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International Contract Practice and Its Expectations in Terms of the Governing Law

1.1 Issues Arising Out of International Contract Practice

International contracts are often written on the basis of rather standardised models that are mainly drafted in English. Not only are they written in the English language, but they also employ a drafting style that is typical for English contracts. This does not mean, however, that the parties intend the contract to be subject to English law. Often, contracts are governed by a law that does not belong to the common law family – which is the name of the legal tradition (so-called legal family) to which English law belongs.[1] A contract between a Norwegian and an Italian party, for example, may contain a clause choosing Swiss law as the governing law. This contract will have no connection whatsoever with the common law, Norway, Italy and Switzerland being countries belonging to the so-called civil law legal family.[2] Yet the contract will most probably be written in English and according to the English contract style, or some hybrid development thereof. This may create tensions between the contractual provisions and the governing law.

Furthermore, and as a consequence of being inspired by the common law, international contracts are drafted in a style that aims to create an exhaustive, and as precise as possible, regulation of the underlying contractual relationship, thus attempting to render redundant any interference from external elements such as the interpreter's discretion or the rules and principles of the governing law.

To a large extent, this degree of detail may achieve the goal of rendering the contract a self-sufficient system, thus enhancing the impression that, if only they are sufficiently detailed and clear, contracts will be interpreted on the basis of their own terms and without being influenced by any governing law.

This impression, however, has been proven to be illusionary, and not only because governing laws may contain mandatory rules that may not be derogated from by the contract. As a matter of fact, not many mandatory rules affect international

[1] Broadly, among the countries belonging to the common law legal family are England, India, many Asian countries, some African countries, Oceania, most of the United States and most of Canada.

[2] Among the countries belonging to the civil law legal family are continental Europe, Turkey, Russia, Japan, some Asian countries, some African countries and the Latin American countries.

commercial contracts, although there are important mandatory rules, for example, in the field of the limitation of liability, that are also relevant in the commercial context.[3]

Perhaps more importantly, the governing law, which may vary from contract to contract, will affect, consciously or not, the way in which the contract is interpreted, construed and applied. In the legal discourse, particularly in US legal theory, an important distinction is being made between interpretation and construction.[4] While interpretation is the process of clarifying the linguistic meaning of a text, construction is the process of inferring legal effects from that text. Often, it is expected that interpretation assumes an unclear text;[5] construction, to the contrary, does not require lack of clarity. Even if the contract language is clear, the legal effects will not flow solely from the words of the contract. The words will produce the legal effects that the law attaches to them, and they will therefore be understood in the light of the applicable law. As an example of how the process of construction can influence the legal effects of contract wording, see the *Force majeure* clause, discussed in Section 3.5.3. The wording is clear: the seller is exempted from liability if delivery is prevented by an event which is, *inter alia*, beyond the seller's control. What is to be deemed to be beyond the seller's control, however, depends on the applicable law.

Notwithstanding any efforts by the parties to include as many details as possible in the contract in order to minimise the need for interpretation, the governing law will necessarily project its own principles regarding the function of a contract, the advisability of ensuring a fair balance between the parties' interests, the role of the interpreter in respect of obligations that are not explicitly regulated in the contract, the existence of a duty of the parties to act loyally towards each other and the existence and extent of a general principle of good faith – in short, the balance between certainty and justice, see Sections 3.1 and 3.3. That the same contract wording may be interpreted differently depending on the legal tradition of the interpreter (see Section 3.4), largely deprives of its meaning the self-sufficiency goal, since it entails that the legal effects of the contract do not flow solely from the contract, but from the interaction of the contract with the governing law.

It could be tempting to rely on an emerging opinion that legal systems (particularly the common law and the civil law) converge on an abstract level and that, consequently, very similar results may be achieved in the various systems, albeit by applying different legal techniques. This observation, however, does not afford much help to the parties to a specific contract.

Firstly, convergence can rarely be said to be complete, as Section 3.3 will show. Even within one single legal family there are significant differences – for example,

[3] Some examples are discussed in Section 3.6. To what extent mandatory rules of the governing law have an impact in the context of international commercial arbitration will be analysed in Section 5.2.

[4] Lawrence B. Solum, 'The Interpretation-Construction Distinction'. *Constitutional Commentary* 27 (2010), p. 676.

[5] In linguistics, however, interpretation does not necessarily imply the clarification of an equivocal text: the process of understanding the meaning of any word is an interpretation.

between the US and English law regarding exculpatory clauses. Even within the same system, there may be divergences, as the same clause may have different legal effects in the different states within the United States.[6]

Secondly, there is little use in observing that legal systems converge at a high level of abstraction, and that differences are mainly found only at the level of technical implementation. Reducing the divergence to a mere question of technicalities misses the point: it is precisely the different legal techniques that matter when a specific contract wording has to be applied. It would not be of much comfort for a party to know that it could have achieved the desired result if only the contract had had the correct wording as required by the relevant legal technique. The party is interested in the legal effects of the particular clause that was written in the contract, not in the abstract possibility of obtaining the same result from a different clause.

It could be tempting to overcome the inconsistent legal effect of contract terms by invoking transnational sources. Transnational law is believed to provide a uniform system that is independent of the peculiarities of national laws. As Chapter 2 will show, however, there do not seem to be any generally acknowledged transnational principles that are sufficiently comprehensive and specific to give exhaustive and uniform guidance on the interpretation and construction of contracts.

The question of contract interpretation and construction, thus, has to be addressed under the governing law.

As will be seen in Chapter 3, the main difference in interpreting contracts under the common law or the civil law tradition consists in the importance attached to the terms of the contract. The common law tradition privileges a literal interpretation of the contract language and enforces contracts according to their terms if these are sufficiently clear, without being concerned with the results of their performance – in particular, it is irrelevant whether the performance of the contract terms leads to a balanced result. The civil law tradition starts too from the wording of the contract, but then construes it according to its legal system: it supplements the contract terms with ancillary obligations, restricts them with implied assumptions and integrates them with considerations of fairness, good faith and the need to achieve a balance between the parties' interests.

Furthermore, the contract regulates only the issues which fall within the scope of the freedom of contract. However, there are many aspects of a legal relationship that do not fall within this scope, and that consequently are regulated by the applicable law, see Section 4.5. Even a simple contract of sale presents issues that cannot be regulated by the parties – for example, whether the title passed from the seller to the buyer (this is a matter of property law and is outside the sphere of freedom of contract); whether the signature on the contract is binding (this is a question of

[6] Edward T. Canuel, 'Comparing Exculpatory Clauses under Anglo-American Law: Testing Total Legal Convergence'. In Giuditta Cordero-Moss (ed.), *Boilerplate Clauses, International Commercial Contracts and the Applicable Law* (Cambridge University Press, 2011), pp. 80–103, Section 2.

legal capacity and is outside the sphere of freedom of contract); whether the agent could bind the seller (this is a question of agency law and is outside the sphere of freedom of contract). More complex legal relationships will present even more issues that fall outside the scope of contract freedom: in a contract creating a security interest, the existence and effects of the security are regulated by property law; in a contract relying on a board resolution, its existence and validity is subject to the applicable company law and so on.

To avoid external interferences, contracts often contain a series of clauses in which the parties try to take into their own hands those aspects where the balance between certainty and justice may be challenged – the so-called boilerplate clauses. These clauses relate to the interpretation and general operation of contracts and are to be found in most contracts irrespective of the subject matter of the contract. They are relatively standardised and their wording is seldom given attention during the negotiations. Some examples of these clauses will be presented in Section 1.5.[7] Their interpretation under transnational sources will be discussed in Section 2.2.5(f) and their interpretation under various governing laws will be presented in Section 3.4.1.

Furthermore, to avoid external interferences, often contracts contain an Arbitration clause. In this way, the parties agree that disputes between them shall not be solved by courts, but in arbitration – a private disputes settlement mechanism. As arbitration enjoys a significant autonomy from courts and national laws, the influence of national law is reduced, see Section 5.1, although not completely avoided, see Section 5.2. To what extent this autonomy also ensures a uniform interpretation of the contract, will be discussed in Section 3.7.

1.2 International Contracts

The foregoing presented international contract practice as if it was a well-recognised category. However, notwithstanding the mentioned ambitions of uniformity that characterise international contract practice, there does not seem to be a uniform definition of when a contract is considered international (see the Introduction, Section I.2).

In most situations, there are no doubts about the internationality of the legal relationship: for example, a Canadian producer enters into a commercial agency agreement with a Belgian agent for the promotion of its products in the territory of the EU. This is evidently an international contract.

But would the international qualification be as obvious if the Canadian producer established a subsidiary in Belgium, and this Belgian company entered into sales contracts with Belgian buyers? According to one of the most important international

[7] For a more extensive list of boilerplate clauses and an analysis of their legal effects under a variety of legal systems, see Cordero-Moss (2011a).

conventions in the field of international commerce, the 1980 United Nations Vienna Convention on Contracts for the International Sale of Goods, known as CISG (see Section 2.2.4), a contract is international if the parties have their place of business in different states. Even though the seller is a subsidiary of the Canadian producer, therefore, the fact that it is established in the same country as the buyer's prevents consideration of the sales contracts as international.

