2

The Role of Transnational Law

2.1 Introduction

Domestic contracts regulate domestic legal relationships; international contracts regulate international legal relationships. Domestic contracts are subject to domestic law (national law); for the sake of symmetry, international contracts should be subject to international law. However, with some important exceptions such as the 1980 Vienna Convention on Contracts for the International Sale of Goods (CISG), in contract law there are no international sources (in the sense of treaties or conventions). Hence, according to the traditional approach, international contracts are subject to national law: a branch of each national law, known as private international law or conflict of laws, provides mechanisms that permit a choice of applicable law from the various national laws that have a connection with an international commercial relationship and may thus potentially be applicable. That many rules of private international law have been harmonised or even unified at a supranational level does not change the result of their application: international contracts will be subject to national law.

Those who find this asymmetry to be unsatisfactory criticise it for creating an overcomplicated system that is not suitable for international commercial contracts. The mechanism of choice of law is perceived as confusing and unpredictable, and it is moreover criticised for resulting in the application of a national law – which per definition is meant to regulate domestic, and not international, contracts.

Hence, a third system is advocated for, detached from national law and yet not international law – that is, not formally based on treaties or conventions. The third, detached system is often referred to as the *lex mercatoria*, transnational law or delocalisation.

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The delocalisation theory was launched by renowned scholars such as Goldman[1] and Schmitthoff,[2] and has received considerable support.[3] Among other things, the various aspects of this delocalised, transnational approach have repeatedly been the object of courses at the Hague Academy of International Law. These range from the affirmation of an autonomous system for arbitration[4] and the consideration of a uniform law for arbitration,[5] to a more cautious approach analysing the relationship between arbitration and private international law,[6] between arbitration and national law[7] and between arbitration and national courts.[8] Furthermore, courses have been offered on soft law sources for commercial contracts, such as the UNIDROIT

[1] Berthold Goldman, 'Frontières du droit et lex mercatoria'. *Archives de philosophie du droit* 9 (1964), p. 177; 'La lex mercatoria dans les contrats et l'arbitrage internationaux: réalité et perspectives'. *Travaux du Comité français de droit international privé* 2.1977 (1980), pp. 221–70; 'Lex Mercatoria'. *Forum Internationale 3* (1983), p. 3; 'The Applicable Law: General Principles of Law: The Lex Mercatoria'. In *Contemporary Problems in International Arbitration* (Springer, 1987), pp. 113–25; and 'Nouvelles réflexions sur la lex mercatoria'. In Christian Dominicé, Robert Patry and Claude Reymond (eds.), *Etudes de droit international en l'honneur de Pierre Lalive* (Helbing & Lichtenhahn, 1993), p. 241.

[2] Clive M. Schmitthoff, 'The Unification of the Law of International Trade'. *Journal of Business Law*, Annual Issue (1968), p. 105.

[3] Literature on the subject matter is vast. Among the most frequently referred to are Filip De Ly, *International Business Law and Lex Mercatoria* (Elsevier Science Ltd, 1992); Klaus Peter Berger, *The Creeping Codification of the New Lex Mercatoria* (Kluwer Law International, 2010); and Ole Lando 'The Lex Mercatoria in International Commercial Arbitration'. *International & Comparative Law Quarterly* 34.4 (1985), pp. 747–68.

[4] Courses are collected in the Academy's series *Recueil des cours* (Académie de Droit International de la Haye). See the courses by Berthold Goldman, 'Les conflits de lois dans l'arbitrage international de droit privé'. Volume 109 (1963); Pierre Lalive, 'Problèmes relatifs a l'arbitrage international commercial'. Volume 120 (1967); Dominique Hascher, 'Principes et pratique de procédure dans l'arbitrage commercial international'. Volume 279 (1999); Emmanuel Gaillard, 'Aspects philosophiques du droit de l'arbitrage international'. Volume 329 (2007); Luca Radicati di Brozolo, 'Arbitrage commercial international et lois de police. Considérations sur les conflits de juridictions dans le commerce international'. Volume 315 (2015).

[5] Katharina Boele-Woelki, 'Party Autonomy in Litigation and Arbitration in View of the Hague Principles on Choice of Law in International Commercial Contracts'. Volume 379 (2016).

[6] Pieter Sanders, 'Trends in the Field of International Commercial Arbitration'. Volume 145 (1975); Horacio Grigera Naón, 'Choice-of-Law Problems in International Commercial Arbitration'. Volume 289 (2001); Ted M. de Boer, 'Choice of Law in Arbitration Proceedings'. Volume 375 (2015); George Bermann, 'International Arbitration and Private International Law'. General Course on Private International Law, Volume 381 (2016); Jean-Michel Jacquet, 'Droit international privé et arbitrage commercial international'. Volume 396 (2019).

[7] Riccardo Luzzato, 'International Commercial Arbitration and the Municipal Law of States'. Volume 157 (1977); Richard Kreindler, 'Competence–Competence in the Face of Illegality in Contracts and Arbitration Agreements'. Volume 361 (2013); Giuditta Cordero-Moss, 'Limitations on Party Autonomy in International Commercial Arbitration'. Volume 372 (2015); Felix Dasser, 'Soft Law in International Commercial Arbitration'. Volume 402 (2019).

[8] Antonio Remiro Brotóns, 'La reconnaissance et l'exécution des sentences arbitrales étrangères'. Volume 184 (1984); Pierre Mayer, 'L'autonomie de l'arbitre international dans l'appréciation de sa propre competence'. Volume 217 (1989); José Carlos Fernández Rozas, 'Le rôle des juridictions étatiques devant l'arbitrage commercial international'. Volume 290 (2001); Alan Scott Rau, 'The Allocation of Power between Arbitral Tribunals and State Courts'. Volume 390 (2018); Lotfi Chedly, 'L'efficacité de l'arbitrage commercial international'. Volume 400 (2019).

Principles,[9] as well as soft law sources regulating party autonomy,[10] private international law[11] or economic law in general.[12]

An important purpose of the delocalisation theory is to provide a uniform, transnational regulation for international contracts, which can be applied equally all over the world and irrespective of the national legal systems with which the dispute is connected. This regulation would stem from a body of rules spontaneously emerging from the international business community, and its most prominent principle would be the primacy of the parties' will.

This delocalised, transnational system is based on a variety of sources, such as generally accepted principles, trade usages, contract practice, arbitration practice or publications by trade or branch associations such as the International Chamber of Commerce (ICC) or the International Bar Association (IBA). This results in a fragmentary system, the content of which is not easily accessible.

It is legitimate to wonder whether the cure is perhaps worse than the disease. If the alternative to an allegedly confusing mechanism for selecting the applicable law is less than a uniformly applied and exhaustive law, the result is a mixture of national laws and partly harmonised rules – some of which are not necessarily applicable, and others which may be subject to a variety of interpretations (as this chapter will show). The advantages of embracing such a fragmented system are not evident.

Another alleged reason for suggesting that a delocalised, transnational commercial law is desirable, is international contract practice. As seen in Chapter 1, contracts are written adopting the common law style, irrespective of whether there is a connection with English law or another law belonging to the same family. This style is based on the primacy of the parties' will and assumes that all rights and obligations be spelled out in the contract, rather than being implied by the adjudicator or read into the contract by operation of the applicable law. This leads to extensive and detailed contracts which are meant to be self-sufficient, and which do not require integration by default rules of the applicable law. Furthermore, contracts are often standardised and contain therefore the same wording irrespective of which law governs them. Model contracts are being published as soft law and offered for use throughout the world.

An exhaustive and standardised contract does not invite consideration of the applicable law. Contract practice may therefore give the impression that contracts are intended to be subject only to the will of the parties and spontaneous, transnational sources of soft law. In my opinion, however, this conclusion is not justified, see Section 1.4.

[9] Michael Joachim Bonell, 'The Law Governing International Commercial Contracts: Hard Law Versus Soft Law'. Volume 388 (2018); Lauro da Gama, 'Les principes d'UNIDROIT et la loi régissant les contrats de commerce'. Volume 406 (2020).

[10] Boele-Woelki (2016).

[11] Diego Fernández Arroyo, 'Compétence exclusive et compétence exorbitante dans les relations privées internationals'. Volume 323 (2006).

[12] Ignaz Seidl-Hohenveledern, 'International Economic "Soft Law"'. Volume 163 (1979).

Often, the supporters of a delocalised, transnational law link their preference for a delocalised system to the circumstance that disputes connected with international contracts are usually subject to arbitration and not to national courts of law. The assumption is that international arbitration is detached from any national law and that consequently arbitrators must follow the will of the parties, rather than a national law. Transnational law is deemed to be an emanation of usages, practices and generally recognised principles, and thus to be better suited to application in arbitration than national law. In my opinion, this conclusion is not justified either, see Sections 2.3 and 3.7.

The literature supporting a delocalised, transnational system presents various arguments aimed at showing that national laws are not adequate sources for governing international contracts. Arguments range from the rather pragmatic (and irrefutable) observation that it is costly and time-consuming to analyse, for every contract, all potentially applicable laws, to the not necessarily always appropriate statement that conflict rules are a confusing and complicated mechanism and thus should be avoided, or to the usually unsubstantiated statement that national laws' content is adequate to regulate domestic, but not international contracts. This latter argument seems to be less frequently invoked following the publication of principles and rules made specifically for international contracts (such as the UNIDROIT Principles of International Commercial Contracts (UPICC) or the Principles of European Contract Law (PECL) described in Section 2.2.5). As these rules and principles – tailored to international contracts – show no structural differences from those of national laws, it is difficult to affirm that national laws are not adequate for governing international contracts.

Certainly, the variety of national laws to which an international contract may be subject requires awareness of the different systems, and contract practice must be adapted to the law that is applicable under any given circumstances. This is costly and time-consuming. As Chapter 1 showed, many drafters accept the risk flowing from not considering the applicable law and draft contracts that are not adjusted to the applicable law – assuming this as a calculated legal risk. The alternative envisaged by the proponents of a delocalised, transnational law, is a uniform law applied in the same way all over the world. This would obviously be much more efficient.[13] When seeking

[13] That such efficiency would be desirable is not evident: just as the diversity in languages makes communication less efficient but enriches the cultural picture, so should the various legal traditions be seen as a strength rather than a weakness. There does not seem to be an evident or unified need for harmonisation, and voices are raised to underline that it might be 'better to celebrate our diversity rather than continue the quest for (a dull) uniformity' (Ewan McKendrick, 'Harmonisation of European Contract Law: The State We Are In'. In Stefan Vogenauer and Stephen Weatherill (eds.), *The Harmonisation of European Contract Law* (Hart Publishing, 2006), pp. 5–29, 28). Voices are also raised to warn against being led 'into accepting the view that all non-state norms are a panacea for all ills, or that State laws or borders are the enemy' (Symeon C. Symeonides, 'Party Autonomy and Private-Law Making in Private International Law: The Lex Mercatoria That Isn't'. In *Festschrift für Konstantinos D. Kerameus* (Ant. N. Sakkoulas & Bruylant Publishers, 2006), pp. 1397–423). That harmonisation of substantive law is not necessarily the only way to go was, at a certain point, recognised by the European Commission: in February 2009, the work on a European contract law and, in particular, the Common Frame of Reference (CFR) project was transferred

solutions that adequately cater to the peculiarities of international contract drafting, however, it is necessary to consider how feasible and effective those solutions are.

