only once all the essential terms are agreed on by both parties, there is a binding contract.

Every offer also has its time limit for which it is binding. An oral offer or a written offer made towards a present person must be accepted immediately. If your friend offers you his laptop for CZK 8000 on Monday during the class and you do not answer, he is free to offer it to somebody else since the offer was not accepted, was made orally towards a present person and thus has expired. If you decide next day that you would like to buy it, you basically make a new offer to buy his laptop which he can accept if still interested (notice that the subjects are now in the opposite position). If an offer is made in writing towards a person who is not present, such offer must be accepted in the time limit stated by the offeror in the offer. If there is no time limit stated in the offer, the offer must be accepted in a **reasonable** period of time. What would be considered reasonable depends on several factors such as type of goods or performance (it will definitely be longer in case of the sale of a house than in case of the sale of a cell phone), means of communications used (longer for post than for e-mail), an established practice between parties etc. A consideration of what is a reasonable period has to be made on a case-by-case basis.

Form of the contract

Czech civil law is based on the principle of informality. Most of the contracts can thus take any form the parties choose – oral, tacit, written or notarial deed. There are, however, exceptions, where law requires specific forms and those are contracts relating to real property which have to be in writing or articles of association of capital companies which have to be in the form of notarial deed. Also, according to the Czech civil code, if at least one party to the contract requires a specific form of the contract (e.g. a written contract), a contract which does not fulfil such form is not binding. Other contracts do not require specific form.

Offers made in catalogues or advertisements

As we said, an offer once made is binding and if accepted, a contract is established. You have probably experienced several times that you came to the supermarket for some specific promotion which you saw in the leaflet and there you realized that they are out of stock. Was the offer in the leaflet binding? Is the out of stock situation a breach of the binding offer on the side of the supermarket? It is a practical exception from the rule that the offer made in catalogues, advertisements, leaflets etc. are binding subject to out of stock. Once the supermarket is out of stock, the offer stops being binding.

### 6.3.1 Changes in obligations

In commercial practice, it is very common that obligations need to be changed during their existence either in subject or content.

Changes in subject of the obligation

Once a contract is concluded, it is binding for both parties (creditor and debtor). If one of the parties wishes to unilaterally release from the contract, they can do it through the change in subject.

Change of the creditor

(i) Creditors often sell their receivables to the third parties from various reasons, e.g. because the debtor does not pay voluntarily and the creditor does not want to get involved in court proceedings which is costly and risky. The sale of the receivable to the third party is called **an assignment of the receivable**. To assign the receivable, a creditor does not need to have the consent of the debtor. The content of the obligation does not change but the debtor is now obliged to pay to the new creditor instead of the original one.

(ii) since the adoption of the new civil code as of 1 January 2014, it is now possible to **assign the whole contract** with all the rights and duties. However, only a party who has not yet received the performance can assign the whole contract and under the condition that the nature of the contract does not exclude it. If, for example, you entered into the contract with a famous photographer to take pictures from your wedding, he cannot successfully assign the contract because such performance is unique for you. In other words, you chose him specifically and you have no interest in any other photographer.

Change of debtor

Under specific circumstances, also a debtor can be changed during the existence of obligation.

(i) In case of **take-over of debt**, an original debtor stops being a debtor and a new debtor replaces him. The creditor must, however, give a prior consent to such take-over so that the status of a creditor does not worsen. A creditor thus can refuse to accept a new debtor who would have less credibility than the original one.

(ii) In case of **accession to debt**, both an old and a new debtor are jointly and severally liable and thus there is no need to have consent of the creditor because the position of a creditor gets stronger (instead of one debtor there are two of them).

Changes in the content of obligations – rights and duties

The parties to the contract are free to change or modify their current rights or duties arising out of the contract either because they have no interest in the original performance or they simply want to amend the current obligation with new rights or duties. Also, it is possible that such modification is necessary because there is some kind of dispute between the parties.

**(i)** **Novation agreement** means that either the original obligation is terminated completely and replaced with a new one (**private novation**) OR the original obligation is just amended with new rights or duties (**cumulative novation**).