A dispute arising out of these contracts could nevertheless be deemed to be international under the UNCITRAL Model Law on International Commercial Arbitration (see Section I.2 of the Introduction, Section 2.2.6(d) and Chapter 5), which considers as international also disputes in which a substantial part of the obligations of the commercial relationship is to be performed in a state different from the parties' state.

The widest definition of internationality is apparently to be found in the EU Regulation on the Law Applicable to Contractual Obligations (see Section I.2 of the Introduction and Section 4.3). As was mentioned in the Introduction, the Rome I Regulation permits the parties to any contract to choose the governing law, irrespective of whether there is an international element. However, Article 3(3) restricts this very wide understanding: if, apart from the choice of a foreign law, all other elements are located in the same state, the chosen law will not have the effect of governing the contract, but will only be incorporated into the contract as if it was a term of the contract. The contract, together with the incorporated chosen law, will still be subject to the local governing law – in particular, to its mandatory rules. Therefore, the simple choice of a foreign law is not sufficient to render the contract international.

It is interesting to point out that this provision has been applied in a rather restrictive way in England. Some decisions were rendered before Britain's exit from the European Union ('Brexit'), some after. Following Brexit, Britain is no longer an EU member and therefore Rome I Regulation no longer applies; however, England has enacted a statute on choice of law that reproduces the Rome I Regulation.[8] After Brexit, English courts are no longer bound to follow the case law by the Court of Justice of the European Union (CJEU), and their application of the provision corresponding to Article 3(3) does not necessarily have significance for the application of Rome Regulation I in the EU. However, considering that many international contracts, particularly in the field of financing, insurance and transportation, choose English courts to solve disputes, the definition of international applied by English courts is of great interest, even though it does not necessarily coincide with the definition applied in the European Union.

In a series of cases, English courts had to determine whether the choice of English law was valid for financial contracts entered into between two Italian parties, and that

[8] The Law Applicable to Contractual Obligations and Non-Contractual Obligations (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/834).

were to be performed in Italy. The criteria for considering the contracts to be fully domestic were met, but the courts nevertheless considered them international. The contracts regulated financial derivative relationships, so-called Swap agreements. The agreements were entered into on the basis of a standard form known as the ISDA (International Swaps and Derivatives Association) Master Agreement, see Section 2.2.6(c), which is utilised all over the world. The ISDA Master Agreement contains a choice of law clause subjecting the relationship to English law. In evaluating whether this contract between two Italian parties that was to be performed solely in Italy was domestic or international, the English Court of Appeal conceded that all elements of the relationship between the parties were connected only with Italy. However, the court considered that the contract was based on a standard which is used internationally. This was sufficient to render the contract international. Hence, the Court considered the choice of English law to be full and not restricted by Article 3(3) of the Rome I Regulation.[9]

1.3 The Models for International Contract Drafting

English is undeniably the common language for international business transactions. Communication between the business parties is mainly carried out in English and contracts that formalise the deals are written in English. When searching for models for specific contract terms or for entire contracts in the English language, the most common approach is to find contracts originally written in English and these are usually English contracts written by English lawyers and subject to English law.

This has bigger consequences than the mere linguistic aspect: contracts that are drafted by lawyers educated in the common law tradition and that are subject to the common law are developed to meet the requirements of the common law and to satisfy the common law criteria for contracts. Historically, most of the internationally distributed publications offering model contract collections reproduced common law-style contracts. As a result, law firms and corporate lawyers in a variety of jurisdictions (not only in common law jurisdictions) learnt to draft international contracts on the basis of these models. This has grown into a style of drafting contracts. International financial institutions impose the use of US or English-style contracts for the transactions that they are financing, irrespective of whether the financed entities or the investors involved come from common law states or not, or whether or not most of the related contracts are governed by English law, or another system of common law. As a result, operators in civil law states become accustomed to drafting in the common law style to meet the expectations of financial institutions.

[9] *Dexia Crediop Spa* v. *Comune di Prato* [2017] EWCA Civ 428. See also *Dexia Crediop SpA* v. *Provincia di Pesaro* [2022] EWHC 2410 (Comm). The High Court reached the same result in a dispute on a Swap agreement between two Portuguese parties, *Banco Santander Totta SA* v. *Companhia de Carris de Ferro de Lisboa SA* [2016] EWHC 465 (Comm).

During the former Soviet Union's and the East European countries' transition to market-driven economies in the 1990s, for example, the European Bank for Reconstruction and Development, an international organisation devoted to financing East European and former Soviet Union projects, almost exclusively adopted common law contract models for projects that were to be carried out in those civil law countries, even when all of the parties involved belonged solely to the civil law tradition.

Contract types developed through practice, such as, for example, Swap contracts and other contracts for the trade of financial derivatives, are standardised by branch associations following the common law contract style. As a result, new types of transactions are regulated exclusively by common law-style contracts, and these contracts are used to regulate not only international transactions, but even domestic transactions within civil law systems. Contracts for the hedging of financial risk, for example, might be written in English and inspired by English law, even if they are entered into by a Norwegian company and a Norwegian bank and are governed by Norwegian law. This applies not only to the abovementioned Swap contracts but to any types of financial contracts, even where there is no world-wide accepted model such as the ISDA.

The above-described widespread use of common law models is such that it is increasingly affecting even traditional contract types and domestic legal relationships, such as the rental of real estate or sale agreements within the borders of the same country. Even contract models applied by the Norwegian public sector for public procurement, to name one example, are increasingly drafted on the basis of these models, which are generally considered to represent state-of-the-art contracting among the law firms that might be hired by the relevant state body to draft the tender documentation. The Anglo-Americanisation of contract models, therefore, influences not only firms and companies that engage in international commerce, but also individuals, companies and even public bodies with purely domestic interests.

These contract models do not reflect the tradition of civil law.

As will be seen in Chapter 3, a civilian court reads the contract in the light of the numerous default rules provided in the governing law for that type of contract. Extensive provisions are not required in the contract if the contract is subject to a law that regulates most of the legal relationship, see Chapter 3.

The common law drafting tradition, in turn, requires extensive contracts that spell out all of the obligations between the parties and leave little to the court's discretion or interpretation – because common law courts see it as their function to enforce the bargain agreed upon between the parties, rather than to replace it with a bargain which the interpreter deems to be more reasonable or commercially sensible.[10] Thus, English courts will be reluctant to read into the contract obligations that were not expressly agreed on by the parties. Since English courts often affirm that a sufficiently

[10] *Charter Reinsurance Co Ltd* v. *Fagan* [1997] AC 313.

clear contract wording will be enforced, parties are encouraged to increase the level of detail, and to write around mechanisms that have proven to be problematic (regulation applicable by operation of law and not aligned with the parties' interests) by formulating clauses that will place the issue outside the scope of the regulation (see, for example, the Liquidated damages clauses described further on in this section).

This drafting style follows the same approach that inspired the original common law models: *caveat emptor*.[11] A commercial contract between professionals, often written by expert lawyers, is expected to reflect careful evaluations made by each of the parties of its respective interests. The parties are assumed to be able to assess the relevant risks and to make provision for them. The negotiations are expected to be carried out in a way that adequately takes care of each of the parties' positions, and the final text of the contract is deemed to reflect this. The contract is deemed to have been written accurately, so that each party may use the contractual terms to objectively quantify its risk and, for example, insure against it.

Another reason for privileging an accurate application of the contract's wording is that contracts may be assigned to third parties – for example, as collateral for other obligations, or in the context of other transactions. Furthermore, contracts may be relied on in financing arrangements: the parties can agree that a loan will be repaid by the cash flow generated by the performance of a contract that the borrower has with a customer. Furthermore, contracts may be insured: in order to be able to calculate the risk and the consequent premium to be paid, the insurance company will need to carefully assess the rights and obligations arising out of the contract. Commercial practice is, therefore, based on the possibility that third parties, such as an assignee, a bank or an insurance company may rely on the contract. In order to rely on the contract, to ascertain its value or to assess the risk, these third parties must be put in a position to carefully evaluate the contract's content, predict its performance and ascertain the precise scope of the rights and obligations flowing from it.

Contracts should therefore contain all elements according to which they will be interpreted, and interpretation must be made objectively and on the basis of the contract's wording. Third parties who come into contact with the contract have no possibility of being able to assess the subjective position of each of the parties, their respective assumptions, their non-expressed intentions and the content of their communications during the negotiations or even after the conclusion of the contract. Under these circumstances, a literal and thus predictable application of the contract is perceived as the only fair application of contracts. It might be unfair to draw on external elements in addition to the wording of the contract, such as, for example, the conduct or silence of one of the parties that may have created expectations in the other party at some stage during the negotiations or even after the contract was

[11] This formula was pronounced by Lord Mansfield in *Stuart* v. *Wilkins* [1778] I Dougl. 18, 99 Eng. Rep. 15 and has since been used to characterise the approach of English contract law, whereby each party has to take care of its own interests.

signed. How can a contract circulate and be used as a basis for calculating an insurance premium, granting financing or be assigned to a third party if its implementation depends on elements that are not visible in the contract itself?