Are harmonised and comprehensive sources available on a transnational level that are capable of fully regulating the interpretation, construction and application of contracts, thus making national contract laws redundant?

Do the drafting style and practice constitute a sufficiently clear basis for selecting the applicable sources, thus making redundant any rules meant to select the applicable law?

Do contract practice and arbitration ensure that the transnational law is applied as a uniform regime?

As this chapter will show, there are currently no full alternatives to a state governing law when it comes to principles of general contract law upon which the interpretation and application of the agreed wording is based.

Admittedly, in the past decades, sources of soft law have been produced and have gained considerable recognition.

Soft law is based on non-binding rules and principles. As opposed to hard law, it does not stem from authoritative sources, but derives from business practice and is generally laid down in instruments issued by commercial organisations or international bodies. Sources of soft law may be used as a model for legislation or for drafting contracts, they may take the form of rules governing certain relationships, they may contain guidelines for certain conducts and so on. Their application depends on the voluntary adoption by the involved parties. Soft law can be found in disparate fields: from the respect of human rights (see Section 2.2.6(g)), to procedural issues (see Sections 2.2.6(d), (e) and (f)), to contractual matters.

Within the field of contractual matters there are, broadly speaking, two types of soft law sources: those that have a specific scope of application and thus assume that other sources will regulate all issues that do not fall within that scope (see Sections 2.2.6(a), (b) and (c)), and those that have a general scope of application and aspire to be the only applicable source (see Section 2.2.5). These latter are meant to render the transnational law more systematic and more easily accessible. The most notable source of soft general contract law is the UPICC, see Section 2.2.5. This restatement is systematic and has a high level of quality. In my opinion, however, the development of systematic sources of soft law does not achieve the replacement of the applicable law, see Section 2.3. As a matter of

from the Commission's Consumer Affairs Directorate to its Justice, Freedom and Security Director, of which Jonathan Faull was Director General. Mr Faull stated, in the evidence he gave to the House of Lords' inquiry on European contract law, that 'the thrust is very much one of mutual recognition rather than harmonization', see the UK House of Lords European Union Committee, Social Policy and Consumer Affairs (Sub-Committee G), 12th Report of Session 200809, *European Contract Law: The Draft Common Frame of Reference, Report with Evidence* (10 June 2009), https://publications.parliament.uk/pa/ld200809/ldselect/ldeucom/95/95.pdf, question 143. See also Sections 53 and 93 of the Report. Also, a law and economics-inspired view has received attention in Europe, according to which legal systems compete to offer the most attractive regulation. For an overview and a criticism of this view in the context of contract law, see Stefan Vogenauer, 'Regulatory Competition Through Choice of Contract Law and Choice of Forum in Europe: Theory and Evidence'. *European Review of Private Law* 21.1 (2013), pp. 13–78.

fact, a full replacement of the governing law is not even the goal of the UPICC, see Section 2.2.5(b).

Restatements of soft law, compilations of trade usages, digests of transnational principles and other international instruments may be invaluable for specific contract regulations, such as the INCOTERMS used for the definition of the place of delivery in international sales (see Section 2.2.6(a)).[14]

However, these sources do not, for the moment, provide a sufficiently precise basis for addressing questions such as 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, or the existence and extent of a general principle of good faith. Some of the mentioned transnational sources – in particular, the UPICC and the PECL, as well as the various products of extensive work on a European contract law that started at the beginning of the millennium, such as the Draft Common Frame of Reference (DCFR) and the proposal for a regulation on a common European sales law (CESL), both based on the PECL – solve these questions by making extensive reference to the principle of good faith; however, good faith is a legal standard that requires specification, and there does not seem to be any generally acknowledged legal standard of good faith that is sufficiently precise to be applied uniformly and irrespective of the governing law, as Sections 2.2.5(f) and 2.3.3 will show. An instrument with the task of harmonising different legal traditions must be precise and leave little to the court's discretion; otherwise, the harmonised rules are applied differently by the different countries' courts.[15]

Moreover, these instruments grant the interpreter much room for interference regarding the wording of the contract based on the central role given to the principle of good faith. This seems to contradict the very intention of the parties as it is embodied in contract practice: as seen in Chapter 1, contract practice has ambitions of being exhaustive and self-sufficient. Any correction by principles such as good faith would run counter to the expectations of the parties. In turn, this makes it difficult to see these transnational sources as an emanation of the parties' will and practice.

There are undoubtedly difficulties in determining the exact content of such a harmonised non-national law. As will be seen in the following sections, the principles that can be determined as being part of a transnational law are mainly quite vague and therefore cannot be used to decide on specific disputes of a legal–technical character.

[14] The INCOTERMS, however, do not cover all legal effects relating to the delivery: for example, they do not determine the moment when the title passes from the buyer to the seller, as pointed out by Maria C. Vettese, 'Multinational Companies and National Contracts'. In Cordero-Moss (2011), pp. 20–32, Section 2.

[15] Horst G. M. Eidenmuller, Florian Faust, Hans Christoph Grigoleit, Nils Jansen, Gerhard Wagner and Reinhard Zimmermann, 'The Common Frame of Reference for European Private Law: Policy Choices and Codification Problems'. *Oxford Journal of Legal Studies* 28.4 (2008), pp. 659–708.

Furthermore, this delocalised law is quite fragmentary, leaving many areas of a dispute uncovered.

It has been argued that the open and incomplete character of the transnational law is not a disadvantage, but a positive characteristic: by not containing specific solutions or clear criteria, the transnational law would permit an arbitral tribunal to develop solutions in a creative way, acting as a 'social engineer'.[16] The parties would delegate to the arbitral tribunal the task of developing the criteria according to which the decision will be taken. This approach exhibits a deep trust in the capability of the arbitral tribunal as a lawmaker, but it seems to disregard the criterion of predictability. As this chapter will show, transnational law lacks a framework within which arbitrators would develop their solutions – this would make the arbitrators' creative work even less predictable. Fascinating as the idea of arbitrators as social engineers may be, the prospect of having to plead in front of a tribunal that develops its own criteria for decision-making alarmingly reminds one of the position of Josef K. in Franz Kafka's dystopian novel *Der Prozess*.

To the extent that the difficulty in identifying transnational rules and their fragmentation are seen as a negative aspect of the transnational law (which, in my opinion, they should be), a remedy may be found in the abovementioned soft law sources that restate, systematise and standardise rules and principles – such as the UPICC or the PECL (which, together with the 1980 Vienna CISG, are sometimes referred to as the 'Troika'; a body of transnational law that is particularly apt for governing commercial contracts).[17] Indeed the important production of systematic soft law significantly simplifies access to principles and rules that otherwise would be difficult to assess – assuming, of course, that the sources of soft law are representative of generally acknowledged principles or usages.

Subjecting a contract to regulation by commercial practices or generally acknowledged principles or restatements thereof, however, would leave too much room for discretion, as will be seen, thus representing an uncertain ground for the solution of potential disputes.

The theory of a delocalised, transnational law seems to be based on the misconception that commercial parties desire a flexible system that the interpreter (judge or arbitrator) can adapt to their needs. Practitioners, however, emphasise that they desire a predictable legal system that can be objectively applied by the interpreter.[18] The task of adapting the contract to the specific needs of the case is a task for the

[16] Lando (1985), p. 752 and 'The Law Applicable to the Merits of the Dispute'. *Arbitration International* 2.2 (1986), p. 112.

[17] See, for example, Ole Lando, 'CISG and Its Followers: A Proposal to Adopt Some International Principles of Contract Law'. *The American Journal of Comparative Law* 53 (2005), p. 379.

[18] This position was exemplarily explained by F.A. Mann. For references, see Giuditta Cordero-Moss, 'Delocalisation and Re-Localisation in Commercial Law and the Law of Arbitration: The Continued Relevance of F.A. Mann's Thought'. In Gerhard Danneman and Jason Allen (eds.), *Legal Aspects: The Life and Legacy of F.A. Mann* (Oxford University Press, forthcoming), Section 4.

contract drafters, not for the interpreter.[19] We have seen in Chapter 1 the different approaches taken by transaction lawyers who draft the contracts, and by litigation lawyers who deal with the disputes arising out of the contracts. One of the aspects that interests litigation lawyers is the enforceability of rights (whether these are based on a contract or on an arbitral award). Also, it is extremely important that the parameters for enforceability be predictable:[20] if the criteria upon which the dispute will be decided are uncertain, it will be impossible to assess the risk connected with the dispute. How can a party embark on a costly proceeding that might last for years, without having been able to assess the risks connected with it?

2.2 Sources of Transnational Law

There is no standard definition of a delocalised, transnational law. It can be referred to as a non-national set of rules and principles that is held to apply to international contracts. The sources that are often mentioned in the international literature as a basis for such a transnational law have different places in the system:

(i) *Usages of the trade or customs* (see Section 2.2.1) are, under the traditional view, the proper content of what goes under the name of *lex mercatoria*.[21] They are a source of law to all effects and, once proven, they are binding. Statutory confirmation of the quality of customs as sources of law can be found in various national laws. Contract practice and arbitration practice – if sufficiently proven and generalised – may be seen as part of trade usages or customs.

(ii) *General principles of law* (see Section 2.2.2) are part of the law and, once established, they are applied and given effect to. There does not seem to be a consensus on the definition of these principles.[22] Generally recognised principles are usually identified by assessing a convergence among various legal

[19] For an interesting analysis of this aspect, see Willem Grosheide, 'The Duty to Deal Fairly in Commercial Contracts'. In Stefan Grundmann and Denis Mazeaud (eds.), *General Clauses and Standards in European Contract Law. Comparative Law, EC Law and Contract Law Codification* (2006), p. 201. The practitioners' reluctance to agree on the assumption that international contracts are drafted and should be interpreted outside of a domestic system of law was confirmed in Marcel Fontaine and Filip De Ly, *Drafting International Contracts* (Brill, 2006), pp. 629ff. The book is an analysis of contract terms based on the reports prepared by the Working Group on International Contracts, a group that has existed since 1975 and consists of practising lawyers who specialise in drafting, interpreting or litigating international contracts, as well as of academics. Criticising the possibility of a contract that is independent from any governing law, see also Symeonides (2006), pp. 6ff.

[20] School of International Arbitration of Queen Mary University of London, *2010 International Arbitration Survey: Choices in International Arbitration* (2010). See also the study made by Gilles Cuniberti, 'Three Theories of Lex Mercatoria'. *Columbia Journal of Transnational Law* 52 (2013); Ralf Michaels, 'Non-State Law in the Hague Principles on Choice of Law in International Commercial Contracts'. In Kai Purnhagen and Peter Rott (eds.), *Varieties of European Economic Law and Regulation: Liber Amicorum for Hans Micklitz* (Springer Verlag, 2014).

