

# Validity of Open Contract in International Trade Law

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Received: November 18, 2016

Accepted: December 9, 2016

Online Published: February 28, 2017

doi:10.5539/jpl.v10n2p241

URL: <https://doi.org/10.5539/jpl.v10n2p241>

## Abstract

Open contracts are agreement whereby parties of the contract can insert terms and conditions in the contract, delete them, or revise them. Some contracts for the supply of goods or construction are examples of such contracts. One party (usually a contractor or seller) can have many initiatives by increasing and decreasing the price or by changing elements of the contract. Certainly, there are many reasons, motives, and important goals in creating this type of conventions and its acceptance by the legal community. Discovery of these reasons and the goals leads to fundamental changes and definition of this type of contract could be a major driver of reform in Iranian contract laws, as Iranian community prefers to use example or pre-specified forms of contracts. Therefore, referring to the Principles of European Contract Law and implementation of the legal provisions, legal doctrines, and jurisprudence, presentation of new concepts such as open contract as well as analysis of its nature, validity, and effects leads to establishment of grounds for accepting new contractual frameworks and its localization of contractual rights in Iran because it has been rejected due to traditional perspectives. It may result in legislation to pave the way for solving many legal problems in specialized issues such as oil contracts. In this regard, in addition to genealogy of open contract, this article aims to examine its types and its effects legally in the laws of countries like Iran and European countries.

**Keywords:** open contract, validity of open contract, warranty, supplement, international trade law

## 1. Introduction

Development and expansion of trade in domestic and international level, problems in this regard, especially in the context of continuous contracts such as contractual obligations that their implementation and conclusion requires a relatively long time, possibility of changes in social conditions, inflation, lack of accessories to fulfil the obligation or impossibility of determining the price due to economic fluctuations, the famous vote on March 13, 1916 by the French government in case the municipality of Bordeaux and Gas Company are reasons and examples for the necessity to predict a way to revise contracts. Naturally, these problems and consequences has led to emptiness and extreme need of oil and petrochemicals merchants and companies to new and advanced procedures and rules like developed countries. Therefore, the discovery of a new form of agreement having maximum security and compatibility with changing conditions cause easy conclusion of these agreements at the international and domestic levels in the field of extensive trade relations. In this regard, open contract is an innovative example of corresponded contracts to new needs of the international business community as a type of contract in legal communities. In open contract, parties can include specific provisions and conditions in the agreement, eliminate it, or revise it totally. Undoubtedly, parties' satisfaction in the revision is irrefutable. Some supplies of goods or construction contracts, which are concluded in open-end forms, are examples of this type because one party (contractor or seller) have much freedom with reducing of increasing price through changing other contractual elements; in this manner, he creates a formalist way to shirk some responsibilities.

## 2. Open Contract

Before defining open contract, the term contract should be described.

### 2.1 *The Literal Meaning of Contract*

The literal meaning of contract includes the covenants, ownership, financial and non-financial agreements, remunerative, and non-remunerative agreements. It covers all agreements having been made to cancel a present effect. There is no sign of any interference in the literal meaning of contract by Iranian legislators. This clear idea compensates the deficiency in Article 183 of Iran Civil Law. In other cases, the term contract has been used

without any contextual meaning; here, he refers to the literal meanings of a contract.

### *2.2 Contextual Meaning of Contract*

In any case, contract can be implied as a legal agreement between two or among more parties on a certain subject in order to establish a common legal effect. Contract is a bilateral legal action; it is met when the parties make a conclusion and agreement freely. The meaning of contract is identical in literature, public conversations, and the science of law. It refers to two-sided cooperation of two or more persons' wills in the establishment of a legal effect. In terms of its coverage domain, it contains two types of certain and uncertain contracts. In its specific implication, it refers only to uncertain contracts. In this regard, Article 10 of Iran Civil Code stipulates, "Private contracts shall be binding on those who have signed them, providing they are not contrary to the explicit Provisions of a law" (Shahidi, 2007, p. 41). Oxford Legal Dictionary has defined open contract as an agreement for selling land that its only stipulated terms and conditions are the specifications of parties to the contract, the property, and the price of the contract. Other terms are proviso. For example, the contract should be completed within a reasonable time, transfer cost should be paid by buyer... an open contract is valid if it is in writing, it is proved by documents, or it is implemented partially. The term open contract is usually uses in contrast to closed contracts. It refers to agreements in which parties have not concluded a full agreement; some elements of the contract have been left silence intentionally to enable them to change or correct it without mutual consent. The term open contract is usually uses in contrast to closed contracts. It refers to agreements in which parties have not concluded a full agreement; some elements of the contract have been left silence intentionally to enable them to change or correct it without mutual consent.