This heightens the impression that a well thought through formulation in the contract may solve all of the problems that may arise out of the contract and thus avoid the necessity of applying the governing law.

When adopting the common law style, drafters may apparently be tempted to overdo things, and to write provisions that seek to elevate the contract to the level of law.[12] This indulgence in self-referencing (also known as 'boot-strapping') makes one think of the tales featuring Baron Munchausen, namely that where the Baron attempts to lift himself (and his horse) up from a swamp by pulling his own hair. The eagerness in drafting may reach excesses that have been defined as 'nonsensical' by a prominent English expert.[13] For example, the ubiquitous Representations and Warranties clause (see Section 3.5.1) may list, among the matters that the parties represent to each other, that their respective obligations under the contract are valid, binding and enforceable.[14] This Representation is itself an obligation under the contract and subject to any ground for invalidity or unenforceability that might affect the contract, so what value does it add? A contract clause affirming that the contract is valid has a classical precedent in the known paradox of Epimenides of Crete, which states that all Cretans are liars.

It is particularly interesting that this Representation is criticised by an English lawyer, because it shows that the attempt to detach the contract from the governing law may go too far, even for English law, and this notwithstanding that the drafting style adopted for international contracts is no doubt based on the English and US drafting traditions – which in turn encourages a seemingly self-sufficient style.

The Representation on the validity and enforceability of the contract is not the only attempt to detach the contract from the governing law: as will be seen, other clauses, which often recur in contracts, regulate the interpretation or construction of the contract and the application of remedies independently from the governing law.

Chapter 3 will show that some of these clauses will not achieve the desired results if the contract is subject to civil law. This is due to the overarching principle of good

[12] A similar attempt to elevate the contract to the level of law may be found in the assumption that the contract's choice of law clause has the ability to move the whole legal relationship out of the scope of the application of any law, but the law chosen by the parties. The choice of law made by the parties, however, has effect mainly within the sphere of contract law. For areas that are relevant to the contractual relationship, but are outside the scope of contract law, the parties' choice does not have any effect. Areas such as the parties' own legal capacity, the company law implications of the contract or the contract's effects on third parties within property law are governed by the law applicable to those areas according to the respective conflict rule, and the parties' choice is not relevant. See Chapters 4 and 5.

[13] Edwin Peel, 'The Common Law Tradition: Application of Boilerplate Clauses under English Law'. In Cordero-Moss (2011a), pp. 129–78, footnote 160.

[14] A representation clause on the validity and enforceability of the contract is a typical part of boilerplate clauses. See, for example, the contract database Law Insider, www.lawinsider.com/clause/representations-and-warranties-of-both-parties.

faith that, in different ways, prevents a literal interpretation and application of the contract leading to unfair results.

Interestingly, some of these clauses do not seem to achieve the desired results, even under English law. As noted by Peel,[15] observers may tend to overestimate how literally English courts may interpret contracts.

Be that as it may, contract practice shows that it is based on the illusion that it is possible, by writing sufficiently clear and precise wording, to draft around problems and circumvent any criteria of fairness that may inspire the court in the interpretation of the contract. Peel actually confirms that this is supported indirectly by English courts themselves, who often found their decisions on the interpretation of the wording rather than on substantial considerations such as the balance between the parties' interests. In respect of some contract clauses, which interestingly attempt to regulate the interpretation of the contract precisely, it seems that the drafting efforts are not likely to achieve results that might be considered unfair by the court, no matter how clearly and precisely the wording was drafted, and in spite of the English courts' insistence on making this a question of interpretation. For these clauses, therefore, English courts will not decide in the over-formalistic way that is often assumed to be typical of English courts, see Section 3.4.

In respect of other clauses, however, the criteria of certainty and consistency seem to be given primacy by the English courts. This ensures a literal application of the contract notwithstanding the result, as long as the clause is written in a sufficiently clear and precise manner.

The clause on Liquidated damages, for example, is designed to escape the common law prohibition of penalty clauses. The clause is meant to determine, in advance, the amount of damages that may arise if one party fails to perform the contract. By predetermining the damages, the parties avoid the uncertainty connected with having to prove that there has been a loss, that the loss was due to the other party's default and the amount of the loss. A fixed sum to be paid in case of default is efficient, and in addition it has a function as an incentive to properly perform the contract. It can be compared to a fine that the defaulting party has to pay in case of default. Under some civilian laws, it is very common to agree on contractual fines which come under the name of penalty. Under the common law, however, a fine is deemed to be a penal feature that cannot be agreed in a contract. For this reason, contract practice developed the Liquidated damages clause. The clause has the same function as a penalty but is structured as a clause regulating reimbursement of damages. This reformulation is sufficient to render the arrangement admissible under common law.

This clause provides a significant example of how drafting may be used to achieve a result that otherwise would not be enforceable: this is defined as the possibility of the parties being able to manipulate the interpretation to avoid the intervention of the courts,[16] as will be seen in more detail in Section 3.5.2.

[15] Peel (2011), Section 3. [16] Peel (2011), Section 2.7.

Since international contracts are based on common law models, the common law terminology is adopted in international contracts that are governed by civil laws – even though the applicable law permits contractual penalties, and where it would not be necessary to structure the penalty as a pre-estimation of damages. This creates problems of coordination with the civil governing law, as will be seen in Section 3.5.2.

The Liquidated damages clause is one example of the different approaches taken to drafting and interpretation in the common law and in the civil traditions. Whereas the former permits circumventing the law's rules by appropriate drafting, the latter integrates the language of the contract with the law's rules and principles.

The possibility of writing around problems is thus quite rooted in the common law tradition; international contracts adopt models developed under the common law, and they are often written as if they were assuming that any issues might be solved by properly drafted clauses, quite irrespective of the governing law.

1.4 The Dynamics of Contract Drafting

As seen in the previous section, the drafting style of commercial contracts usually attempts to create a self-sufficient system. The assumption that is not necessarily always consciously relied on, and derives from the common law style, is that, if the parties had wanted to restrict or qualify the application of the contract provisions, then they would have written the restrictions or the qualifications into the contract. Imposing the application of the governing law's construction based on principle of good faith and ancillary obligations would interfere with the contract and create uncertainty.

As Chapter 3 will show, however, this goal for self-sufficiency may not be fulfilled when the contract is subject precisely to a governing law that bases its construction on the principle of good faith and ancillary obligations.

We will explain the reasons for this gap between the ambitions of self-sufficiency of the contract style and the actual legal effects of the contract under the governing law.

Often, contracts are written by lawyers who are not experts in the applicable law. They are written even before it is clear which law will govern the contract. In a negotiation between a Norwegian and a Brazilian party, for example, the discussions will initially be carried out between the relevant technical or commercial officers of each of the parties. At a certain point, each of the parties will involve its lawyer. The lawyers will be asked to start putting the agreed technical and commercial terms into a contractual form. This draft will be negotiated and modified until it reflects the commercial understanding of the parties. At this stage, the contract will be fully drafted. It is usually only at this point that the parties insert or discuss the clause choosing the law that will govern the contract. In our example, the parties may choose a third, neutral law – for example, English law. In this case, the Liquidated damages

clause in the model can be retained without creating any inconsistencies with the governing law. If the parties choose, for example, Norwegian law, it would be better to change the Liquidated damages clause into a Penalty clause. However, at this stage, it is too late to adjust the contract terms to the governing law. The parties have already negotiated and agreed on the commercial, technical and financial substance of their relationship, including the specifications, the pricing, the level of payments to be made in case of default and so on. They rely on the substance of their agreement, and do not worry about the gap between the contract terms and the governing law. As Chapter 3 will show, however, the contract has different legal effects under each of these laws.

This approach does not necessarily derive from the parties' ignorance of the legal framework surrounding the contract. More precisely, the parties may often be aware of the fact that they are unaware of the legal framework for the contract. They are aware that the interpretation and construction of the contract under the governing law may result in an outcome which is different from what would follow a literal application of the contract wording. They nevertheless write those clauses in the contract and accept, as a calculated risk, the possible discrepancy between the wording and the result.

Furthermore, some of the clauses in a contract are often inserted without the parties having given any particular consideration to their content. This applies particularly to the already mentioned boilerplate clauses, which are inserted more out of habit than out of a specific need or intention to regulate those matters in that particular way.

Considering the importance that the governing law has for the application and even the effectiveness of contract terms (see Chapter 3), it may seem surprising that the parties negotiate details of their deal and draft the corresponding provisions before even considering the question of which law will govern the contract, and that they insert contract language without having it carefully considered.

However, this practice is not necessarily always unreasonable. From a merely legal point of view, it may make little sense; from the overall commercial perspective, however, it is more understandable.