[21] Substantiating this position, see Roy Goode, Herbert Kronke and Ewan McKendrick, *Transnational Commercial Law: Texts, Cases and Materials*, 2nd ed. (Oxford University Press, 2015), paras 1.63 ff.

[22] For an overview of the various theories, see De Ly (1992), pp. 193ff.

systems, case law and scholarly works. Sometimes, general principles of public international law, often as determined in state–investor arbitration, are deemed to be a source of transnational commercial law.[23] This is quite a paradox, as principles of public international law are generally derived from a comparison of, among other things, national authoritative sources. Giving these principles the quality of sources of commercial law, gives a somewhat circular reasoning that does not always lead to reasonable results, see Section 2.2.3.

(iii) Sometimes a broader definition is used that covers, in addition to spontaneous sources, authoritative national and international sources (such as treaties and conventions) as long as they regulate international business activity.[24] An example is the CISG, see Section 2.2.4.

(iv) *Soft law* refers to sources that do not have binding force, but that are taken into consideration as long as the parties voluntarily apply them, see Sections 2.2.5 and 2.2.6. A notable source of soft law concerns the restatements of general principles of contract law (such as the UPICC or the PECL). To the extent that these restatements of principles can be deemed to reflect generally recognised principles, they will be relevant in determining the content of the general principles of law; otherwise, they will be considered for their persuasive authority. According to some, even standard contracts may be considered a source of soft law.

Some of the soft law instruments listed are extremely widely acknowledged, and after years or even decades of general use in practice, are, in some cases, deemed to have become an international trade practice, and are therefore applied even if the parties have not made reference to them (if the applicable law directs or permits the judge to apply trade usages). Others are in the process of obtaining a generalised acknowledgement and cannot be considered as customary law yet; therefore, they are applicable only to the extent that the parties have made reference to them in their agreement.

Irrespective of the degree of acknowledgement of all the abovementioned sources of transnational law, their application faces the question of the relationship with the state law that governs the transaction: is transnational law a replacement of state law, or does it integrate it – and to what extent can the state law be replaced or integrated?

These questions will be dealt with in the following sections by analysing some examples. The examples will show that transnational law is an extremely useful tool with which to integrate the law applicable to an international transaction, but it is not capable of replacing it completely, and it cannot prevail in the case of a conflict with the mandatory rules of applicable national or international rules.

[23] For example, the Trans-Lex Transnational Law Digest and Bibliography (www.trans-lex.org/) uses investment awards to substantiate numerous principles listed therein as part of the 'new *lex mercatoria*'.

[24] Lando (1985), pp. 748f.

Moreover, we will see that transnational sources are not so detailed as to provide a uniform basis for understanding principles such as that of good faith – and this in spite of the circumstance that many transnational sources attach great significance precisely to the principle of good faith: in the interpretation of contracts, in respect of contract performance as well as concerning the exercise of remedies for non-performance. There is, therefore, no harmonised standard for contract interpretation and construction in the transnational law, nor harmonised guidelines for contract performance and for the exercise of remedies.

2.2.1 Trade Usages

Trade usages are often referred to as an important source of transnational commercial law.[25] Among the most important sources of trade usages are contract practice and arbitration practice. Assessing a trade usage might be quite demanding.

In respect of the principle of good faith, which Section 3.4 will show is so important in the interpretation and performance of a contract, there does not seem to be evidence of a uniform usage that might be valid for all types of contracts on an international level or for one single type of contract.

(a) Contract Practice

As seen in Chapter 1, international contracts are often drafted without the parties bearing in mind which law will govern the contract. The clause choosing the governing law is often negotiated after the parties have agreed on all the commercial aspects of the transaction, and after the regulation of such commercial content has been drafted. Sometimes, the parties do not reach an agreement on which governing law to choose, and therefore they do not write a Choice-of-law clause in their contract. At times, the parties do not attach significant importance to the choice of the governing law and agree on the proposal of one of the parties without paying attention to the implications of that choice. At other times, the parties do not even think of the question of the governing law. In all these situations, the result is that a contract is drafted without awareness of which legal system the contract was subject to. In other words, the parties assumed that the contract represented a sufficient regulation of their relationship, that it would be enforceable without any problems in all relevant jurisdictions and that it would not be affected by rules or principles external to the contract, other than those to which the parties may have made reference (or they deliberately took the risk that the assumption was fallacious).

This may lead one to assume that international commercial contracts are autonomous and not subject to any national law. The autonomous contract would,

[25] Goode et al. (2015), para 1.64 ff., convincingly argue that trade usages are not self-validating and require external validation, usually in the form of a reference contained in the governing law.

according to this theory, be detached from domestic law and would have to be interpreted and applied autonomously in the light of its own language, non-state principles and rules of international trade. In turn, this may be perceived as a basis for a uniform contract practice, which in turn would be deemed to be a trade usage.

Two objections may be made which will be analysed in more depth in Chapters 3 and 4: first, the detachment is not full. And second, even if the detachment were full, this would not ensure that contracts are interpreted uniformly.

(i) Detached Contracts The theory of the autonomous or detached contract may, to a certain extent, be connected with the doctrine of the internationalisation of contracts entered into between foreign investors and states. These contracts prompt the necessity of restricting the state's role as a sovereign that may introduce new legislation, and thus unilaterally and unduly modify the conditions of the investment, see Section 3 of the Introduction. To avoid such abuses, the 1965 Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID) establishing the ICSID arbitration, provides, in Article 42, that the tribunal is to apply (in the absence of a choice of law made by the parties) 'the law of the host countries . . . and such rules of international law as may be applicable'. This formulation is usually interpreted to mean that the national law of the host country is to be applied inasmuch as it does not violate international law.[26] Investment agreements formalising oil investments in Libya contained governing law clauses according to this principle; following nationalisation of the investments, three arbitral proceedings were initiated and led to three different results: in the *Liamco* case, the tribunal applied Libyan law, amended with a general principle regarding the necessity of providing compensation if assets are nationalised;[27] in the *BP* case, the tribunal found that there were no principles common to both Libyan and international law, and proceeded to apply general principles of law;[28] and in the *Texaco* case, the tribunal assumed that the parties had wished to submit the agreement to public international law.[29]

This may inspire the parties also to detach from national law in commercial contracts. As will be seen in Section 2.2.3(b), however, principles and doctrines developed in the sphere of investment protection are not necessarily automatically transferrable to the sphere of commercial contracts. In the Libyan cases, the arbitrators could easily apply the well-established public international law principle about compensation on expropriation; in a commercial dispute, in contrast, the arbitrators may need to find sources on quite technical questions, such as the conditions for

[26] See Christoph Schreuer, Loretta Malintoppi, August Reinisch and Anthony Sinclair, *The ICSID Convention: A Commentary*, 2nd ed. (Cambridge University Press, 2010), Article 42, para 153 ff.
[27] *Libyan American Oil Company* v. *The Government of the Libyan Arab Republic* [1982] 62 ILR 140.
[28] *British Petroleum (Libya) Ltd* v. *The Government of the Libyan Arab Republic* [1979] 53 ILR 297.
[29] *Texaco Overseas Petroleum Company, California Asiatic Oil Company* v. *The Government of the Libyan Arab Republic*, award of 9 January 1977 [1978] 17 ILM 3.

excluding liability, or the relevance of the negotiations and the subsequent conduct of the parties in the interpretation of the contract. Section 2.2.5 will show that transnational principles are not sufficiently specific and systematic to harmonise the various laws and create a set of general principles that may govern all aspects of general contract law; Section 2.3 will show that transnational sources do not have the ability to fully replace a governing law. Hence, and as will be illustrated, commercial contracts may not be subject to 'internationalisation' and thus be able to escape from the scope of the governing law to the same extent as investment contracts may with states.

(ii) Standard Contracts The European Commission seemed to encourage, albeit for a short period,[30] standard contracts as a tool towards harmonisation of the various state contract laws.[31] It was soon realised, however, that contracts, even if they are standardised, are subject to a governing law and cannot derogate from this law's mandatory rules. Therefore, a standard contract, to be effective across the entire territory of the EU, would necessarily have to comply with the strictest of the criteria set by the various member states. This, in turn, would have prevented the standard contracts from adopting any more flexible criteria offered in other member states, hence preventing progress in contract practice. This would not have led to a seemingly desirable harmonisation.

That a contract, even a standard contract, is subject to a governing law and that the governing law's impact reaches even beyond that law's mandatory rules, is shown in Section 3.4. As will be shown in Chapter 3, national laws differ from one another in respect of how contracts are to be interpreted, and this may lead to standard contracts being interpreted differently and having different legal effects depending on the governing law (in particular, regarding the ISDA Agreement, see Section 3.4.3).

As shown in this chapter, furthermore, transnational sources do not have the ability to harmonise the general contract law and thus cannot ensure a uniform interpretation of standard contracts.

Standard contracts, therefore, do not seem to be the appropriate tool with which to harmonise commercial contract laws. Moreover, there is an abundance of standard terms issued by a large number of organisations such as the ICC; branch associations such as the ISDA, the International Federation of Consulting Engineers (FIDIC) or Orgalime; or even by commercial companies. Standard contracts prepared by FIDIC and Orgalime compete to regulate similar contractual relationships within the same branch of construction; the very fact of this competition speaks against their ability to reflect a harmonised transnational law.

[30] First Annual Progress Report on European Contract Law and the Acquis Review, COM(2005) 456 final.

[31] See *Communication from the Commission to the European Parliament and the Council – A more coherent European contract law – An action plan,* COM (2003) 68 final and *Communication from the Commission to the European Parliament and the Council – European Contract Law and the revision of the acquis: the way forward*, COM (2004) 651 final.

The wealth of documents issued by a disparity of sources creates an additional uncertainty, since it creates the risk of attaching normative value to terms written by organisations or institutions that do not act impartially.[32]

As a tool for harmonising international contract law (in the particular proposal commented upon here, EU law), it has been proposed[33] that standard contracts should be negotiated by organisations representing the involved parties. The democratic selection of the drafting parties would ensure legitimacy, and the collective character of the negotiations would ensure a balanced result that takes into account all of the involved interests.[34] In the proposal, EU enactments should give these documents the force to derogate from mandatory rules of the applicable law, thus avoiding the abovementioned prospect of having to comply with the strictest of the potentially applicable laws. This regime would indeed solve the problems of legitimacy and of compliance with the law. However, these contracts would not be immune from another major problem affecting transnational sources: the lack of a uniform standard for interpretation, as will be seen in this chapter.[35]

(iii) 'Good Commercial Practice' In the course of the EU work towards a European contract law (see Section 2.2.1(iv)), some instruments were developed: the Academic DCFR, the Acquis Principles and the CESL (see Section 2.2.5). These instruments seem to indirectly endorse the idea of an autonomous contract. They have a double approach to commercial contracts: they extend rules of consumer protection to commercial contracts (including an extensive and mandatory principle of good faith) and then moderate the effect of this extension by making a reservation for contrary good commercial practice.