## **3. Types of Open Contract**

### *3.1 Instances of Open Contract*

#### *3.1.1 Purchase Order in Form of Open Contract*

Contract of sale is an example of swap contract with two parties or position whereby they seek profit and exchange because the buyer acquires the possession of property or asset by paying its price to the seller. Nowadays, swap contracts are concluded differently from it traditional conventions. With regard to the particular circumstances of time or location, buyer does not confirm the deal amount or the price in long-term contracts such as oil contracts; they may even do not determine the subject of their contract. Each case is an example of open contract (Business Dictionary, 2016).

#### *3.1.2 Contract of Unlimited Insurance Coverage*

This type of contract is observed more in land or sea transport contracts. One limitation of general and conventional insurance contracts was the fact that policyholder were committed to pay a all a high percentage of premiums at the time of issuing insurance policy. It was difficult because the final loads were carried in other months. Then, a new type of contract was concluded calling contract with open coverage. The basic characteristics of such contracts are as follows:

- 1) The insurer and the insured agreed on some general issues like rates and terms as well as covered risks. In this situation, the policyholder is not obliged to announce vehicle profile and capital under cover unless all loads are covering by insurer. If a part of the goods is not insured, insurer should implement enough control on the loads.
- 2) In this case, each week the certificate of insurance issued by insurers by an agreement between the insurer and the policyholder and the premium is paid in proportion to the investments carried by insurance office. In this way, policyholder has heartsease because all loads carried by a vehicle are insured with a just and definite rate. In addition, the loads are under insurance coverage during all transportation times and it is not necessary to present a demand and issue a policy for each transport. Since the contract period is usually one year, repeated planning, discussion, and agreement is not required. This type of contract is usually employed by transportation companies carrying goods goods actively in day and night. In this way, policyholder is easy and he does not need to call for issuance of ploey at days or nights (Atiyah & Adams & MacQueen, 2010, p.18).

### *3.2 Types of Contract in Terms of Open Conditions*

#### *3.2.1 Open Condition in Relation to Object*

In some contracts, the object of the contract is specified. Nevertheless, when the subject of contract is variable the object is inevitably not fix and specified. This is observed more in the contracts known as order construction or production. The openness of subject in these contracts has different types.

### 3.2.2 Open Amount (Quantity)

It is not possible to determine the size or volume of transaction in some contracts. In this situation, the subject of contract in terms of amount is unknown (Taher Khani, 2013, p. 92). In this regard, two types of contracts are noteworthy:

- **Output contracts:** It is an agreement in which a producer agrees to sell his or her entire production to the buyer, who in turn agrees to purchase the entire output in a specific period.
- **Requirement contracts:** It is a contract in which one party agrees to supply as much of a good or service as is required by the other party. In this type of contract, seller controls his production and the buyer determines the amount of his requirements. This type of contract is effective through the application of an objective criterion based on the goodwill of the parties.

### 3.3 Open Properties (Quality)

As long as the open quantity of a contract is allowed, the open quality of contract seems applicable. Several raw materials with different qualities can be used in the production of many artefacts that has influence on price of produced commodity. In many countries, this principle is executed for sale of public goods. According to Article 6-108, the principle is executed not only for the sale or renting goods but also for the provision of services (Lando & Beale, 2007, p. 314)

## 4. Open Price Term

Discussion about open contracts inevitably draws attention to the concept of open price term. There are discussions and disagreements on the nature and validity of this new concept by contemporary legal experts; many books and articles has been authored in this regard. In the field of international trade, open price is used for contracts in which one of the traded objects are open (especially price) and its final determination is suspended to future. In other words, the price is not clear at the time of conclusion. It is applied by Black's Law Dictionary to a situation in which parties intend to conclude a contract despite failure to set the price; thus, the let it open. There may be not agreement about the price or it will be determined by future discussions; however, the price may be determined based on the target market, other provisions, or by other person or authorities (Garner, 2016, p.1091).

However, it is not possible to count the instances of certainty and uncertainty of price in contracts because numerous examples may be presented for it. For example, when a merchant ship breaks down at sea and spare parts are needed to repair it while the arrival of parts will corrupt cargo or damage the ship, the captain prefers to purchase spare parts for any price (Darab Poor, 2008: 225). When a person enters a restaurant and order food without knowing its price, the price is not a subject for him and the sale is open; in this situation, the contract for price may be classified under the title of open, close, or fluctuate.

## 5. Validity of Open Contract in International Law and International Trade

### 5.1 Validity of Open Contract in Domestic Law of Other Countries

After discussing the concept of open contract, identify its importance and instances, its types, and its legal nature, it is the time to discuss the validity of this type of agreement. Since open price contract is one of the prevailing type of open contracts, much attention of domestic laws are consumed to regulate this contracts. it signifies accepting its validity.