A contract is the result of a process in which both parties participate from opposite starting points. This means that the final result is, necessarily, a compromise. In addition, time and resources are often limited during negotiations. This means that the process of negotiating a contract does not necessarily meet all of the requirements that would ideally characterise an optimal process under favourable conditions. What could be considered an indispensable minimum in the abstract description of how a legal document should be drafted does not necessarily match with the commercial understanding of the resources that should be spent on such a process. This may lead to contracts being signed without the parties having negotiated all of the clauses, or without the parties having complete information regarding each clause's legal effects

under the governing law. What may appear, from a purely legal point of view, to be unreasonable conduct, is actually often a deliberate assumption of contractual risk.[17]

Considerations regarding the internal organisation of the parties are also a part of the assessment of risk. In large multinational companies, risk management may require a certain standardisation, which in turn prevents a high degree of flexibility in drafting individual contracts. In balancing the conflicting interests of ensuring internal standardisation and permitting local adjustment, large organisations may prefer to enhance the former.[18]

It is, in other words, not necessarily the result of thoughtlessness if a contract is drafted without having regard for the governing law. Neither is it a symptom of a refusal of the applicability of national laws. It is the result of a cost–benefit evaluation, leading to the acceptance of a calculated legal risk.

Thus, it is true that boilerplate clauses, originally meant to create certainty about the interpretation and operation of the contract, may create uncertainty upon interaction with the governing law.[19] The uncertainty about how exactly a clause will be interpreted by a court is deleterious from a merely legal point of view. However, this uncertainty may turn out to be less harmful from a commercial perspective: faced with the prospects of employing time and resources to pursue a result that is unforeseeable from a legal point of view, the parties may be encouraged to find a commercial solution. Rather than maximising the legal conflict, they may be forced to find a mutually agreeable solution. This may turn out to be a better use of resources once the conflict has arisen.

In addition, this kind of legal uncertainty is evaluated as a risk, just like other risks that relate to the transaction. Commercial parties know that not all risks will materialise, and this will also apply to the legal risk: not all clauses with uncertain legal effects will actually have to be invoked or enforced. In the majority of contracts, the parties comply with their respective obligations and there is no need to invoke the application of specific clauses. In the situations where a contract clause actually has to be invoked, the simple fact that the clause is invoked may induce the other party to comply with it, irrespective of the actual enforceability of the clause. An invoked clause is not necessarily always contested. There will be, thus, only a small percentage of clauses that will actually be the basis of a conflict between the parties. Of these conflicts, we have seen that some may be solved amicably, exactly because the uncertainty of the clause's legal effects acts as a deterrent against litigation and as

[17] See more extensively, David Echenberg, 'Negotiating International Contracts: Does the Process Invite a Review of Standard Contracts from the Point of View of National Legal Requirements'. In Cordero-Moss (2011a), pp. 11–19. See also the debate in the APA seminar mentioned in Section 3.7.2.

[18] See more extensively, Maria C. Vettese, 'Multinational Companies and National Contracts'. In Cordero-Moss (2011a), pp. 20–32.

[19] This observation is made by Viggo Hagstrøm in 'The Nordic Tradition: Application of Boilerplate Clauses under Norwegian Law'. In Cordero-Moss (2011a), pp. 265–75, Section 2.

an incentive to find a commercial solution rather than pursuing legal avenues. This leaves quite a small percentage of clauses upon which the parties may eventually litigate. Some of these litigations will be won; some will be lost. The commercial thinking requires a party to assess the value of this risk of losing a lawsuit on enforceability of a clause (also by considering the likelihood that it will materialise) and compare this value with the costs of the alternative conduct. The alternative conduct would be to assess every single clause of each contract that is entered into, verify its compatibility with the law that will govern each of these contracts and propose adjustments to each of these clauses to the various other contracting parties. This, in turn, requires the employment of internal resources to revise standard documentation, and external resources to adjust clauses to the applicable law, and possibly to engage in negotiations to convince the other contracting parties to change a model of the contract with which they are well acquainted. In many situations, the costs of adjusting each contract to its applicable law will exceed the value of the risk that is run by entering into a contract with uncertain legal effects.

Often, to mitigate the risk of writing a contract that is unenforceable under the applicable law, the final draft of the contract is submitted to a local law firm with the request for verification that it is in compliance with the applicable law. This review, however, is normally limited to verifying that no mandatory rules are being violated. It does not extend to the compatibility of the drafting style with the applicable legal tradition, nor does it explain how the contract is interpreted or supplemented by the governing law.

The sophisticated party, aware of the implications of adopting contract models that are not adjusted to the governing law and consciously assessing the connected risk, will identify the clauses that matter the most, and concentrate its negotiations on those, leaving the other clauses untouched and accepting the corresponding risk.

A further element that may be relevant is the specialisation of lawyers. Often, lawyers who draft contracts are specialised in negotiating and drafting contracts, but not in litigation. When a contract that they have drafted is signed, they will turn to the negotiation of the next contract. If a dispute arises out of one of the contracts that they have drafted, it will not be the drafting lawyers who will be involved, but litigation lawyers. Therefore, the drafting lawyers will not have the opportunity of verifying how the clauses work in practice. The success of a clause will not be measured against the way in which the clause is interpreted or in terms of its effectiveness in avoiding disputes because the drafting lawyer is not involved in this phase. The success of a clause will be measured against the frequency with which the clause is accepted by the other party during the negotiations. That the drafting lawyer rarely sees how the clauses work in practice may contribute to enhancing the gap between the drafting style and the legal effects of international contracts.

Litigation lawyers have a quite different approach to contract terms. A litigation lawyer works on a specific dispute and has the goal of solving that dispute on the basis of the applicable sources. To permit an assessment of whether the dispute shall be litigated or whether a commercial settlement is to be preferred, the contract's legal effects and enforceability are central in the evaluation of the litigation lawyer. The contract will, therefore, be read in light of the governing law, and all applicable sources will be assessed.

The foregoing shows that no hasty conclusions should be drawn from the practice of drafting contracts without considering the applicable law. This practice does not justify the disregard of national laws in the field of international contracts or arbitration.

1.5 Examples of Self-Sufficient Contract Drafting

In this section are examples of some contract clauses that often recur in international commercial contracts. With these clauses, the parties try to take into their own hands those aspects that are usually decided by the governing law, such as interpretation and construction of the contract. The aim is to create the contract's own general contract law, thus rendering the applicable law redundant.

In the matters regulated by these clauses, however, the balance between certainty and justice may be challenged.

For example, a clause may specify that the contract is the only source of obligations between the parties and that no other sources are allowed. Nevertheless, under some circumstances, excluding side agreements on which one of the parties has relied may seem unfair. Certain governing laws, therefore, may permit considering such side agreements, and the contract clause prohibiting their consideration will not be applied literally.

As another example, a clause may specify that a party does not lose its contractual right to terminate even though it does not exercise it within a reasonable time. Nevertheless, under some circumstances, it may seem unfair to permit exercising a remedy that is not a proportionate reaction to an old event of termination but is only meant to take advantage of a market change. Certain governing laws, therefore, may prevent exercise of a contractual remedy, and the contract clause permitting it will not be applied literally.

These and other scenarios are examined in Section 3.4.1.

Each applicable law may have its own balance between certainty and justice, and this may affect the interpretation and construction of the very same contract clause that aims at regulating interpretation and construction of the contract. Chapter 2 will show that the interpretation of these clauses is not uniform under transnational sources, and Chapter 3 will show that the wording of the clauses may have differing legal effects depending on the governing law.

1.5.1 Boilerplate Clauses

Some clauses are frequently part of international commercial contracts, irrespective of the type of contract. Not only are they generally expected as an integral part of contract drafting, they are also immediately recognised and thus very seldom discussed during the negotiations. The drafting of these clauses is often considered to be a mere 'copy and paste' exercise. They are often referred to as having 'boilerplate', standard language with a general applicability that follows automatically and does not require any particular attention. Through these clauses, the parties attempt to regulate the contract's interpretation, its construction, the exercise of remedies for breach of contract and the legal effects of future conduct. At the same time, these clauses attempt to exclude any rules that the applicable law may have on these aspects.

Generally, the result that the clauses seek to achieve is to give effect to the wording of the contract, insulating it from the assumptions, ancillary obligations and so on, that may follow from the governing law.

The following are examples of some of the most typical boilerplate clauses.

(a) Entire Agreement Clause

The purpose of the Entire agreement clause (also known as the Merger clause or Integration clause) is to attempt to isolate the contract from any source or element that may be external to the document. This is also often emphasised by referring to 'the four corners of the document' as the borderline for the interpretation or construction of the contract. The parties' aim is thus to exclude terms or obligations that do not appear in the document. A typical Entire agreement clause might read as follows:

> This Agreement constitutes the entire agreement between the Parties and supersedes any prior understanding or representation of any kind preceding the date of this Agreement.