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| E.g. two parties enter into the purchase contract for the sale of 20 bottles of red wine from Moravia and before the fulfilment of the contract the purchaser changes his mind and would like 30 bottles of white wine instead of the red wines. He communicates with the seller who is willing to change the contract as well. This is a typical example of private novation where the original obligation ceases to exist and is replaced by the new one. Of course, the consent of both parties is necessary. |

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| E.g. two parties enter into the lease agreement for an apartment in the Prague city centre for 1 year. After the term of the lease elapsed, both parties agree to prolong the contract under the same conditions for another year. They amend the original contract with the respective extension of the term. This is a cumulative novation. Again, the consent of both parties is necessary. |

**(ii)** **Settlement agreement** is of use if some provisions of a contract are unclear or disputable between parties and thus they must be replaced with new provisions in order to remove such dispute.

### 6.3.2 Extinction of obligations

There are several ways how an obligation can come to an end, either with or without satisfaction of the debt.

**A. With satisfaction of the debt**

(i) **Fulfillment of obligation** is the easiest and most preferable option for both parties since the aim of the contract has been achieved. For example, a student comes to a coffee shop for a cup of coffee, he orders a coffee, pays the price and gets his

cappuccino. The deal is done, the contract is fulfilled and both parties are happy. There is no obligation left between them.

(ii) An obligation may extinct by **mutual agreement** of both parties. To stay with the example with the coffee shop, imagine that the student, after he ordered his cappuccino and paid the price realizes that he has no time left and wishes to cancel his order. If the seller agrees, an obligation has extinct by mutual agreement and the seller will return the money to the student.

(iii) If both parties have mutual rights and duties between each other, the claims may be **set off**. To give an example how it works in practice, imagine that Charles lent Lucy CZK 2000 because she ran out of money. A couple of days later, Charles lost his cell phone and did not want to invest much money in the new one and so Lucy offered him her old phone which was fully functional for CZK 2000. Charles was more than happy for such offer and asked Lucy to set off their mutual claims – his duty to pay the purchase price of CZK 2000 against his right to receive the loan of CZK 2000 back from Lucy. All duties were thus cleared and neither Charles, nor Lucy had to pay anything.

**B. Without satisfaction of the debt**

(i) **Remission of debt** is the unilateral action of the creditor who releases the debtor from his debt. By remission, the obligation between the creditor and debtor becomes extinct.

(ii) **Termination** is also a unilateral way how to extinct the contract but it is of use only where such possibility was agreed in contract or if such right arises from law. Typically, contracts concluded for indefinite period (such as lease contracts or employment contracts) may be terminated by the unilateral termination. The termination must be delivered to the other party and the contract then ends after the notice period elapsed. The length of the notice period is either agreed between the parties or is stated by law (3 months for leases of apartments, 2 months for employment contracts etc.).

(iii) **Withdrawal** from the contract is again the unilateral way how to extinct the contract but such possibility must be explicitly agreed in contract or such right must arise from law. Under the Czech Civil Code, it is possible to withdraw from the contract only in case of a material breach of contract (e.g. some goods have defects even after several repairs). The result of a withdrawal is that the obligation is cancelled from the very beginning and thus parties must return the performance they accepted from the other party.

(iv) **Death of debtor** leads to the extinction of the obligation only where the obligation was supposed to be fulfilled by the debtor personally**,** otherwise the obligation is subject of inheritance. E.g If I want to have a famous photographer on my wedding and he dies before the wedding, such obligation becomes extinct with the death of a photographer because I simply have no interest in his heirs taking photos of my wedding. On the other hand, debts from loan agreement or purchase contracts with no specific subject-matter are subject to inheritance and thus do not become extinct with the death of debtor.

(v) **Death of creditor** leads to the extinction of an obligation only if the performance was limited to his person only, for example damages for pain and suffering. Most of the receivables are, however, subject to inheritance.