#### 5.1.1 Countries with Civil Law

In French law, determination of object of trade is a validity condition of contract and it is not allowed to suspend price to traders, but contract parties can predict a method to determine the price after conclusion regardless of the parties' will (Kashani, 2006, p. 64). Article 1129 of French Civil Code stipulates:

“Every obligation should have a definite object in terms of its subject. The obliged quantity can be uncertain provided that it could be changed.” (Noori, 2001, p. 17).

According to this Article and Article 1592 of French Civil Code, French lawyers argue that suspending price to a third party is allowed and referring to objective conditions is permitted (Kashani, 2006: 64). It does not differ whether it the contract is sales contracts with variable rates or day rate (Jafari Langroodi, 2009, p. 528-529). They believe that price should be determined at the time of conclusion or it should be determinable later by elements depends not on the will of parties. Parties should mention their objective information in the contract and determining the price should not be suspended to later agreement by them. Objective factors may be stock quotes, common prices, the official list of prices of goods etc. Independency to future provisions and will is a

common point in all contracts (Huet, 2001, p. 155).

#### 5.1.2 Countries with Common Law

This type of contracts has been allowed in England. Article 8 of the Law on Sale articulates about open contract that the price may not be mentioned to be determined in an agreed process. Referring to objective conditions is one of the methods that can be agreed (Atiyah & Adams & MacQueen, 2010, p. 31). In Common Law, an open contract is correct and effective only when the parties intend to have their commitment to sales. In other words, its suspension to a future agreement rejects its effectiveness; it is called “to be agreed”. Therefore, if determining criterion requires reconciliation or another contract, it will be legally invalid and ineffective. In May & Butcher (1934) case, only those sale contracts are subject that contain agreements on price, date of payment and delivery method. House of Lords ruled that the contract is incomplete because there is no agreement on subjects and elements of the agreement. If the contract is completely silent about this issue, they could employ legal regulations stipulated in selling goods with criteria of rationality. However, parties should that they did not intend to be committed to provisions, thus, it is not effective. In addition, the legal system of England has accepted other types of open contract such as unlimited-term contracts (Treitel, 2003, p. 53).

#### 5.1.3 American Law

Although there is no stipulated order in United States Uniform Commercial Code (UCC), Articles 2-305 of this law talks about referring to rational and conventional standards to determine price. It can be concluded that open contract is generally effective in American Law.

### 6. Validity of Open Contract in International Trade

Article 5.7 of UNIDROIT stipulates, “here a contract does not fix or make provision for determining the price, the parties are considered, in the absence of any indication to the contrary, to have made reference to the price generally charged at the time of the conclusion of the contract for such performance in comparable circumstances in the trade concerned or, if no such price is available, to a reasonable price.” Articles 104.6, 108.6, 109.6, 101.7, and 102.7 of PECL principles have expressly discussed open contracts. Article 55 of the Convention on the International Sale discusses open contracts. These show that this type has been accepted in international business law.

### 7. Validity of Open Contract in Iranian and European Laws

#### 7.1 *Open Amount*

It may be not possible to determine the price of a contract exactly in some cases due to some limitations to determine it including the time limitations or lack of enough information about the amount or requires materials. It is possible in open contracts for the parties to disregard the exact determination of amount or to postpone it for another time after conclusion of the contract.

##### 7.1.1 Law of Iran

There is no exact text about the condition of open amount; it has even a strict stance regarding the determination of the amount of the transaction. It obliges the parties to determine it. In the case of disregarding the amount of the trade subject, the contract is ambiguous and this condition can affect all the contract and terminate it.

##### 7.1.2 European Laws

#### 7.2 *Open Price*

The main focus on the open contract in Iranian law is seen in paragraph 3 of article 190 of the Civil Code when It stipulates that for the validity of a contract some conditions are essential including the intention and mutual consent of both parties to the contract, the competence of both parties, there must be a definite thing that forms the subject matter of the contract, and the cause of the transaction must be lawful. Accordingly, the parties to an open contract with open price can let the price to be open and refuse to determine it at the time of conclusion for their reasons.

##### 7.1.2 Open Price Contract

In open price contracts, the open status of the price can be presupposed in two forms. First, the parties of the contract agree on the method or process of determining the price and make it determinable; second, they are silent about the price of the contract. Investigation of legal systems as well as European laws indicates that different countries have chosen different approaches in this regard.

## 8. Validity of Contracts with Determinable Consideration

In many cases, it is not possible or proper to determine the consideration exactly; but the parties can agree at least on the process of determining the consideration (Kiayi, 1997, p. 377). Although the number or such contracts are unlimited, it seems all can be categorized in two groups. In some cases, determination of consideration depends on other criterion and the parties or a third person's wills are not involved in them. For example, parties agree to determine the price of the contract according to a specific market; or they may agree to calculate the consideration by adding a specific percent to the final price of the production. The second common method to determine the consideration of contracts is referring its determination to one of the parties, to arbitration, or to a third person. In all cases, the will of parties, or a third person, is effective in determination of the price (Taher Khani, 2013, p. 120).