As Chapter 2 will show, there does not seem to be a uniform transnational standard for interpreting this clause. As Chapter 3 will show, the ability of this clause to obtain the desired result varies considerably depending on the governing law.

To understand the origin of the Entire agreement clause, it is necessary to keep in mind that many international contracts are based on English models. English contracts are written to meet the requirements and to take advantage of the possibilities contained in the English law of contracts. Traditionally, an interpreter of English law contracts is bound by the language of the contract. As a general rule, the interpreter would not be allowed to take into consideration external circumstances when interpreting and construing the contract, such as the parties' conduct during negotiations or after the signature of the contract.[20] This is traditionally known as the *parol evidence* rule, which

[20] *Wilson* v. *Maynard Shipbuilding Consultants AG Ltd* [1978] QB 665. More extensively, see Sections 3.1 and 3.2.

prevents the parties from producing any evidence to add to, vary or contradict the wording of a contract when its terms are being construed, and imposes that the contract be read exclusively on the basis of the provisions that are written therein.[21] The purpose of this rule is to enhance predictability in the course of commerce; in balancing the contrasting interests of, on one hand, establishing the real intention of the parties and, on the other hand, preserving predictability within commercial transactions, the parol evidence rule favours the latter. In the interests of certainty, therefore, a written contract is to be interpreted objectively and independently from extrinsic circumstances that are characteristic of the factual transaction. Gradually, however, a series of exceptions to the parol evidence rule has been created by court practice, mainly to ensure that the interpreter is aware of what the factual background of the parties was when they entered into the contract. Thus, it is permitted that evidence is produced of the factual background existing at or before the date of the contract (but not after that date, as is the case in the civil law systems), at least in respect of facts that were known to both parties.[22] The Entire agreement clause is, in part, a countermove to this exception to the parol evidence rule. The parties may seek to prevent the admission of evidence of the factual background by inserting an Entire agreement clause in their contract, stating that the document contains the entire contract.[23] This explains the origin of the Entire agreement clause in English contract practice: it is mainly meant to avoid the exceptions to the parol evidence rule that have evolved in court practice, and to reinstate the original regime of strict adherence to the text of the contract.

When it is used in contracts subject to a civil law, however, the clause may be applied differently.

To illustrate how the use of an Entire agreement clause may clash with the good faith principle, imagine a situation whereby one party regularly purchases raw materials for its production from a supplier. After some years of cooperation, the producer informs the supplier that it intends to upgrade its production, and that therefore the material to be supplied will have to be made according to a different alloy. The supplier is reluctant to accept the change because it would require significant investments. After negotiations and considering the importance of the volume that would be sold to the producer, the supplier accepts changing the alloy for the material that it is going to supply to the producer for the next five years. This is formalised in a side letter. Meanwhile, the frame supply agreement under which the parties had been operating is about to expire, and the producer sends the supplier a draft renewed frame agreement. The draft does not reflect the changed alloy that the parties had just negotiated and does not mention the side letter. The supplier is relieved that the producer evidently after all has been convinced by the supplier's argument against the change and continues producing the material according to the

[21] *Adams* v. *British Airways plc* [1995] IRLR 577.
[22] *Investors Compensation Scheme Ltd* v. *West Bromwich BS* [1998] All ER 98 and *Bank of Scotland* v. *Dunedin Property Investments Co Ltd* [1998] SC 657.
[23] *McGrath* v. *Shaw* [1987] 57 P & CR 452.

old specifications. When the producer invokes breach of contract because the side letter with the new alloy was not complied with, the supplier invokes the Entire agreement clause.

According to the clause's wording, the supplier is not bound by the side letter. However, in some legal systems, particularly those belonging to the family of civil law, as well as in soft sources such as the UNIDROIT Principles of International Commercial Contracts (UPICC) (see Section 2.2.5), the parties' attempt to exclude the relevance of facts or of the parties' conduct whenever these are not expressly reflected in the wording of the contract, may contradict a duty of good faith that the parties may have towards each other. This may in turn lead to a restrictive interpretation of the clause.

Whether this clause actually manages to achieve uniform results will be discussed in Sections 2.2.5(f)(i) and 3.4.1(a).

(b) No Waiver Clause

The purpose of a No waiver clause is to ensure that the remedies described in the contract may be exercised in accordance with their wording at any time and irrespective of the parties' conduct. This clause is originally meant to exclude the effects of the rule on acquiescence under English law. The rule on acquiescence would lead to a result that is similar to the requirement of exercising rights and remedies in good faith, present in many civil law regimes and in the transnational sources analysed in Chapter 2: if the innocent party behaves in such a clear and unequivocal way that the defaulting party may understand it as the expression of an intention by the former to waive its remedy, then the innocent party loses the possibility of exercising its remedy. Inserting a No waiver clause in the contract is meant to prevent any passive behaviour of the innocent party being interpreted as a clear and unequivocal representation, and therefore prevents the effects of the rule on acquiescence.[24]

The parties try, with this clause, to create a contractual regime for the exercise of remedies without regard to any rules that the applicable law may have on the time frame within which remedies may be exercised and the conditions for such exercise. The No waiver clause is inserted to avoid these 'invisible' restrictions on the possibility of exercising contractual remedies. A typical No waiver clause reads as follows:

> The failure of any party at any time to require performance of any provision or to resort to any remedy provided under this Agreement shall in no way affect the right of that party to require performance or to resort to a remedy at any time thereafter, nor shall the waiver by any party of a breach be deemed to be a waiver of any subsequent breach.

To illustrate how the use of a No waiver clause may clash against the good faith principle, imagine a situation whereby a company borrows a considerable sum from

[24] For an analysis of this clause and its implications, with further references, see Peel (2011), Section 2.2.

a bank to expand its production facilities. The loan agreement contains the usual covenants imposing on the borrower to carry out its activity, throughout the duration of the loan, in a way that does not prejudice its ability to repay its debt. The loan agreement gives the bank the power to terminate the loan with immediate effect if the borrower breaches these obligations. Imagine that the loan was at a fixed interest rate, which turns out to be too low as interest rates unexpectedly increase due to pandemic, wars and related inflation. The loan agreement is binding for several years, and the bank looks for a way to terminate it as a new loan agreement would incur a higher interest rate than the old one. The bank recalls that the borrower had, some years earlier, breached one of its obligations. At that time, interest rates were low, and the bank was not interested in terminating the loan. Now, however, the situation has changed, and the bank invokes the old breach of contract to terminate the agreement. The borrower argues that the old breach had no consequences and that the loan has been properly performed ever since, and that therefore there is no basis on which to terminate. The bank invokes the No waiver clause and argues that it has the power to terminate on the basis of the old breach.

According to the clause's wording, the bank is entitled to terminate. However, many legal systems have principles that protect the defaulting party's expectations and restrict the innocent party's formal rights so that the exercise of these rights does not result in an abuse. These rules may affect the exercise of remedies in a way that is not visible in the language of the contract.

As Section 2.2.5(f)(ii) will show, there does not seem to be a uniform transnational standard for interpreting this clause. As Section 3.4.1(b) will show, the ability of this clause to obtain the desired result varies considerably depending on the governing law.

(c) No Oral Amendments Clause

The purpose of this clause is to ensure that the contract is implemented at any time according to its wording and irrespective of what the parties may later have agreed, unless recorded in writing.

This clause is useful when the contract is going to be exposed to third parties in connection with the raising of finance or insurance. Third parties who assess the value of the contract must be assured that they can rely on the contract's wording. If oral amendments were possible, an accurate assessment of the contract's value could not be made simply on the basis of the document.

The clause is also useful when performance of the contract requires the involvement of numerous officers of the parties, who are not necessarily all authorised to represent the respective party. The parties must feel sure that the contract may not be changed by an agreement given by some representatives who are not duly authorised to do so. In a large organisation, it is essential that the ability to make certain decisions is reserved for the bodies or people with the relevant formal competence.

A typical No oral amendments clause reads as follows:

> No amendment or variation to this Agreement shall take effect unless it is in writing, signed by authorised representatives of each of the Parties.

As Section 2.2.5(f)(iii) will show, there does not seem to be a uniform transnational standard for interpreting this clause. As Section 3.4.1(c) will show, the ability of this clause to obtain the desired result varies considerably depending on the governing law.

1.5.2 Subject to Contract Clause

In connection with larger commercial contracts with long-lasting and complicated negotiations, a widespread practice is to sign various documents in the course of the negotiations, usually named 'Letter of Intent', 'Heads of Agreement' or 'Memorandum of Understanding'. In the traditional picture of contract formation, a letter of intent is hard to categorise: it is not an offer, it is not an acceptance, and it is not the final contract text. It is a pre-contractual document with an unclear function.[25]

The legal effects of a letter of intent cannot be assessed once and for all, mainly because the content and function of letters of intent vary considerably from case to case. What is common to all of these forms is that they have a clause, usually the last one, stating something along the following lines:

> This document is a letter of intent and is not binding on the parties. Failure to reach an agreement shall not expose any party to liability towards the other party.