### 6.3.3 Subjects of contracts

In order to have a valid contract, it must be concluded by persons who have a legal capacity to enter into contract. A capacity to enter into contracts of natural persons is being gained gradually until they reach 18 years of age when they get a full legal capacity. At the age of 18 thus humans have capacity to enter into all contracts no matter how complicated they are. What about youths or even children? Can they enter into a valid contract? Yes, they can enter into those contracts for which they are mentally and emotionally mature. It needs to be considered individually case-by-case taking into account the age of the youth and the respective contract. It is quite clear that a seven year old kid can buy an ice cream (a valid purchase contract) but cannot buy a car or a house. A fifteen year old kid can buy for example a motorbike (which the seven year old could not) and an 18 years old can buy whatever he/she likes provided that he/she has money for it. Apart from age, humans have to lack mental illness which would make them incapable to enter into contracts.

Legal persons (companies) get their capacity to enter into contracts upon their incorporation (registration in the commercial register). Since legal persons are an artificial construct made by law, they must act through their representatives – typically statutory bodies whose acts are binding for the company or their employees. Employees may act on behalf of the company in the field of their specialization – e.g. HR director is entitled to sign employment contracts on behalf of the company but not to sign purchase contracts with the suppliers which is outside the scope of his/her daily activities). In practice, these representatives of legal persons attach their signature next to the company's name in the contract.

## 6.4 Division of the contracts

**A. Consensual x Real contracts**

Consensual contracts are completed by the mere agreement of the contracting parties. Most of the contracts are consensual (purchase agreement, contract for work, credit agreement, employment contract etc.).

To complete a real contract, there must be something more than mere consent of both parties – the transfer of a thing from one party to the other. Examples of real contracts are loan of money or movable property pledge. A loan agreement is thus completed not in the moment both parties agree on basic elements of the contract (amount of money, due date etc.) but only once the money is provided to the debtor. The same is valid for movable property pledge, such contract is completed once the movable to which the pledge relates is transferred from the pledger to the pledgee.

**B. Formal x informal contracts**

Those contracts which require specific form (either written or even the form of a notarial deed) are called formal contracts. Such specific form might be required by law or by one or both parties to the contract. The Czech Civil Code is based on informality of contracts and thus most of the contracts do not require any specific form. There are some exceptions, e.g. § 560 of Civil Code states that legal action establishing or transferring a right *in rem* to **immovable property**, as well as legal action changing or abolishing such right requires written form (purchase or donation contract for a house, land, apartment etc.). In the field of commercial law, articles of association of capital companies (limited liability company, joint stock company) require the form of **notarial deed.**

Informal contracts are those contracts that do not require any specific form and can thus be concluded orally, in writing or even implicitly. Most of the contracts in the Czech law are informal.

**C. Synallagmatic x asynallagmatic contracts**

Synallagmatic contracts are those contracts in which parties obligate themselves reciprocally to one another so that the duty of one party is correlative to the duty of the other. E.g. purchase contract (one party provides **money** and the other provides **goods or services**, an employment contract, (the employer provides money as salary and the employee provides work), lease agreement (rent in exchange for use of property), contract for works (works in exchange for money) etc. Only such party who has already fulfilled its contractual duty or is ready to do so, can require performance from the other party – e.g. only the landlord who made the apartment accessible to the tenant may require rent.

Asynallagmatic are those contracts in which parties have no reciprocal duties. A typical example is a donation agreement where only a donor has a duty to provide a donation and there is no reciprocal duty of a donee.

## 6.5 Content of the contract

Parties to the contract either include all content into the contract itself but in commercial business, where a lot of similar contracts are concluded very often (insurance contracts, banking contracts,..), it is often practical to determine a part of the content of a contract by reference to standard commercial terms. Such terms must be either attached to the offer by the offeror or the parties must be at least aware of such terms. The pros of the commercial terms are that they are general, usable for a wide range of contracts and thus it is easier and cheaper for the entrepreneur to enter into contracts with many customers (a very simple contract to which general terms including the detailed provisions which are used for all the contracts are attached). It is also very simple to modify all the contracts by modification of general terms without the need to modify all the contracts one by one.