### 8.1 Iran Law

There is not any specific text about the validity of such contracts. It is conveyed from paragraph three of Article 190 that the subject matter including both consideration and the considered matter must be certain. Article 216 of the law stipulates, "The object of a transaction should not be ambiguous except in special cases where a general knowledge of the matter would be sufficient." It is understood from the exception to the general rule in this article that the object of transaction should be certain among the parties. The sufficiency of a general knowledge should be regarded as an exception. As well as achieving this inference, one may ask about the cases in which a general knowledge is sufficient for the validity of contracts. Moreover, the provisions to recognize and distinguish it from other situations is a reasonable question. In addition, what are the limitations and amount of object of transaction required for a detailed knowledge? Such questions will be answered in a study about open contract based on the country in which the rule has been stipulated.

### 8.2 European Laws

As the Iranian Law, the certainty of trade object is condition transaction validity in French law. According to French lawyers, certainty of trade object is something rather than its definite price. Thus, the contract is correct if parties have predicted a process to determine the amount of payment so that it is determined without interference of a party's will (Eslam Panah, 2001: 321). Article 1129 of the French Law stipulates, "Every obligation should have a definite object in terms of its subject. The obliged quantity can be uncertain provided that it could be changed." (Noori, 2001: 17).

According to the second part of this article, the capability of the object for determination of its amount in transaction is a condition for validity of contract. This issue has also been accepted in the law of Switzerland. Article 184 obligation laws of the country under the title of General Conditions of Sale and Swap stipulates, "Price will be definite enough if it is determinable (Vahedi, 2011: 32). This Article is used when a process has been predicted explicitly to determine price in a contract. In the first place, price should be specified and contract is valid.

In Principles of European Contract, Article 2-101, Conditions for the Conclusion of a contract has been stipulated as following:

(1) A contract is concluded if:

- (a) The parties intend to be legally bound, and
- (b) They reach a sufficient agreement without any further requirement.

(2) A contract need not be concluded or evidenced in writing nor is it subject to any other requirement as to form. The contract may be proved by any means, including witnesses.

This article counts the necessary conditions for conclusion of a contract and it is located in the first part of the second chapter where legal obligation is known as a necessary and enough elements for conclusion of a contract. If parties decide to be committed to perform an obligation, the contract is concluded. This condition is explained and expanded in Article 2-102 of Principles of European Contract and argues that the intention of a party to be legally bound by contract is to be determined from the party's statements or conduct, as they were reasonably understood by the other party. In the final words of Article 2-101, it emphasizes, "contract need not be concluded or evidenced in writing, nor is it subject to any other requirement". In other words, no specific form has been predicted for conclusion of a contract. Moreover, there is necessity to determine other characteristics of a contract including price. In addition, the presence of objects of transaction is not required when the contract is concluded and the contract is concluded by presence of the two mentioned conditions. Therefore, in Principles of European Contract, the English doctrine of "presence of object" has not been accepted. Besides, Article 6-104

stipulates, “Where the contract does not fix the price or the method of determining it, the parties are to be treated as having agreed on a reasonable price (Hesse, 2001: 22). Accordingly, this article sets a rule for validity of contracts in certain conditions because maintaining contract for intention of the parties to be bound by the terms of the contract seems reasonable in these situations.

## 9. Conclusion

This article has studied the concept, validity, and effects of open contract separately. In terms of its concept, open contract is established due to an agreement by two wills to create a legal effect in which parties can be silent according to their demands and interests and assign determination of some specific conditions to future. After evaluation of the positive and negative effects of open contract, it can be said that the traditional approach, which stresses on the strength and stability of contracts and consequently the security of legal relations, requires determination of all contents at the time of conclusion of the contract. In other words, this approach claims social expediency whereby contracts have enough strength and they are enforced properly. In addition, economy-based approach, which insists on efficiency and utility of contracts, challenges the possibility of designing a complete contract are regards it as a costly transaction; it requires the employment of open terms in contracts to enable parties to enforce contracts with future ambiguous situations. In addition to describing types of open contract conditions, the validity of each has been investigated with respect to the legal system of Iran and European countries. It concluded that this contractual framework is legally regarded as a contract, not as preliminary agreements. Analysis of its validity based on uncertain contracts under Article 10 of Civil Code is incorrect. In terms of its effects, open contracts are considered as binding contracts between parties by referring to the principle of necessary arrangements; thus, parties are not allowed to terminate the contract. It is applicable to third party of a contract; in the case of violating obligations by parties of the contract, it has executive sanctions. It is suggested for other researchers to determine a certain position in civil law for this contractual framework in order to transform the provisions of the civil code and adapt it to public increasing needs, which is the outcome of contemporary modern life.

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