As will be seen in Section 2.2.5(f), the principle of good faith is given a central role in these collections of principles, but has a content that is difficult to specify in a uniform way. Reference to good commercial practice as the only concretisation of the principle of good faith assumes that the interpreter is in a position to define good commercial practice and to assess its content. For want of better guidelines, it may be

[32] See Goode et al. (2015), paras 1.53 ff.; Symeonides (2006), p. 6, who wishes a 'check to the unbounded euphoria that seems to permeate much of the literature on the subject' of non-state norms as a source of the new *lex mercatoria.* See also Federico Cafaggi, 'Self-Regulation in European Contract Law'. In Hugh Collins (ed.), *Standard Contract Terms in Europe: A Basis for and a Challenge to European Contract Law* (Kluwer Law International, 2008), pp. 93–139, 137ff.

[33] For a suggestion to promote autonomous agreements that are not affected by the differences among the various contract laws, see Hugh Collins, 'The Freedom to Circulate Documents: Regulating Contracts in Europe'. *European Law Journal* 10.6 (2004), pp. 787–803. For an incisive analysis of how standard contract terms would not be capable of being autonomous because they are subject to, among other things, the governing law's influence in respect of the normative context and the interpretation, see Whittaker (2006).

[34] In a certain sector of Norwegian business, this practice is widespread and successful, and results in standard contracts that are known under the name of 'agreed documents'. These standard contracts have a high degree of persuasive authority, and courts tend to accept the solutions contained therein, even though they would not be acceptable in a contract negotiated between private parties: see Rt. 1994 p. 626.

[35] A similar criticism is made by Whittaker (2006), 54ff.

assumed that the sources of good commercial practice do not differ significantly from the sources of the transnational commercial law that are analysed here: trade usages, general principles and soft law. As will be seen in Section 2.3, these sources are not capable of giving a clear and harmonised picture of the transnational law of commercial contracts; hence, they do not give a clear picture of what good commercial practice is. In addition, scholarly works on the convergence of legal systems may be considered as relevant. As Section 3.3 will show, little guidance seems to be found there either.

In addition to those sources, contract practice may be given particular attention. As seen in Chapter 1, contract practice generally adopts contract models prepared on the basis of English law or at least of common law systems, which, according to the traditional conception discussed in Chapter 3, do not contemplate good faith and fair dealing as a general standard. Contract practice is, therefore, quite distant from the principles underlying the DCFR and the CESL. Even if, as will be seen in Section 3.4, the system of English law might not always allow for the effects of all contract clauses, common law contract models are clearly drafted on the assumption that the contracts shall be interpreted literally and without influence from principles such as good faith. As a consequence of the broad adoption of this contractual practice, the regulations between the parties move further and further away from the assumption of a standard of good faith and fair dealing, even in countries with legal systems that do recognise the important role of good faith.

This renders it even more difficult to specify the content of the general clause of good faith by reference to the general standard of good commercial practice.

(iv) A Uniform Contract Practice? Even evidence that certain conduct is common in a certain branch of the trade does not necessarily mean that there is a binding usage to that effect.[36]

As seen in Chapter 1, commercial contracts often contain clauses that recur in all types of transactions and present relatively constant language, the so-called boilerplate clauses such as: Entire agreement, No waiver, No oral amendments, No reliance, Liquidated damages, Sole remedy, Assignment, Representations and Warranties and several others. Their main aim is to create a self-sufficient system for the contract. The contract is meant to be interpreted solely on the basis of its terms and without reference to external elements. The purpose of these clauses is, in other words, to avoid interference by principles such as good faith and fair dealing. While each of these clauses is quite common in commercial contracts, there is no evidence that any of these clauses has specific legal effects that may be considered generally recognised on an international level. These terms are typically adopted from common law

[36] Goode et al. (2015), paras 1.64 ff., referring to *Libyan Arab Foreign Bank* v. *Bankers Trust Co* [1989] QB 728. On the establishment of uncodified usage and the *lex mercatoria*, see Roy Goode, 'Usage and Its Reception in Transnational Commercial Law'. *International & Comparative Law Quarterly* 46.1 (1997), pp. 1–36.

contract models, and, as will be seen in Chapter 3, can be incompatible with the civil law model based on good faith and fair dealing. Even within English law, and even more so within the common law legal family in general, there is not necessarily one single generally acknowledged interpretation of the scope of each of these clauses.[37] There seems to be no basis, therefore, to assume the existence of a uniform interpretation of these contract terms that could elevate them to the status of trade usages.[38]

Not only are the legal effects of these clauses not uniformly recognised, it also seems that the parties do not always consciously insert those clauses into the contract with the clear intention of obtaining certain effects. As shown by the description of the dynamics of contract drafting made in Chapter 1, parties may not even have been aware of the detailed content of the boilerplate clauses, or they may have willingly taken the risk that they would not have had the intended effects under the applicable law. This does not seem to comply with the criteria that need to be met in order to qualify a certain practice as a trade usage; namely, the requirement that the parties are convinced that that conduct is a legal obligation (*opinio juris ac necessitatis*).

Some of the strongest supporters of a spontaneous transnational law seem, over time, to have turned their back on their own earlier position and started to prefer more structured, semi-legislative instruments. This became apparent in the long-lasting process of developing a European contract law, which has so far created the publications of the DCFR.

The process was launched by a Communication from the Commission of the European Communities.[39] The Communication asked stakeholders to comment on possible ways to harmonise European contract law. Among the alternatives that were presented were a spontaneous development left to market forces and the introduction of an optional instrument: a systematic regulation of contract law that the parties could decide to opt into.

In their joint response to the Communication, the academic group defining itself as the Commission on European Contract Law (the author of the PECL, chaired by the Danish Professor Ole Lando) and its successor, the Study Group on a European Civil Code (the co-author of the DCFR), bluntly dismissed the primary source of transnational law – the spontaneous development by market forces of appropriate regulations and models – as not sufficient to bring about a uniform regulation of private law.[40] Earlier, these very parties had praised this source as the most adequate source

[37] See Peel (2011), pp. 136ff.

[38] One clause that seems to have reached a uniform interpretation, at least in the field of maritime law, is the clause 'time is of the essence', which thus transplants into civilian systems the English law formalistic power to repudiate a contract for a breach that might be immaterial: see § 348 and 375 of the 1932 Norwegian Maritime Code.

[39] Communication from the Commission to the Council and the European Parliament on European Contract Law, COM (2001) 398 final.

[40] Response to the Commission Communication by the Commission on a European Contract Law, Study Group on a European Contract Law, *Response to the Commission Communication by the Commission on*

of regulation for international commerce.[41] The PECL that represent (together with the UPICC) one of the best and most comprehensive codifications of transnational law are also dismissed with the observation that, for the moment, such a restatement cannot be reckoned to replace state law: what it lacks – in addition to a more comprehensive and detailed scope – is the legal basis for being considered as binding even when it does not comply with the mandatory rules of state laws. Hence, the joint response proposes that restatements of principles be enacted with binding force,[42] and it proposes extending the conflict rules of European private international law so as to permit choosing restatements of principles as a governing law.[43]

The same doubts as to the effectiveness of a free development by market forces as well as to the usefulness of a restatement are expressed by the ICC in its response to the Communication – the ICC was, for numerous decades, one of the most convinced supporters of the transnational law as an efficient alternative to state laws. The ICC's Department of Policy and Business Practices expresses 'concerns as to whether non-binding principles are sufficient',[44] though emphasising the importance of the Principles as a first step towards harmonisation.

2.2.2 General Principles

General principles are traditionally listed in scholarly writings as one of the important sources of transnational law that may contribute to the harmonisation of different legal traditions.[45] There does not seem to be a consensus on the definition of these principles;[46] the most recognised criteria for identifying which principles are generally recognised seem to be the reliance on a convergence among various legal systems, case law and scholarly works.

A widely appreciated paper by Lord Mustill identified, four decades ago, twenty-five principles that, in arbitration practice and the literature, were considered as being generally recognised.[47]

European Contract Law and the Study Group on a European Civil Code, ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/ cont_law/comments/5.23.pdf, p. 44, 26.

[41] See, for example, Lando (1985); 'Lex mercatoria 1985–1996'. In Åke Frändberg and Ulf Göranson (eds.), *Festskrift til Stig Strömholm* (Iustus Forlag, 1997), pp. 567ff.

[42] Response to the Commission Communication, p. 35.

[43] Response to the Commission Communication, p. 37.

[44] International Chamber of Commerce (ICC), Department of Policy and Business Practices Document 15 October 2001, *Response to the Commission Communication by the Commission on European Contract Law and the Study Group on a European Civil Code*, AH/dhh Doc. 373/416, p. 3.

[45] De Ly (1992), pp. 193ff.

[46] For an overview of the various theories see De Ly (1992), pp. 193ff. Goode et al. (2015), paras 170, 3.22, convincingly argue that their meaning and content is so uncertain that they are rarely invoked in practice.

[47] Michael Mustill, 'The New Lex Mercatoria: The First Twenty-five Years'. *Arbitration International* 4 (1988), p. 86. [4o] Mustill (1988), p. 92.

A criticism moved by Lord Mustill against the principles generally included in the *lex mercatoria*, is that several of these principles cannot be deemed to be generally recognised because they are not known in the common law system; for example, the principle prohibiting the abuse of a right and the principle requesting good faith in the pre-contractual phase.[48]

Both principles will be touched upon in Section 2.2.5(f) because they are part of the UPICC, the PECL, the DCFR and the CESL. As will be seen in Chapter 3, there are few principles in respect of good faith and fair dealing that may be considered common to the civil law and common law systems; even among civil law systems, there are considerable differences.[49]

Furthermore, according to Lord Mustill's evaluation, the principles included in the *lex mercatoria* are 'so general that they are useless'.[50] It is tempting to agree with this evaluation: principles such as *pacta sunt servanda* or *rebus sic stantibus* can hardly be of guidance when solving a dispute with specific questions of a technical–legal character. The former states the sanctity of an agreement, and the latter states that an agreement is not binding when the conditions under which it was entered into change substantially. Both principles are important fundaments of most laws, and there is no reason to criticise them. However, these principles have such a high degree of abstraction that it may be very difficult to solve a dispute simply on their basis. The sanctity of a contract, for example, assumes that a contract has been entered into; however, the principle does not contain any specific guidelines as to when and how a contract is considered as being entered into.

(a) Battle of the Forms

An example of the insufficiency of abstract principles to solve specific disputes is the so-called 'battle of the forms'. A company that produces and sells certain products may have developed a set of general conditions of sale, and endeavours to apply these conditions for each sale contract that it enters into. If the buyer of these products has developed its own general conditions of purchase, each of the parties' desire to apply its own general conditions may lead to a battle of the forms. The legal question that arises in connection with battles of forms is to be solved on the basis of the rules on the formation of contracts under the applicable law.