Letters of intent may be quite detailed, so much so that they sometimes could be mistaken to be the final contract – if it were not for the Subject to contract clause. One reason for entering into such a detailed a letter of intent in advance of the final contract is that the parties may not yet have negotiated all of the specific aspects of their cooperation and may therefore not be in a position to be able to write the contract with the degree of detail with which they would feel comfortable. As the details may have a significant impact on the evaluation of the transaction, it is understandable that the parties do not want to be bound until all technical, financial, commercial and other elements have finally been agreed upon.

If the parties do not, and with good reason, want to be bound until they have agreed on all the aspects of their cooperation, why do they describe their cooperation in such a precise way in the letter of intent? What is this document meant to achieve? The document is said to not be binding, not only in respect of the freedom not to finalise

[25] More extensively, see Giuditta Cordero-Moss, 'The Function of Letters of Intent and Their Recognition in Modern Legal Systems'. In Reiner Schulze (ed.), *New Features in Contract Law* (Sellier European Law Publishers, 2007b), pp. 139–59.

the cooperation, but also in respect of the content of the cooperation: should one party, during the negotiations, depart from some of the parameters that were set forth in the letter of intent, it would not be in breach of contract because the document is not a binding contract. During the detailed negotiations, numerous issues may arise that have an impact on the parties' respective evaluation of their own and the other party's contribution to the cooperation, and this may have consequences relating to the split of the profit and liabilities between themselves. It is, therefore, understandable that the parties do not want to be bound to some items of the deal as long as the others are unclear.

While it may from a legal point of view be possible to argue that a certain parameter was not binding, its disregard may create practical difficulties during the negotiations, and a sudden change of position in such an important respect might undermine the mutual trust that is necessary for successful cooperation.

Therefore, the letter of intent may be seen as an attempt to convey a certain moral pressure against unjustified modifications to the terms contained therein. Sometimes, the moral pressure is expressed in the same clause determining the non-binding character of the document, which continues with a provision according to which 'the parties shall continue negotiations in good faith', or 'the parties shall use their best efforts to reach an agreement'. Often these clauses are not considered to be particularly binding: they are defined as being 'only' best effort obligations and, therefore, they are deemed to be without any binding content. The legal effects of these obligations will be touched upon in Section 3.4.2.

If the parties want to maintain full liberty in respect of the negotiations, why do they execute a document describing in relative detail the result that the negotiations are supposed to achieve? Sometimes the explanation may be found in a malicious use of the ambiguity of this document.

It is not unusual for one party to emphasise the last article of the letter of intent regarding the parties not being bound. In these cases, a party may deem that the most important function of a letter of intent consists in establishing that the parties are not bound. A party may, for example, wish to keep all possibilities open to start similar cooperation with a third party, or to enter that specific market on its own. A letter of intent specifically stating that the parties are not bound may create the illusion that any break-off of the negotiations is acceptable. The non-binding character will be invoked if one party wishes to break off the negotiations or to modify the terms set forth in the letter of intent, whereas the moral commitment will be invoked if it wishes to prevent the other party from doing so.

Some legal systems, particularly those belonging to the family of civil law, as well as soft sources such as the UPICC, contain an overarching duty of good faith that may restrict the liberty to break off negotiations if a party did not act in good faith. Also in this case, as we saw for the previous clauses, Sections 2.2.5(f)(iii) and 3.4.2 will show that there is no uniform standard according to which the clause can be interpreted.

1.5.3 Termination Clause

Termination clauses stipulate that the contract may be terminated prior to its planned expiry if certain events occur; for example, one party may be given the power to terminate the contract early upon breach by the other party of certain obligations.

Often, Termination clauses distinguish between termination as a consequence of an 'Event of default', and termination as a consequence of an 'Event of termination'. The former entails that one party failed to perform its obligations under the contract. The latter entails that one party, though not in default, is affected by circumstances that render the contract less interesting for the other party. For example, if the affected party's economic situation deteriorates, the innocent party may find it too risky to be bound by the contract. In a sort of anticipation of a future default, the innocent party may be given the possibility to terminate the contract. Usually, the contract regulates different consequences for termination following an Event of default or an Event of termination.

The Termination clause is meant to be operative irrespective of the consequences of the breach (that is, there is no need to ascertain whether the breach was so fundamental that termination is justified) or of the early termination (that is, there is no need to verify whether termination of the contract is a proportionate remedy under the given circumstances). By this clause, the parties attempt to avoid the uncertainty connected with the evaluation of how serious the breach is and what impact it has on the contract. This evaluation is due to the requirement, to be found in most applicable laws, that a breach be fundamental if the innocent party shall be entitled to terminate the contract. By defining certain terms as essential in the contract, or by spelling out that certain breaches give the innocent party the power to terminate the contract, the parties attempt to specify effects that arise automatically, instead of allowing for an evaluation that takes all of the circumstances into consideration.

To illustrate how the use of a Termination clause may clash against the good faith principle, imagine the situation that was described in Section 1.5.1(b), whereby a company borrows a considerable sum from a bank to expand its production facilities. Among the obligations of the borrower, there is one providing that the borrower shall send its audited financial statements to the bank within a certain date from their approval. The borrower breaches this obligation and sends the financial statements one day too late. The financial statements show that the borrower's financial position is strong, and there is no ground to worry about the borrower's ability to repay its debt. However, the bank exercises its contractual right to terminate the loan upon a breach by the borrower of one of its obligations. The borrower argues that the breach does not have any consequences on the performance of the main obligation, and that the termination is motivated by the bank's desire to take advantage of the change in the interest rates, not by the consequences of the breach. Moreover, a termination would have disastrous effects for the borrower, since the

borrower would need to immediately repay the whole outstanding amount that should have been repaid over several years. The bank points out that the termination clause is clear and gives it the absolute right to terminate upon a breach.

The clause's terms permit the bank to terminate; however, many legal systems, particularly those belonging to the family of civil law, as well as soft sources such as the UPICC, may restrict the applicability of clauses that do not reflect a reasonable balance between the parties' interests.

As Section 2.2.5(f)(iv) will show, transnational sources do not seem to provide a sufficiently detailed standard of interpretation that could ensure a uniform application of a Termination clause. As Section 2.2.5(f)(iv) will show, the effects of a Termination clause may vary depending on the governing law.

1.5.4 Arbitration Clauses

The wording of Arbitration clauses is another good example of the importance of English law requirements to the drafting of international contracts. It is also an example of international contract drafting's resistance to change: as will be seen, international Arbitration clauses gradually assumed a wording that was originally meant to respond to some needs for clarity under English law. English law does not have this need for clarity anymore, but Arbitration clauses continue to use the same wording.

Arbitration clauses are very detailed in the definition of their scope. This seems to have been a reaction particularly to some English court decisions that placed considerable emphasis on the language of the Arbitration clause and drew (out of words that actually were not intended to restrict the scope of the Arbitration agreement) unexpected conclusions as to which disputes could be deemed to fall within the scope of the Arbitration clause.

To name one example, a court interpreted a clause that referred to arbitration any disputes 'arising under' a certain contract. The court found that the clause covered only those disputes which may arise regarding the rights and obligations created by the contract itself. In contrast, a clause referring to arbitration disputes 'in relation to' the contract or 'connected with' the contract, was held to have a wider scope.[26]

This led to more and more detailed formulations aimed at clarifying that the Arbitration agreement covers all possible disputes between the parties. These fine verbal distinctions have now been abandoned by English courts: in the words of the House of Lords, these distinctions

> reflect no credit upon English commercial law. It may be a great disappointment to the judges who explained so carefully the effects of the various linguistic nuances if they could learn that the draftsman … obviously regarded the expressions 'arising under this charter' … and 'arisen out of this charter' …

[26] *Overseas Union Insurance Ltd* v. *AA Mutual International Insurance Co Ltd* [1988] 2 Lloyd's Rep 63.

> as mutually interchangeable. . . . [T]he time has come to draw a line under the authorities to date and make a fresh start.[27]

The House of Lords affirmed that the parties

> are unlikely to trouble themselves too much about [the clause's] precise language or to wish to explore the way it has been interpreted in the numerous authorities, not all of which speak with one voice . . .. [I]f the parties wish to have issues as to the validity of their contract decided by one tribunal and issues as to its meaning or performance decided by another, they must say so expressly.[28]

Notwithstanding the clarification given by the House of Lords, the London Court of International Arbitration (LCIA) still determines the scope of its Model Arbitration clause by reference to 'any dispute arising out of or in connection with this contract, including any question regarding its existence, validity or termination'.[29]

This detailed formulation has even spread beyond the area of English law: the Model Arbitration clause recommended by the Arbitration Institute of the Stockholm Chamber of Commerce refers to 'any dispute, controversy or claim arising out of or in connection with this contract, or the breach, termination or invalidity thereof'.[30] Similarly, the Model clause of the Swiss rules refers to 'Any dispute, controversy or claim arising out of, or in relation to, this contract, including the validity, invalidity, breach or termination thereof ',[31] and the Model clause of the UNCITRAL Arbitration Rules to 'Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof'.[32] Along the same lines, although somewhat more succinctly, the Model clause of the International Chamber of Commerce (ICC) refers to 'All disputes arising out of or in connection with the present contract'.