## 6.6 Adhesion contracts

As was said in the very beginning of this chapter, the Czech civil law is based on the principle of the protection of weaker party. In practice, it is very common that during a contracting process, one party is in a stronger position than the other (typically in case of an entrepreneur contracting with a consumer but also e.g. a big corporation contracting with a sole entrepreneur). The weaker party cannot influence (or can influence in a limited way only) the content of such contract. Usually, such party can only accept it or reject it but not modify it (e.g. insurance agreements, current account contract). The protection of the weaker party in these **adhesion contracts** is such that they cannot include clauses that are difficult to read (very small letters), that are difficult to understand for average person, or that are particularly disadvantageous without any reason. It is important to note that an adhesion contract is not a type of contract as such but it is any contract fulfilling the condition that one (weaker) party could not influence the content of the contract (all form contracts).

## 6.7 Consumer protection

The Czech Civil Code is based on the protection of a weaker party, especially a consumer who is always understood a weaker party. A consumer is every **natural person** who, **outside his/her trade or business**, enters into a contract or acts in other way **with an entrepreneur.**

Every contract with one party being a consumer and the other being an entrepreneur is called consumer contract (purchase contract concluded between an entrepreneur and a consumer, contract for works, credit contract etc.). Again, a consumer contract is no contractual type as such, it only expresses that one party to the contract is a consumer who benefits from the special legal protection.

What is the protection of a consumer then? First, prohibited are such provisions that create a material imbalance in the rights or duties of the parties **to the detriment of the consumer.** This does not apply to the subject-matter of the contract or contractual price to which the consumer protection does not relate (if a consumer agrees to pay a specific price for the goods or performance, he/she cannot later argue that such price is higher than a competitive price).

<u>In particular, prohibited are contractual provisions that:</u>

- exclude or limit rights of the consumer from defective performance of the entrepreneur or that exclude or limit right to be compensated for damage

- bind the consumer to perform his duties whereas an entrepreneur is obliged to perform his duties upon the conditions dependent on his will

- establish right of an entrepreneur to withdraw from a contract without stating the reason but a consumer does not have such right

- enable an entrepreneur to modify contractual rights and duties without the consent of the consumer

- restrict the right of the consumer to file an action.

The above provisions are prohibited by law and it is not possible to depart from such prohibition to the detriment of the consumer. Such provision would be invalid.

Moreover, if a contractual provision allows for a different interpretation, it shall be interpreted in the most favourable way for consumer.

## 6.8 Distance contracts

Further protection of a consumer relates to so called distance contracts. Those are the contracts entered into by consumers using the means of distance communications. It means that parties to the contracts are not simultaneously present (teleshopping, on-line shopping, catalogue, fax) and thus a consumer has no possibility to take a look at the goods and consider whether they fit to his/her needs. Thus, there are specific rights of a consumer (as opposed to the purchases in the brick-and-mortar store where a consumer can see the goods, try themt, etc.) and specific duties of an entrepreneur, such as:

- If a contract is concluded using electronic means, an entrepreneur is obliged to provide consumer with written contract and Terms and Conditions
- An entrepreneur has **information duties** towards a consumer which must include: contact details of an entrepreneur, description of the goods or service and their main characteristics, specification of price, payment methods and delivery, costs of delivery, rights arising out of defective performance, warranty etc.
- And most importantly, a consumer has a right **to withdraw from the distance contract within 14 days upon the delivery** of the goods without any reason. This is the consequence of the fact that a consumer cannot see or try the goods in advance. The consumer must then return the goods without any delay (within 14 days upon the withdrawal at the latest) and the entrepreneur must return all money including delivery costs to the consumer. The consumer has a right to withdraw from the distance contract within 14 days upon delivery even if the goods were ordered on-line (phone/fax etc.) and picked up in person. The term of 14 days thus starts running on the day when the goods were picked up.

The right to withdraw from the distance contract within 14 days does not, however, apply to customized goods, grocery, newspaper, magazines or computer programmes if the original package was removed.

In case the entrepreneur delivers some goods which the consumer did not order (for marketing purposes with the hope that a consumer will order the goods next time), the consumer may keep them free of charge and does not have to even inform the entrepreneur of his/her decision.

## 6.9 Off-premises contracts

Special protection relates further to consumers entering into contracts outside the business premises of the entrepreneur or with an entrepreneur who does not have business premises at all (door-to-door contracts, contracts concluded with dealers on the street, roadshows etc.). In these cases, the entrepreneurs use the element of surprise, pressure on consumer, inability to compare the offer with the offers of other sellers and thus consumers are again protected.