Broadly speaking, there are various approaches: traditionally, an acceptance has to conform to the offer; otherwise, it would be considered as a rejection of the offer and thus a counter-offer. According to this so-called mirror-image rule, therefore, in the

[48] Mustill (1988), p. 111, respectively, footnotes 85 and 87.

[49] Even Zimmermann and Whittaker, despite the observation that the principle of good faith is relevant to all or most of the doctrines of modern laws of contract, conclude that each system draws a different line between certainty and justice, Reinhard Zimmermann and Simon Whittaker (eds.), *Good Faith in European Contract Law* (Cambridge University Press, 2000), p. 678.

[50] Mustill (1988), p. 92.

eventuality that one party's offer makes reference to that party's general conditions, and the other party's acceptance makes reference to that other party's general conditions, there is no conformity between the offer and acceptance, and the response to the offer is to be considered a counter-offer. If the first party, not paying attention to the exchange of conflicting general conditions, starts performing the contract, this will be considered a tacit acceptance of the other party's counter-offer. This is the so-called 'last-shot theory', according to which the battle of the forms is won by the party who sent its conditions in last.[51]

Some legal systems contain a rule according to which, in the case of a conflicting offer and acceptance, a contract may be deemed concluded to the extent that the acceptance was in conformity with the offer, while the general conditions knock each other out to the extent that they are not in conformity with each other, so that none of them will be applicable (the so-called 'knock-out theory').[52]

The principle of *pacta sunt servanda* does not give a basis for choosing between the two approaches.

It may be interesting to point out that the battle of the forms is one example of regulation contained in the UPICC which does not represent generally recognised principles, but rules deemed to be most appropriate by the drafters (best rules, see Section 2.2.5(e)). Precisely because a comparative study shows that there are different approaches, the UPICC could not rely on a generally acknowledged principle and formulated instead what the drafters of the UPICC deemed to be the best rule: the knock-out rule, see Article 2(1)(22).

2.2.3 General Principles of Commercial Law and of Public International Law

Generally recognised principles are referred to as sources in a variety of contexts: public international law disputes between states, investment protection disputes between states and foreign investors, commercial disputes between private parties.

Sometimes, legal literature and arbitral awards refer to 'principles rooted in the good sense and common practice of the generality of the civilised nations' as one of the applicable sources in commercial arbitration. This wording is taken from Article 38 of the International Court of Justice (ICJ) statutes regarding sources of public international law to be applied in disputes between states.

The generally acknowledged principles that apply to commercial disputes, however, are not necessarily the same general principles that apply to disputes between states or between foreign investors and the host country. It is necessary to distinguish

[51] *TRW Ltd* v. *Panasonic Industry Europe GmbH* [2021] EWHC 19 (TCC). In this case, however, the parties had at the outset signed a customer file specifying that the seller's terms and conditions would apply unless the seller approved any contrary terms in writing. This wording was sufficient to displace the last-shot doctrine.

[52] See the Bürgerliches Gesetzbuch (German Civil Code) (BGB), § 154(1).

between international disputes involving public international law and those involving commercial law.

Disputes between states, and also between states and foreign investors are often, if not necessarily always, based on rules or general principles of public international law. Disputes between a foreign investor and the host state are mainly based on an alleged breach by the state of a rule of international law, be it a treaty-based standard of treatment or a customary principle. The point with these allegations is that the host state has used its sovereign powers in a manner that violates rules and principles that are binding on states. This is the only, or the most effective, defence available to a foreign investor against the host country: in the absence of rules and principles of public international law, the state would be free from any restrictions on the use of its public powers because it could pass legislation that renders legal within its territory any abusive or discriminatory act . Public international law is the dimension above national sovereignty that sets fundamental and generally recognised (or agreed to) criteria limiting the national states' otherwise unrestricted use of their respective sovereign powers.

Rules and principles of public international law are not necessarily equivalent to the rules and principles of commercial law, whether international or not. Commercial disputes mainly involve obligations of private law between private parties (or, at least, parties acting as private parties). They do not involve any use of public or sovereign powers and therefore do not require any dimension superior to the sovereign state to restrict the latter's otherwise unlimited powers. They mainly concern contractual conduct that is restricted by the contract and by the governing law. To illustrate the difference on a quite elementary level, while investment awards need to resort to public international law in order to find criteria against which it is possible to evaluate whether the state's introduction of a new law or use of administrative powers is legal, it suffices for commercial awards to look at the governing law in order to find criteria for the lawfulness of the buyer's refusal to pay the price in full or the seller's invocation of a circumstance limiting liability. For those who believe strongly in the necessity of avoiding national laws and advocate that transnational law is better for international contracts, this will be a transnational, but still commercial, law. This latter law is not national and can therefore improperly be defined as international; however, it is not the same as the international law in the proper sense. Transnational commercial law creates private law obligations and remedies between private parties: the buyer's refusal to pay the full price, the seller's invocation of the limitation of liability. It has nothing to do with the set of rules that bind the states and limit the exercise of their sovereign powers.

The most evident problems in applying public international law to commercial disputes might arise in the legal systems that adhere to the dualistic theory, according to which the rules of public international law bind the state towards other states but do not represent binding sources within that state until they are ratified or otherwise incorporated into the legal system. However, as will be seen, applying rules that are

meant to regulate the relationship among states as sources for commercial relationships may create problems quite irrespective of the traditional divide between the dualistic and the monistic theory, the latter of which considers public international law as a part of the domestic legal system without the necessity of specific legislation.

For this reason, it may be difficult to apply principles of public international law to commercial contracts, see Section 2.2.3(b), and vice versa: it may be difficult to apply principles of state law in the context of public international law, see Section 2.2.5(d). However, such cross-fertilisation is not excluded, see Section 2.2.3(a).

The uncertain definition of the term 'international' in respect of international commercial law leads sometimes to a cross-fertilisation with institutions of public international law. In turn, public international law is subject to considerable fragmentation.

Fragmentation is a term used to describe a situation in which different branches of public international law exist as if they were self-contained regimes – they develop on the basis of their own assumptions, without necessarily reflecting the fact that they are a part of the larger system of public international law.[53] As a consequence of fragmentation, public international law, which was originally and at least in principle a unitary system of law, may consist of separate regimes. This raises the question of whether it would be possible or advisable to cross-fertilise among these self-contained regimes, or even between regimes outside of the public international law. Could principles, values and mechanisms that have been developed under one regime be useful to another regime? And could they travel across the divide between commercial and public international law?

In the following sections, I will discuss two branches of the law to illustrate the advisability of cross-fertilisation in the first case study, and its inadvisability in the second. This shows that there is no single correct answer to this debate.

Firstly, I will examine international administrative law.

Subsequently, I will discuss international commercial law, to demonstrate the pitfalls that exist in considering international commercial law as part of the public international law system, as it sometimes is.

(a) An Example of Cross-Fertilisation: International Administrative Law

Not only are there different regimes within public international law, there are also different courts, which enhances the impression that the various regimes are indeed separate and self-contained.

[53] The literature on fragmentation is wide. See, for example, the Report of the Study Group of the International Law Commission, *Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law* (2006a), https://legal.un.org/ilc/documentation/english/a_cn4_l702.pdf, as well as *Conclusions of the work of the Study Group on the Fragmentation of International Law: Difficulties arising from the Diversification and Expansion of International Law* (2006b), https://legal.un.org/ilc/texts/instruments/english/draft_articles/1_9_2006.pdf.

Until 2020, for some years I was a judge at, and served as the President of, the Administrative Tribunal of the European Bank for Reconstruction and Development (EBRD). I will draw upon that experience to show how cross-fertilisation can sometimes be useful.

By way of introduction, the EBRD was founded at the beginning of the 1990s pursuant to the changes that occurred in the aftermath of the collapse of the Soviet Union. Following this historically important event, an international bank was established, similar to the World Bank, but with the purpose of aiding the reconstruction and development of the former Soviet Union.

International organisations have many different kinds of immunity. The Headquarters Agreement of the EBRD, which is one of the documents that established the EBRD, is an agreement between the EBRD and the United Kingdom, where the seat of the EBRD is located. Article 4 of this agreement lays down that the EBRD, as an international organisation, has immunity from judicial proceedings within the scope of its official activities. There are some exceptions, but they are not relevant to the topic at hand.

The Bank may need immunity to enhance its functioning as an international organisation, which is desirable. However, there is a flip side. Among other things, immunity means that the employees of the Bank who have a claim against it in connection with their employment may not initiate court proceedings against the Bank. However, under the European Convention on Human Rights, Article 6, everyone is entitled to a fair and public hearing. This exists side-by-side with immunity. To reconcile this contradiction, the solution lies in the establishment of an international administrative tribunal. Similar international administrative tribunals have been established by international organisations such as the World Bank, the United Nations, the International Monetary Fund (IMF), the International Labour Organization (ILO) and many others. The EBRD also has an international administrative tribunal.

These tribunals decide disputes between the employees of the international organisation and the international organisation itself. An employee who has a claim against the EBRD cannot go to court due to the immunity the Bank enjoys. Nonetheless, employees have a human right to access a court. An international administrative tribunal is a special-purpose, international court that permits access to justice, while at the same time respecting the immunity of the Bank.

The EBRD Administrative Tribunal is part of the Bank's internal justice system, which in turn consists of a complex set of rules on internal administrative review procedures and appeals.[54] Among other things, there is a directive contained in Section 2.01 of the appeals process entitled 'Right of Appeal', which provides that a staff member may submit to the Tribunal an appeal against an administrative decision. What is important to note here is that the Administrative Tribunal exists

[54] Available at www.ebrd.com/downloads/integrity/appeals.pdf.

for a staff member or a former staff member: one must be an employee for the purpose of presenting a claim before the Administrative Tribunal, a point to which I will shortly return. Additionally, there are rules on the law applicable by the Administrative Tribunal. In considering an appeal, the Tribunal shall base its decision on the provision of the staff members' contract of employment, the internal law of the Bank and generally recognised principles of international administrative law.[55] In sum, these are the sources that are applied by the Administrative Tribunal.

Our first case study is based on a decision taken by the Administrative Tribunal in 2019.[56] This is a decision that was taken when I was the Chair of the panel, which consisted of three judges. The decision on this appeal was taken against the background of a series of previous decisions. In brief, there was an individual who had been working for the EBRD for many years, not as a formal employee but as an independent consultant. He was an IT consultant who had established his own company for the sole purpose of supplying his consultancy services. This company had entered into a contract with an agent, and the agent had entered into a contract with the EBRD. There was no agreement of employment between the Bank and the consultant. However, he worked full-time rendering services to the EBRD for many years. He was subject to instructions by the Bank and was treated as if he were an employee, despite not formally being one. Therefore, when he was informed that his consultancy contract would be terminated, he expected to be treated as an employee and receive severance pay. The Bank claimed that he was not an employee and was thus not entitled to severance, to which he responded that he was a de facto employee: not in form, but in fact.