A detailed Arbitration clause is meant to counteract restrictive interpretations that may be imposed by the applicable arbitration law. A simple clause may probably have the same effect in many jurisdictions, including those already considered. The detailed wording of many Model clauses is, therefore, redundant. What a detailed Arbitration clause may not achieve, however, no matter how clear and precise it is, is to extend the scope of what the applicable arbitration law considers to be arbitrable. The matter of arbitrability will be analysed in Section 5.4.8.

[27] *Fiona Trust & Holding Corporation and others* v. *Privalov and others* [2008] 1 Lloyd's L Rep 254 at 257.
[28] *Fiona Trust & Holding Corporation and others* v. *Privalov and others* [2008] 1 Lloyd's L Rep 254 at 259.
[29] www.lcia.org/Dispute_Resolution_Services/LCIA_Recommended_Clauses.aspx.
[30] https://sccarbitrationinstitute.se/en/model-clauses/model-clause-english.
[31] www.lcia.org/Dispute_Resolution_Services/LCIA_Recommended_Clauses.aspx.
[32] https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/21-07996_expedited-arbitration-e-ebook.pdf.

1.5.5 Other Clauses

Numerous other clauses could be mentioned to illustrate the self-sufficient drafting style of international contracts. In this book, we will mention clauses on Liquidated damages, *Force majeure*, Hardship, Irrevocability of the offer, Amendments to contracts and Representations and Warranties. These clauses will show that the same wording, in combination with different governing laws, may lead to dramatically different results.

Elsewhere, I have published the results of research analysing a large number of boilerplate clauses and their effects under a variety of legal systems.[33]

1.6 The Chimera of the Autonomous Contract

As previously seen, the text of the final contract is a mixture of legal analysis, the exercise of bargaining power, deference to widespread contract practice, reliance on one's own drafting experience, the need for standardisation, the need for efficiency and the assumption of risk. The proportion of the various components may vary, and in some situations, the assumed risk is well considered whereas, in other situations, it may remind one more of recklessness than of the assumption of calculated risk. Whether calculated or not, a risk is often taken, and is taken as a consequence of the dynamics of contract negotiations, as described in Section 1.3.

A court or an arbitrator who assumes that all contracts are always written following the optimal drafting process (i.e., by carefully considering every single clause and its compliance with the governing law) will assume a coherent and conscious will by the parties to comply with the applicable law. If the contract terms are not well coordinated with the applicable law, which is likely to happen considering the dynamics of contract drafting previously explained, the court or arbitrator who assumes a consistently careful drafting may react by proposing ingenious interpretations in an attempt to reconcile the two aspects. The parties, however, may have taken it as a calculated risk that there was no conformity between the contract terms and the applicable law. The ingenious reconciliation made by an interpreter who assumes that the drafters had a high degree of awareness of the applicable law, may come as a larger surprise to the parties than finding out that some of the contract terms are not compatible with the applicable law.

Additionally, observers may induce, from the practice of drafting contracts without considering the applicable law, that international contract practice refuses to acknowledge national laws. On this assumption, observers may propose that contracts should be governed by transnational rules instead of national laws. However, that the parties may have disregarded the applicable law as a result of a cost–benefit evaluation does not necessarily mean that they want to opt out of the applicable law.

[33] Cordero-Moss (2011a).

When interpreting international contracts, it is important to acknowledge that contract drafting's disregard for the governing law is a consequence of calculated risk, and not a symptom that implies that the drafters refuse to be subject to the governing law. The parties are still interested in enforcing their rights, and enforceability is ensured only by the judicial system of the applicable law.

An important shift in attitude occurs between the contract drafting phase and the contract operation or litigation phase. The phase of negotiations and drafting may be characterised by the above-described commercially inspired cost–benefit evaluations, which induce the parties to minimise the resources employed in tailoring the contract to the governing law, and to rely on a detailed and as exhaustive as possible description of the deal instead. Once a contract is signed, however, a new phase starts. The drafting lawyers (often termed 'transaction lawyers') are not involved with that contract anymore, and contract implementation is usually taken over by engineers or commercial people.

Once a contract is signed, its performance will be administered by an organisational part of the company that did not necessarily participate in the negotiations. In well-organised companies, there will be a contract manager office, or corresponding function, that will carefully read the contract (including its boilerplate clauses) and on that basis prepare guidelines for the rest of the organisation on how to perform the contract – for example: in case of default, what kind of notices should be sent by which office of the company to which body of the other party, and within what time limits; what procedure to follow for amending the agreement or for making a variation order and so on. At this stage, all the terms of the contract are taken seriously by the parties and are used as a measure for what conduct is permitted or required under the contract.

Furthermore, once a dispute arises, yet another part of the company or an external lawyer will be involved. In order to assess the company's legal position and suggest a strategy for solving the dispute, they will carefully consider all the terms of the contract. Should, for example, a party have duly followed the procedure for notice of defect contained in the contract, the strategy will be developed on the basis of the assumption that that party's rights are intact (unless mandatory rules of the governing law have been violated). The company may, therefore, be more inclined to assert its rights strongly and if necessary, bring action in court. If that party has not followed the contractual procedures, it may assume that its rights are not intact and may take a more cautious approach to avoid the dispute ending up in court.

When a dispute arises between the parties, or a difference in the interpretation becomes apparent, other lawyers are involved, who usually deal with dispute resolution (often termed 'litigation lawyers'). As seen in Section 1.4, these litigation lawyers have a different approach from their negotiating counterparts: they often do not even talk to the drafting lawyers, so that transaction lawyers are seldom informed about the problems arising out of their contracts, and litigation lawyers seldom get insight into the reasoning behind specific wording. Litigation lawyers

carefully analyse the specific contract and its effects under the governing law and try to assess as precisely as possible the chances of winning a case in court or securing a favourable arbitration result on the basis of the contract wording, the applicable law and the degree of factual background that the governing law allows. On the basis of this assessment, they will develop a strategy that may range from seeking to reach a commercial solution if the probability of winning in court is not high, to insisting on the party's own position in cases where the prospects of a successful legal suit are high. In this phase, therefore, predictability of the legal framework and of the criteria applied for a decision are of the utmost importance.

It can be useful here to quote an observation made by F.A. Mann, one of the most important jurists in the field of, among others, financial law and arbitration. In the occasion of a meeting of the Institute of International Law some decades ago, F.A. Mann strongly criticised the emerging delocalised approach – that is, the theory according to which international contracts and international arbitration are not subject to national laws, but to a transnational regime, see Chapter 2. He affirmed:

> I confess that I simply do not know what this means. Arbitrations take place on earth, in territories, in localities. They do not take place in a vacuum. . . . I fear that, when you speak of 'delocalization' you mean something like 'delegalization', the rejection of the control of law. If, as I fear, this is a correct interpretation, the disagreement is fundamental and almost of a philosophical character. . . . More than 50 years of very intensive and extensive practical experience have taught me that, when parties embark upon arbitration proceedings . . . they want to win and want to be told with what degree of likelihood they will win. In other words, they want to know the *law*. They are not in the least bit interested in what you seem to understand by 'delocalization'. Nor are they interested in compromise solutions. On the contrary, they regard any tendency on the part of the arbitrators to adopt such solutions as a sign of weakness. In other words, they expect a judicial decision arrived at after a judicial process.[34]

In the context of such a picture, it is doubtful that the effects of the governing law on the contract should be disregarded in order to permit the drafter's ambitions of self-sufficiency to be realised.

1.7 The Relational Contract

We have seen the contours of an international commercial practice modelled on the common law tradition, aimed at ensuring an accurate application of the contract language and at insulating itself from any external influence, be it the governing law or the interpreter's discretion.

[34] Deliberations of the XVIII Commission of the Institute of International Law, *Yearbook – Institute of International Law I* (1989), p. 173.

However, this is not the only approach to international contracts. The diametrically opposite approach can be seen, too, when considering the theory of the so-called relational contract.

It is sometimes assumed that long-term contracts require a higher degree of flexibility in their regulation than discrete contracts that are performed simultaneously by the parties. This assumption was at the basis of the work that led to the 4th edition of the UPICC in 2016.[35] In this context, the theory of relational contracts was mentioned.[36] This leads to a dynamic and creative relationship between the contract terms and the UPICC, according to which the UPICC may forge contract terms independently from the wording of the agreed terms, if the circumstances so require.

There is a clear tension between this approach and the expectations of predictability of commercial parties.