Consumers who entered into off-premises contracts have a right **to withdraw from such contract within 14 days upon the delivery** of the goods without any reason. The consumer must return without any delay (within 14 days upon the withdrawal at the latest) the goods and the entrepreneur must return all money including delivery costs to the consumer.

## 6.10 Summary

The most common title for obligations are contracts which can be defined as an expression of the will of the parties to create an obligation between each other and to be bound by the content of such contract. A contract is created once an offer of the offeror is accepted by the acceptant. If the offer is accepted with modifications relating to the essential terms, there is no contract but it rather is a counteroffer which is subject to acceptance by the original offeror. An offer must also be accepted on time in order to have a binding contract. In case of oral offers or written offers toward a present person, they must be accepted immediately otherwise such offer expires. In case of the written offers, they must be accepted within the time limit stated in them or in a reasonable time limit. Czech Civil Code is based on informality of contracts and thus most of the contracts may take any form (oral, written, tacit, notarial deed) with the exception of the contracts relating to the real property which must be in writing and articles of association of capital companies which must take a form of notarial deed. Offers made in catalogues, advertisements, leaflets etc. are binding subject to out of stock.

The contracts may be changed in the subjects and the content. The change of the creditor is done either through the assignment of the obligation or the assignment of the whole contract. The change of the debtor can take the form of the take-over of the debt or the accession to debt. The change of the content of the contract takes the form of either novation agreement where the original obligation is terminated and replaced by the new one (private novation) or the original obligation is amended with new rights or duties (cumulative novation) or settlement agreement which is used for solving the disputes between parties. The obligations may become extinct with or without the satisfaction of the debt. With satisfaction of the debt, they become extinct upon the fulfillment of obligation, as a result of mutual agreement of both parties and by setting off the mutual claims.

The obligations may become extinct unilaterally without a satisfaction of the debt by the remission of the debt, the termination, the withdrawal from the contract and under some circumstances, the obligation becomes extinct upon the death of one of the parties (creditor or debtor).

A capacity to enter into contracts of natural persons is being gained gradually until they reach 18 years of age when they get a full legal capacity. Legal persons (companies) get their capacity to enter into contracts upon their incorporation (registration in the commercial register).

One of the dominant principles of the Czech Contract Law is the protection of a weaker party, especially a consumer. A consumer is every natural person who, outside his/her trade or business, enters into a contract or acts in other way with an entrepreneur. The protection of a consumer relates to the special information duties of the entrepreneur towards a consumer and to the right of a consumer to withdraw from the distance contract or off-premises contract within 14 days upon the delivery of the goods without any reason. Also, the provisions that create a

material imbalance in the rights or duties of the parties to the detriment of the consumer are prohibited.

## 6.11 Self-assessment questions

1. Are the following statements true or false?

a) An oral offer must be accepted immediately.

b) One of the dominant principles of contractual law is freedom of contracts.

c) A consumer can be a legal person if he/she acts outside of his/her business.

d) Most of the contracts in Czech law do not require any specific form.

Select one correct answer:

2. What is the specific legal protection of a consumers who buy goods online (i.e. without a possibity to actually see the product):

a) He/she can only require a detailed description of the product together with the real photos.
b) He/she can return the product without any reason within 14 days upon the delivery and he/she gets full price back.
c) He/she can return the product within 24 months if he/she does not like it.

3. The contracts always become extinct in the following case:

a) Death of credit
b) Death of debtor
c) Fulfillment of an obligation
d) Selling the receivable to a third party

4. Answer the following questions briefly:

a) What are obligations?

b) When is a contract made?

c) When do humans get their legal capacity to enter into contracts?

d) How can an obligation arise?

5. Name one possible change of content of obligation. Explain shortly what such change means.

## 6.12 Further reading

Act no. 89/2014 Coll., Civil Code, as amended. For the English wording of the Czech Civil Code refer to: https://www.cak.cz/assets/pro-advokaty/mezinarodni-vztahy/civil-code.pdf