The question which then arose was whether the Administrative Tribunal had jurisdiction in such a situation. The power of the Tribunal is limited to hearing appeals submitted by staff members. The contract between the appellant and the Bank stated: 'Nothing contained in these conditions or in the contract shall be construed as establishing or creating any relationship other than that of independent contractor between the bank and the agent.' There was no formal employment agreement. The question was whether the appeal was admissible, given that under the directive on appeals, the tribunal only has jurisdiction when the appellant is a staff member.

The tribunal then had to decide if it should rely on form and focus on whether the appellant was formally an employee, or whether it should rely on substance, and examine the underlying reality. This is a very controversial question in international administrative law in general, and within the Administrative Tribunal of the EBRD in particular. There were several cases on this question, all of which raised dissent because there was no unitary understanding of the law in this area.

[55] Article 3.02 of the Directive on Appeals Process.
[56] Case EBRDAT 2019/AT/06, available at www.ebrd.com/who-we-are/corporate-governance/administrative-tribunal.html.

In the case at hand, the Tribunal had in a previous decision determined that it falls within its jurisdiction to evaluate whether the appellant was a staff member or not.[57] The decision that will now be examined began by recalling the abovementioned controversial issue of jurisdiction, and then dwelled on the law applicable to the substance in this case. As already mentioned, the constituent documents of the Administrative Tribunal specify which law shall be applied: the staff members' contract of employment, the internal law of the Bank (which comprises the staff regulations and the Bank's administrative practice) and the generally recognised principles of international administrative law. It is in connection with this last issue, the generally recognised principles, that the notion of cross-fertilisation could be very useful.

After having looked at the contract and the internal law of the Bank, the Tribunal considered the generally recognised principles of international administrative law: not of *public* international law in general, but, more specifically, of international *administrative* law. Here, international administrative law could either be seen as a self-contained regime, with its own generally recognised principles which are completely isolated from the rest of public international law, or it could be seen as a constituent unit of public international law. The decision stated that it is possible to draw a parallel between generally recognised principles in public international law and generally recognised principles in international administrative law. The Article on the applicability by the Tribunal of generally recognised principles can be seen as a parallel of Article 38 of the statute of the ICJ, which lists the sources of public international law. Therefore, whatever is found in the literature and case law relating to the principles of public international law, and particularly to the method for determining whether a principle can be deemed to be a generally recognised principle, can be applied analogically to international administrative law, to the extent that these two regimes are compatible.

There is, however, no automatic correlation. It must be ascertained what the principles are that have been developed in connection with public international law, and whether they can be applied correspondingly in international administrative law. Therefore, we need a mechanism for understanding how Article 38 of the ICJ is to be interpreted.

The decision went on to examine what at the time was the latest source available on this issue: the First Report on General Principles of Law, adopted by the 71st session of the International Law Commission in 2019.[58] According to the Report, generally recognised principles can be principles that are formed within the international legal system, or they can be principles derived from national legal systems. This distinction was followed

[57] Case EBRDAT 2018/AT/02, available at www.ebrd.com/who-we-are/corporate-governance/administrative-tribunal.html.

[58] International Law Commission (ILC), *First Report on General Principles of Law*, adopted at the Commission's 71st session of 29 April–7 June and 8 July–9 August 2019 (2019).

in the decision. Principles that are formed within the international legal system include treaties, customs and jurisprudence from other comparable international courts.

Another point of discussion is what would be deemed as comparable international courts. In the jurisprudence of international administrative tribunals, it is case law from other administrative tribunals that is routinely referred to. International administrative law is therefore treated as if it were a self-contained, completely isolated system. The jurisprudence of other administrative tribunals is, of course, important; however, that does not mean that the jurisprudence of other international courts would be completely irrelevant. There is no jurisprudence directly on this point; however, a comparable international court could be the European Court of Human Rights (ECHR), or any other court to the extent that its decisions correspond to interests that are also present in the case at hand.

As previously alluded to, in the case law of international administrative tribunals in general, and of the Administrative Tribunal of the EBRD in particular, there are broadly two approaches, which I designate as the 'formal approach' and 'substance approach'. The former is the approach that looks at the label given to the legal relationship in the contract. If the contract denies that there is an employment agreement, the appellant would not be deemed a staff member. This approach prevails in the practice of international administrative tribunals.[59] The latter approach would look beyond the fact that the contract states that there is no employment agreement and examine the reality of the situation more closely. The decisions of international administrative tribunals have predominantly adopted the 'formal approach', but there are a few that have adopted the 'substance approach' as well.[60]

The other source of generally recognised principles relies, as just seen, on national legal systems – that is, principles existing within a sufficiently large number of national legal systems to be relevant on an international level.

It is important to note that it is not sufficient to count the number of legal systems that have one approach and to call them 'generally recognised' as an international principle. It must also be ascertained whether these principles can be applied at the international level. Transposing national principles to international law means that the values that underlie a regulation that is common to numerous national systems is elevated to the level of international law. In order to transpose a principle, it is necessary to make sure that it is adequate, so that it is a principle that reasonably can also be elevated to the level of international law.

These principles can be found in the national administrative law, civil service law or labour law, and this is what the decision did. The decision looked at general labour law and found a principle according to which the employer shall not abuse its position and deprive the employee of employee protection. This was a principle found in a plurality of systems. The decision considered a recent comparative research of labour law in

[59] ILOAT 4045, ILOAT 3459, ILOAT 3551, ILOAT 67, UNAT 233, IMFAT 1999–1.
[60] ILOAT 701, ADBAT 24, WBAT 215, ILOAT 122, EBRDAT 2018/AT/02.

Europe.[61] On the basis of a comparative exercise, the research concluded that there is a principle according to which there must be 'primacy of the facts'. So, it's the substantive approach, and not the formal approach, which prevails.

The substance is, therefore, a restriction to the freedom of contract. It is not acceptable to simply rely blindly on what is written in the contract. It is necessary to consider what the substance is: what the facts show, in spite of what the form affirms. This is what comes as a result of a comparative exercise in the European law and in the US case law – formal circumstances cannot shield from employer liability. It is less clear in the United States than in Europe, but there are references in the case law decisions showing that.[62] On this basis, it was concluded that there is, in a sufficiently large number of legal systems, the principle of the 'primacy of the facts'.

The next step is to find out whether this principle can be elevated to the international level: whether there is a transposability. The decision makes this assessment on the basis of a balancing of the conflicting interests in the national sphere and in the international sphere.

In the national sphere, the conflicting interests are, on the one hand: the free exercise of entrepreneurial autonomy, as well as the freedom of contract; and, on the other hand: the protection of the weaker party. For example, the employee or the person who is doing the work may be forced by the circumstances to accept some terms of contract that they would never have accepted if they had had a stronger bargaining power. In the national sphere, the balancing of these conflicting interests is generally resolved with the principle of the primacy of the facts.

At the international level, the conflicting principles would be the managerial discretion of the organisation on one hand, and the principle of avoiding abuse of power on the other.

Having seen that these two principles must be balanced also in the international sphere, it is possible to transpose the solution that is found at the national level to the international level. This exercise shows that there is a general principle that is also applicable in an international context.

The conclusion in the decision was that, on the one hand, there is a presumption in favour of the wording of the contract; on the other hand, and exceptionally, the wording of the contract may be disregarded to privilege the substance. However, the threshold for disregarding the terms of the contract is very high, and it assumes that there is no functional justification for the arrangement that has been made, that the organisation is abusing its power and depriving the employee of its protection, or that there is a very clear divergence between the situation in fact and the contractual regulation.

[61] Wolfgang Portmann, Bernd Waas and Guus Heerma van Voss, *Restatement of Labour Law in Europe*, Volume I (Hart Publishing, 2017) (see 'The Concept of Employee').

[62] *Browning-Ferris Industries of California, Inc., d/b/a BFI Newby Island Recyclery* and *FPR-II, LLC, d/b/a Leadpoint Business Services* and *Sanitary Truck Drivers and Helpers Local 350, International Brotherhood of Teamsters*, 362 NLRB 1599 (2015).

In this case, the outcome of the decision was negative for the employee. The abovementioned reasoning was meant to confirm the power of the Tribunal to decide on whether there is, in the particular situation, an employment relationship in spite of the fact that there is no formal employment contract. If there is a de facto employment relationship, the appellant qualifies as an employee and has access to the Bank's internal justice system. If there is no de facto employment relationship, the appellant does not qualify as an employee, and the Tribunal does not have jurisdiction on the dispute. The abovementioned reasoning, therefore, was necessary to legitimate the Administrative Tribunal's jurisdiction on this issue. In the specific case, the Administrative Tribunal found that there was no employment relationship, and that therefore the appeal had to be dismissed.

There is, of course, a difference between affirming, in theory, the power to decide on a certain issue, and deciding the merits of the particular case. In this particular case, the appellant was not an employee, and this led to the dismissal of the appeal. The conclusion by the panel was unanimous, but there were two concurring opinions. All judges agreed on the conclusion that the appellant was not an employee, and that therefore the Tribunal had no jurisdiction. However, the two concurring judges did not agree on the necessity to carry out the abovementioned reasoning and to verify whether the appellant was a de facto employee. They considered the reasoning about generally recognised principles to be irrelevant and looked at the international administrative law as a self-contained legal system that only needs to regard case law by international administrative tribunals. Consequently, in the view of the concurring judges, there was no room for cross-fertilisation between the public international law and the administrative law.

(b) An Example of Fragmentation: Unilateral State Declarations and Contract Law

An example of cross-fertilisation between public international law and international commercial law that is not feasible can be found in a well-known digest of principles of transnational commercial law: Trans-Lex, see Section 2.2.5(g).

The digest affirms that the principle of good faith is an important part of the transnational commercial law, and it refers to various sources upon which the principle of good faith relies. Of particular relevance here is that, among the court decisions invoked as a source of the principle of good faith for commercial contracts, there are some decisions of the ICJ.

Among the ICJ decisions listed as the source for the principle of good faith in commercial contracts, the digest mentions the decision taken in *Nuclear Tests (Australia* v. *France)*.[63] This decision is rendered in connection with Australia's

[63] [1974], Judgment, ICJ Reports, p. 253, 267ff., available at www.trans-lex.org/380700/mark_901000/nuclear-tests-judgment-icj-reports-1974-p-253-et-seq/#toc_0.

reaction against France carrying out nuclear tests in the South Pacific in spite of having made declarations that it would not do so.

In the part of the decision that the Trans-Lex emphasises as relevant, the ICJ analyses whether unilateral declarations made by a state with the intention of being bound are binding on it. The Court observes that one of the basic principles governing legal obligations is that of good faith and continues by affirming that ' [j]ust as the very rule of *pacta sunt servanda* in the law of treaties is based on good faith, so also is the binding character of an international obligation assumed by unilateral declaration'.