The notion of relational contracts as long-term relationships which require mutual trust between the parties, has found its way even in English law, see Section 3.3. Some High Court decisions found that a general principle of good faith is to be implied in relational contracts,[37] and this triggered a considerable interest in the notion of relational contract. However, the Court of Appeal seems to be quite reluctant to recognise the category of relational contracts and to imply good faith obligations.[38] Furthermore, as explained in Section 3.3, the principle of good faith that may be implied under English law is a much more modest requirement than the dynamic and creative relationship envisaged by the UPICC.

The theory of relational contracts dates to the 1960s and 1970s, when Ian Roderick Macneil and Stewart Macaulay wrote their seminal works on this subject.[39]

In short, the relational contract theory promotes an understanding of contract as relation, rather than as a rigid set of legal obligations which with each party is bound to comply accurately. In relational theory, a contract is an ongoing relation based on mutual trust and on the parties' common desire to serve their interests – interests that

[35] See, for example, the document that was used as a basis of the Working Group's first session: 'The UNIDROIT Principles of International Commercial Contracts and Long-Term Contracts'. Position paper prepared by Professor Michael Joachim Bonell, October 2014, UNIDROIT 2014 Study L – Doc. 126.

[36] 'The UNIDROIT Principles of International Commercial Contracts and Long-Term Contracts', paras 6, 9, 41 and 49, as well as Annex I, comments by professor Neil B. Cohen, p. ii and by Justice Paul Finn, 'The UNIDROIT Principles of International Commercial Contracts and Long-Term Contracts', p. v f., and Annex II, containing the document that was used as a basis to present a proposal, similar to the proposal described in Section 3 of this chapter, for the 2010 edition of the UPICC – that proposal was rejected by the Governing Council in 2010: Position Paper with Draft Provisions on Termination of Long-Term Contracts for Just Cause by Professor Francois Dessemontet, UNIDROIT 2009 – Study L – Doc.109 (Excerpts), p. xi.

[37] *Al Nehayan* v. *Kent* [2018] EWHC 333 (Comm); *Alan Bates* v. *Post Office Limited* [2019] EWHC 606 (QB).

[38] *Candey Limited* v. *Bosheh & Anor* [2022] EWCA Civ 1103.

[39] Ian R. Macneil, 'Whither Contracts?' *Journal of Legal Education* 21 (1969), p. 403; 'The Many Futures of Contracts'. *Southern California Law Review* 47.3 (1974a), pp. 691–816; 'Restatement (Second) of Contracts and Presentation'. *Virginia Law Review* 60 (1974b), p. 589; and 'Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical, and Relational Contract Law'. *Northwestern University Law Review* 72 (1977), p. 854; Stewart Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study'. *American Sociology Review* 28.1 (1963), pp. 55–67.

are assumed to be aligned. The basis for this relationship is given not by legal obligations set forth in contract terms, but by social norms. The contract terms are a flexible framework that adapts to changing circumstances because it contains implied obligations based on a shared understanding of the social and economic context. The contractual relationship is, thus, collaborative, rather than being antagonistic. There is no need to specify in the contract detailed mechanisms to cater for any possible development, because contracts do not need to be complete: they will be formed throughout the life of the relation, on the basis of social norms and mutual trust.

More recently, the notion of relational contract has been at the centre of research carried out by the International Association for Contract and Commercial Management (IACCM) of the University of Tennessee. Together with the Swedish law firm, Lindahl, they have published a White Paper called 'Unpacking Relational Contracts'.[40] The main underlying idea is that the contract does not need to be complete (in fact, it is impossible to write a contract that regulates each and every situation that may arise throughout the life of the contract). Also, the parties do not need to comply with the contract in case circumstances develop. The relation of mutual trust that binds the parties, as well as the parties' common interest in implementing the business arrangement they envisage, will be sufficient basis to complete or adapt the contract whenever a development in circumstances requires it.

This flexible, dynamic conception of contracts is in contrast with commercial practice, at least for some types of contract.

Not all commercial or long-term contracts are designed to be adapted on the basis of discretionary evaluations made in the course of the contract's life. Such a flexible contract requires that all parties have a common interest in jointly pursuing the adjustment of the contract terms.

However, in many contracts the parties have opposed interests, and it is completely unrealistic to expect them to jointly pursue a common interest. These contracts are designed to contain mechanisms to cater for possible developments. These mechanisms contain clear criteria that the parties carefully negotiated at the moment of entering into the contract. When negotiating these contracts, the parties evaluate the various risks that may arise, and make provision for those risks in the contract. They allocate the consequences between each other or provide for specific adjustment mechanisms. Furthermore, as previously explained, many commercial contracts rely on an accurate application of the terms as agreed in the contract. The predictability that derives from applying the contract according to its wording is essential in multinational companies to properly exercise contract management and risk control; it is essential for commercial parties to obtain financing or to insure their activity, because financial institutions and insurance companies need to carefully assess the creditworthiness of the borrower and the size of the risk – and this can be done only

[40] www.vestedway.com/wp-content/uploads/2016/10/Unpacking-Relational-Contracting_v19.pdf.

on the basis of an accurate evaluation of the terms of the contract; it is essential for the lawyers to develop a strategy in case of disputes. For these reasons, parties usually spend considerable resources in negotiating detailed contracts and forming their contracts as exhaustively as possible. Parties even include provisions on the interpretation and general operation of the contract (so-called boilerplate clauses), that are intended to provide a form of 'private' general contract law for the contract – thus isolating it from any possible external interference, including from the governing law.

Admittedly, the ambition of a fully self-sufficient contract reveals itself often as an illusion, as the present chapter and Chapter 3 explain. This ambition relies on the expectation, first, that the negotiating parties are capable of foreseeing and regulating the effects of each and every possible development that may occur during the life of the contract. Experience and analytical skills may contribute to foreseeing a large part of these developments, but it certainly cannot be excluded that unforeseen situations will arise. To this extent, the considerations made by theorists of the relational contract deserve support.[41]

However, the flexible frame posited by the relational theory assumes that the parties' respective interests are always aligned. This gives the parties an incentive to find a reasonable solution to any difference that may arise – because an antagonistic conduct would prevent the parties from achieving their common goal.

Alignment of the parties' interests, however, is not always to be found.

Imagine a contract for the exploration, development and production of mineral resources, entered into between the host country and a foreign company. Contracts of this kind have a duration of decades and a quite uneven distribution of the parties' rights and obligations. In the initial phase of contract performance, the company carries the burden of huge investments: in the phase of exploration and development, the company carries out extensive activity on its own costs without any compensation but the prospect of participating in the profit once the company has developed the field, built the infrastructure and so on. In this phase, both parties' interests are aligned: they are all interested in creating a profitable production of mineral resources. After many years of investment and activity, when production starts, the company may at last start covering its costs and eventually making a profit. At this point in time, however, the parties' interests are no longer aligned. The company has contributed its know-how and resources and is interested in benefitting from the proceeds of the sales of the mineral resources. The state has obtained the development of its field and no longer needs the company to run the production. To optimise its profit, the state may be tempted to consider the company as an unnecessary cost now that it has made its contribution. Without binding and precise rules on profit sharing, the company runs the risk of being squeezed out.

[41] This is what the White Paper on relational contracts defines as the 'contract paradox', www.vestedway.com/wp-content/uploads/2016/10/Unpacking-Relational-Contracting_v19.pdf.

A flexible, relational contract counting on the parties' common interests would not be very useful.

Considerations such as these were discussed in the Working Group that prepared the 4th edition of the UPICC, on which I had the honour of participating. The logic of the relational contract suggested that the UPICC should provide for the possibility of terminating a long-term contract for convenience. This, however, would have allowed for possible abuses, as in the example just given. Eventually, the provision on termination for convenience was not included in the final text.[42]

1.8 The Balance

The approach to international contract practice is, as previously seen, not uniform.

On the one hand, there are ambitions of autonomy and of delocalisation of contracts: the contract is seen as self-sufficient and based on a uniform regime detached from national law, where the language of the contract is sovereign and the only basis on which arbitral tribunals base their decisions.

On the other hand, there are ideals, grounded in national law and in transnational sources, aimed at ensuring that the parties act loyally, for which contract terms are a flexible tool that can be bent to achieve the common goal of the parties.

Can these different approaches be reconciled? Neither of these theories seems to fully reflect the effects of international contracts.

Considering that the main interest of the parties is to be able to assert their rights in a predictable and enforceable manner, it is necessary to be aware of the scope and effects of transnational sources (Chapter 2), of the effects that the applicable law may have on the terms of the contract (Chapter 3) and on how it is determined which law is applicable (Chapter 4). It is also necessary to be aware of the limits of arbitration and thus avoid surprises when the assumption that party autonomy is completely unfettered in arbitration reveals itself not to be true (Chapter 5).

[42] See Giuditta Cordero-Moss, 'The Unidroit Principles: Long-Term Contracts'. In Pietro Galizzi, Giacomo Rojas Elgueta and Anna Veneziano (eds.), *The Multiple Uses of the UNIDROIT Principles of International Commercial Contracts: Theory and Practice* (Giuffrè Francis Lefebvre, 2020d), pp. 75–96.