The ICJ decision in *Nuclear Tests (Australia* v. *France)* is a decision rendered by a court of public international law and deals with public international law obligations between states. If it extended its relevance to commercial contracts, it would mean that, as a general principle of international law stated by the ICJ, a private party making a commercial offer to another private party is bound by that offer, particularly if the offer is presented as irrevocable. As will be seen, this may create some difficulties.

Unilateral declarations do not always have a binding character in contract law. Among other legal systems, English law does not generally consider unilateral promises to be enforceable. As will be seen in Sections 2.3.2(b), 3.6.1 and 3.6.2, the English law of contract has an additional requirement for considering a promise as enforceable: the requirement for consideration. This requirement can be briefly described as the necessity that both parties have reciprocal benefits and detriments. In the absence of mutual benefit and detriment, a unilateral promise that gives benefit only to the promisee and detriment only to the promisor would be unenforceable. In most typical contracts, the consideration is identified through the price: in a sale agreement, for example, the seller promises to sell the thing (thereby creating for itself the detriment of depriving itself of the thing, and the benefit for the buyer of taking over the thing), and the buyer promises to pay the price (thereby creating for itself the detriment of paying the price, and for the seller the benefit of the transfer of the money).

Following this, the English law of contracts does not consider a unilateral offer as binding, not even if the offer, by its own terms, is irrevocable for a certain period: it is necessary to have consideration, otherwise the promise to keep the offer firm is not enforceable.[64]

How can the unenforceability of irrevocable offers in the English law of contracts be reconciled with the ICJ's clear statement that unilateral declarations are a sufficient source of binding obligations? Is the English rule of consideration in contrast with the principle of good faith in public international law? Could a case be brought against England in the ICJ because English contract law violates public international law? Could a private party be considered liable for a breach of its obligations contained in

[64] *Offord* v. *Davies* [1862] 12 CBNS 748.

an irrevocable offer, notwithstanding that the offer is not binding under the (English) law governing it?

It seems quite evident that English contract law does not violate the basic principles of public international law. It simply has a different scope of application. It does not relate to obligations between states or to unilateral declarations by a state not to carry out atmospheric nuclear explosions off the coast of another state. Similarly, the ICJ was not aiming at creating a precedent for the regulation of commercial offers between private parties.

That the words 'good faith' or 'binding unilateral declaration' may be used both in public international law and in commercial law does not justify the conclusion that they have the same assumptions, functions and meaning in both spheres. Accordingly, the concepts are not interchangeable.

In summary, generally acknowledged principles of public international law are not necessarily capable of creating obligations between private parties and do not represent, therefore, a source of harmonised transnational commercial law.

2.2.4 The CISG

Among the sources of international commercial law reference is often made to the United Nations Convention on Contracts for the International Sale of Goods (CISG). The CISG is a treaty binding ninety-five states.[65] It is an example of uniform law, as it obliges member states to regulate international sales in accordance with the Convention.

The CISG was drafted by the United Nations Commission on International Trade Law (UNCITRAL) and adopted in Vienna in 1980.[66] It is based on two previous attempts to achieve a uniform law on international sales: the conventions relating to the Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF) and to the Uniform Law on the International Sale of Goods (ULIS), both adopted in the Hague in 1964. These two predecessors of the CISG did not obtain widespread success, among other reasons, because their provisions were said to primarily reflect the legal traditions and economic situation of Western Europe. Western Europe was also the region that had been most active in the drafting of the conventions, thus enhancing the impression that these instruments expressed the interests of a certain part of the world. In 1968, the UNCITRAL was given the task of elaborating these two conventions into a text that could enjoy broader support. After having involved states from every geographical region in the process, the UNCITRAL presented the CISG as an elaboration

[65] The updated status can be found at https://uncitral.un.org/en/texts/salegoods/conventions/sale_of_goods/cisg/status.

[66] The full text can be found on the UNCITRAL homepage, https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-09951_e_ebook.pdf, which also contains an updated list of the countries that have ratified it, the reservations that were made, and other items.

of its two predecessors, with modifications that rendered it acceptable to states with different legal, economic and social backgrounds.[67]

The CISG is looked upon with extreme interest, especially in academic circles,[68] and it is praised as the first example of a uniform law that not only creates binding law as an international convention that is ratified by so many states, but as one that gives recognition to the spontaneous rules born out of commercial practice.[69] Furthermore, it is praised as itself becoming an autonomous body of international regulation that adapts to the changing circumstances independently from the legal systems of the ratifying states.[70]

The CISG covers the formation of contracts and the substantive rights and obligations of the buyer and the seller arising out of a contract of sale, such as delivery, conformity of the goods, payment and remedies for breach of the related obligations. It has been suggested[71] that the CISG, together with the UPICC and the PECL, constitute a Troika of transnational law – giving the CISG effects even beyond the scope of its scope of application.

In my opinion, it is not possible to assume a complete coincidence among these instruments, see Section 2.2.5(c). Furthermore, it can be questioned whether the success of an authoritative instrument such as a convention can transform the instrument into soft law that is applicable even without it having been ratified.

The genesis of the CISG and the ideals that inspired it actually confirm that the goal of the Convention is to provide a 'universal' treatment for the most important type of contract within international trade, thus eliminating the barriers to international business that might arise as a consequence of different national regulations. The actual success of the CISG slightly contradicts the universality of its goals,[72] since the number of states that ratified it (95) is not overwhelming compared to other conventions (the New York Convention on arbitration has been ratified by 170 states) and taking into consideration that a state that is of paramount importance within international trade and international commercial law, the UK, has not ratified it. Moreover, Article 6 of the CISG gives the parties the possibility of excluding the

[67] See the Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Contracts for the International Sale of Goods, p. 33. The Note can be found at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-09951_e_ebook.pdf.

[68] See, for example, Bernard Audit, 'The Vienna Sales Convention and the Lex Mercatoria'. In Thomas E. Carbonneau (ed.), *Lex Mercatoria and Arbitration* (Juris Publishing, 1990), pp. 139–60. For a thorough analysis of the enormous impact of the CISG on scholars, see Franco Ferrari (ed.), *The CISG and Its Impact on National Legal Systems* (Sellier European Law Publishers, 2008), pp. 436ff. Ferrari also shows, however, that the level of awareness about the CISG in the business community and among practising lawyers is strikingly low, see pp. 421ff.

[69] This is because of the Convention's reference to trade usages in Article 8.

[70] This is because of the particular rules on the Convention's interpretation laid down in Article 7, which require an autonomous interpretation based on the principles underlying the Convention. On the opinion that the CISG is so widely recognised that it is applicable even without having been ratified, see below in this section.

[71] See, for example, Lando (2005). See also the UNCITRAL, UNIDROIT and HCCH *Tripartite Legal Guide to Uniform Legal Instruments in the Area of International Commercial Contracts (with a focus on sales)* (2021).

[72] This reservation is expressed by McKendrick (2006), p. 6.

applicability of the Convention. This possibility to be able to opt out of the CISG is taken advantage of quite frequently, especially when one of the parties is from the United States.[73]

There are good reasons for questioning the appropriateness of an approach that extends the applicability of international conventions beyond their scope of application:[74] a convention is a binding instrument and is the result of careful negotiations that reflect the extent to which the various states are willing to be bound. The negotiations on the text of a convention sometimes result in wording that is so general or unclear that it can be interpreted as permitting each of the conflicting positions to be supported during the negotiations.[75] In other situations, and perhaps more openly admitting the impossibility of reaching an agreement, conventions may be silent on certain aspects of the matter that they regulate.[76] In yet other situations, they may make open reference to the applicable national law for supplementing or regulating specific aspects.[77] Sometimes conventions permit the ratifying states to make reservations against the applicability of certain rules in the convention.[78] Conventions also contain a detailed description of their scope of application, both territorially[79] and in respect of the subject matter.[80]

All these, and many others, are techniques that are used to obtain a commitment by the ratifying states to at least the minimum regulation that is contained in the

[73] Spagnolo (2010). For a thorough analysis of the exclusion of the CISG, see Ingeborg Schwenzer, Pascal Hachem and Christopher Kee, *Global Sales and Contract Law* (Oxford University Press, 2012), paras 5.17ff.

[74] See Goode et al. (2015), para 1.68, criticising the ICC Award No 5713 of 1989, which applied the CISG as if it was a directly applicable source of transnational law, in spite of the circumstance that the Convention had not been ratified by any of the states involved and without giving regard to the applicable law.

[75] See, for example, Article 4 of the Rome Convention on the Law Applicable to Contractual Obligations (now replaced by the Rome I Regulation), which was interpreted differently by courts belonging to different legal traditions: see Section 4.4(a).

[76] An example is the matter of overdue interest that could not be regulated in detail in the CISG; see for an extensive explanation Goode et al. (2015), paras 8.78 ff. and 16.43 ff.

[77] For example, the CISG refers in Article 28 to national law to determine whether the remedy of specific performance is applicable.

[78] For example, the CISG allows the ratifying states to make reservations against the application of parts of the Convention. The Scandinavian countries, for example, have excluded the applicability of the Vienna Convention to inter-Scandinavian contracts (the so-called Article 94 reservation). Several countries (also including Argentina, Chile, China, Russia and Ukraine) have reserved against the provisions that permit contracts to be created, modified or terminated by other means than in writing (the so-called Article 96 reservation). These and other reservations render the application of the Vienna Convention less uniform than would have been desirable for a uniform law, even among countries that have ratified it (for a full list of the reservations and of the states that have made them, see www.uncitral.org).

[79] For example, the Rome Convention on the Law Applicable to Contractual Obligations (now converted into the Rome I Regulation) is universal and is applied even in relationships where the other party's country has not ratified it, whereas the Lugano Convention on Jurisdiction and the Recognition and Enforcement of Judgements in Civil and Commercial Matters assumes that both involved countries have ratified it, at least the part regarding the enforcement of judgments.

[80] For example, the CISG applies only to contracts of sale, and not to all contracts of sale; its scope of application is specified in Article 2.

convention. A state, for example, may be willing to commit to a convention only if its reservation against the application of a certain rule is accepted. If a state is not willing to commit to a convention, notwithstanding the possibility of reserving against the application of certain rules, it does not ratify it – and the convention will not become binding for that state. How can all these restrictions be disregarded simply by stating that, because some states ratified a convention, the principles underlying that convention are to be considered transnational rules that may be applied beyond their precise scope of application? Would this mean that the whole convention is to be considered transnational law and therefore binding, notwithstanding that a state has made certain reservations or has decided not to ratify it? What, then, is the effect of making the reservations or not ratifying?

This reasoning applies to conventions that intend to create uniform legislation, mainly within the area of private law or other areas within the states' power of legislation. The purpose of these conventions is to align the legislation of its signatory states in the relevant area. These conventions, therefore, have effects within the scope of the states' sovereignty, and depend on states' sovereignty to become effective.

The reasoning may be different in respect of conventions that create rights and obligations among states. Principles of public international law do not necessarily depend on states' sovereignty to become effective, and it cannot be excluded that such principles may be created without the intervention of a particular state. Within the field of public international law it is conceivable that the text of a convention that has not been ratified receives such recognition that it can be deemed to reflect generally acknowledged principles.[81] The fact that a number of states, having ratified the convention, are bound by the rights and obligations contained therein, creates an expectation about the conduct of these states that may be extended to the conduct of other states that have not ratified the convention.

In addition to these systemic objections to the applicability of a convention beyond its scope, there are situations where the convention – having been drafted for the purpose of regulating a certain specific area – presents lacunae or refers to the national governing law. The CISG refers to national law in a series of respects: validity of the contract and effects of the sale on property (Article 4), gaps in the convention (Article 7), specific performance (Article 28), industrial property claims (Article 42), payment modalities (Article 54), retention's effects towards third parties (Article 71) and calculation of interest (Article 78).

An ICC arbitral award[82] illustrates a case of a lacuna. The dispute was between a Korean seller and a buyer from Jordan. The seller was to issue a performance guarantee, and the buyer was to open a letter of credit for the payment of the goods;

[81] For example, the United Nations Convention on Jurisdictional Immunities of States and Their Property of 2004 has not yet entered into force, but the Norwegian Ministry of Foreign Affairs explains that it reflects customary international, as well as Norwegian law: St.prp.nr. 33 (2005–2006).

[82] ICC Award made in Case No 6149 of 1990, in ICCA, *Yearbook Commercial Arbitration XX* (Kluwer International, 1995), pp. 41ff.

the buyer also had to issue a performance guarantee in favour of the final buyer of the goods, an Iraqi buyer. Due to several delays, the delivery was rescheduled and the duration of the letter of credit was extended; a dispute then arose regarding whether the actual delivery was delayed in respect of the extensions, and whether payment was due under the guarantees. The claimant asked the arbitral tribunal to solve the dispute by applying the transnational law, in this case defined as *lex mercatoria*, and affirmed that in that case the *lex mercatoria* was to be deemed equal to the CISG. The arbitral tribunal first noticed that the applicability of the *lex mercatoria* was not undisputed. However, assuming that in that case the *lex mercatoria* could be identified with the CISG, it would have been impossible to solve the dispute on that basis. The tribunal noticed that in that dispute it might be necessary to evaluate situations such as the unjust enrichment or limitation of rights, which are not regulated by the CISG. Therefore, the tribunal decided to apply choice-of-law rules for the purpose of identifying the national governing law and resolved to apply Korean law to the dispute.

2.2.5 The Principles of International Commercial Contracts (UPICC) and the Principles of European Contract Law (PECL)

A trend of the last few decades has been the attempt to achieve harmonisation of legal traditions by creating sources of soft law that address general contract law.

(a) The UPICC and the PECL

Two prominent examples are the UPICC[83] and the PECL.[84] The UPICC were published first in 1994 by the UNIDROIT, an international organisation established in 1926 with the purpose of unifying private law. The work on the UPICC had started in 1981, in a working group under the direction of the Italian professor, Michael Bonell. A second edition was published in 2004, a third in 2010 and a fourth in 2016.[85]

The PECL were published in three volumes, between 1995 and 2002, by the so-called Commission on European Contract Law, a group of academics established in 1982 under the leadership of the Danish professor, Ole Lando. The work on the PECL proceeded largely in parallel with the work on the UPICC, and many members of one working group were also members of the other.

[83] UNIDROIT Principles of International Commercial Contracts, 4th ed. (2016), www.unidroit.org/instruments/commercial-contracts/unidroit-principles-2016/.

[84] Ole Lando and Hugh Beale (eds.), *Principles of European Contract Law: Parts I and II* (Kluwer Law International, 2002); Ole Lando, Andre Prum, Eric Clive and Reinhard Zimmermann (eds.), *Principles of European Contract Law: Part III* (Kluwer Law International, 2003).

[85] On the fourth editions, see Cordero-Moss (2020d).

As a result of the partial overlap in these academic groups, the content, structure and terminology of these two collections of principles are largely similar to each other, with certain key differences that will be highlighted.

A significant difference between the PECL and the UPICC is that the UPICC have no specific territorial scope and apply to any international contract, whereas the PECL have defined Europe as their scope of application. This has prompted higher goals for the PECL: in addition to aspiring to the status of a source of soft law, as described, the PECL aspire to become the prevailing (on a long-term basis, binding) contract law within the EU and to replace the national laws that exist in every state today. The PECL have actually been used as a basis for an extensive work on a European contract law. The work was initiated at the beginning of this millennium,[86] and in 2004,[87] the European Commission entrusted a joint network on European Private Law with the preparation of a proposal for a Common Frame of Reference (CFR). The CFR was intended to be a toolbox for the Community legislator: it could be used as a set of non-binding guidelines by lawmakers at the Community level as a common source of inspiration, or for reference in the law-making process. It was intended to be a set of definitions, general principles and model rules in the field of contract law, to be derived from a variety of sources – such as a systematisation of the existing EU law and a comparative analysis of the member states' laws. The Study Group on a European Civil Code and the Research Group on the Existing EC Private Law[88] jointly used the PECL as a basis for a Draft Common Frame of Reference (DCFR) that was finalised at the end of 2008.[89] The DCFR is subject to debate, both by politicians[90] and scholars,[91] and is referred to as 'academic', to underline that it is the result of the work of two academic groups and is not to be confused with what will be the final result of the European political process.

Another project of the Commission was the Common European Sales Law (CESL), contained in a proposal for a Regulation dated 11 October 2011.[92] This was meant to be an optional instrument that should have applied only if the parties expressly agreed on its application. The CESL was meant to apply to contracts between businesses and

[86] Resolution of the European Parliament on the Annual Legislative Programme of March 16, 2000, 29/12/2000, OJ C 377, p. 323.

[87] Communication from the European Commission to the European Parliament and the Council 'European Contract Law and the Revision of the Acquis: The Way Forward', COM (2004) 651 final.

[88] The Acquis Group also published the Acquis Principles, a systematisation of the existing European law: Research Group on the Existing EC Private Law (Acquis Group), Principles of the Existing EC Contract Law (Acquis Principles) – Contract II: General Provisions, Delivery of Goods, Package Travel and Payment Services (Sellier European Law Publishers, 2009).

[89] Christian von Bar, Eric M. Clive and Hans Schulte-Nölke (eds.), *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR)* (Sellier European Law Publishers, 2009).

[90] *Discussion on the topic of the Common Frame of Reference (CFR) in the Council of the European Union, initiated by the Presidency on 28 July 2008*, 8286/08JUSTCIV 68 CONSOM 39.

[91] Eidenmüller et al. (2008); Nils Jansen and Reinhard Zimmermann, '"A European Civil Code in All But Name": Discussing the Nature and Purposes of the Draft Common Frame of Reference'. *The Cambridge Law Journal* 69.1 (2010).

[92] COM (2011) 635 final.

consumers, as well as to contracts between businesses and small- and medium-sized enterprises. Additionally, the CESL was, like the Academic DCFR, largely based on the PECL. However, the CESL was abandoned. Today, the EU work on contract law has lost the ambition of creating an EU general contract law.[93]

Depending on the development of these processes, the PECL may become the basis of a European body of rules that eventually may be subject to interpretation or application by the European Court of Justice (ECJ). In such a case, over time, a coherent body of case law would be formed, and the content of the general clauses contained in these instruments would be easier to determine. As long as there is no centralised court creating a uniform jurisprudence, it will be difficult to have a harmonised interpretation of these instruments, as Section 2.2.5(f) will show.

Both the UPICC and the PECL are structured and drafted as a codification of contract law, not very different from the civil codes adopted in civil law countries such as Germany, France and Italy, or the US's Restatements of the Law. They consist of a set of Articles, so-called black letter rules, which are provisions written in the form of legislative text. Each Article is accompanied by a Comment, giving information and explanations such as the Article's background, function, application and practical illustrations.

Neither the PECL nor the UPICC are international conventions, nor do they have a binding effect. They are meant to systematically formulate the main rules prevailing in the field of cross-border contracts in a way that may be interpreted and applied equally in all countries where they are applied. They are not merely a record of existing practices: they are, in part, a codification of generally adopted principles of international contracts and, in part, new rules ('best solutions') developed by a large group of experts from around the world, see Section 2.2.5(e).

As the outcome of the work is not binding, and conflicting mandatory rules or principles of the governing law prevail, the working group could agree to rules and formulations more easily than if it were drafting a convention destined to become binding. Moreover, the work did not require unanimity, and controversial matters could be regulated more easily than if a large consensus was expected – as happens when drafting a convention. These two aspects rendered it easier to codify the 'best rules' in a restatement rather than in binding instruments; however, these same aspects render such a restatement less representative than an instrument based on a larger consensus and to which most members are committed.[94]

[93] Directive (EU) 2019/771 of the European Parliament and of the Council of 20 May 2019 on certain aspects concerning contracts for the sale of goods, amending Regulation (EU) 2017/2394 and Directive 2009/22/EC, and repealing Directive 1999/44/EC.

[94] See, extensively, Goode et al. (2015), paras 16.07 ff. and 16.43 ff., explaining, in this light, why the principle of good faith and fair dealing was given such a central role in the UNIDROIT Principles but not in the CISG. See also McKendrick (2006), pp. 5–29, 8. For similar considerations regarding the Hague Principles on Choice of Law in International Contracts see Michaels (2014), Section III.B.

As the following sections will show, the restatements can be a useful complement to the governing law but cannot replace it.

(b) Uses of the Principles

These restatements of principles have multiple goals, mentioned in their respective preambles. The UNIDROIT issued a document containing model clauses that the parties may want to insert in their contract, depending on which of the above-mentioned uses they choose.[95]

The different uses may be summarised as follows:

(i) As they are the result of an extensive comparative study and offer modern and functional solutions, they may be used by legislators as a source of inspiration when legislating in the field of general contract law. Since their issuance, the UPICC have been used as an inspiration for contract law reforms in a variety of countries. Originally meant to be used as a basis for codification in countries in transition or developing countries, the UPICC have also proven successful in legal systems with developed contract laws. The UPICC have, to a larger or lesser extent, influenced reforms in countries such as Russia,[96] Japan[97] and France.[98]

(ii) Due to the persuasive authority that derives from the high quality of the working group that prepared them, they could be used by courts or arbitrators to interpret existing international instruments. On the use of the UPICC to interpret or integrate the CISG, see Section 2.2.5(c).

(iii) Moreover, as a guide to the drafting, they may be used by contractual parties during the preparation of their contract. The commentary to the UPICC is actually from time to time written in a way that resembles a check list for parties.

(iv) The parties to an international contract, furthermore, might decide to subject their contract to the regulation of the restatements as an expression of a balanced, international set of rules, rather than choosing a national governing law (on this particular use of the principles, it is necessary to make some reservations; see Section 2.3). The number of contracts choosing the UPICC is quite low,[99] but the International Association of Lawyers (Union Internationale des Avocats, UIA) signed on 15 July 2020 a Resolution

[95] www.unidroit.org/instruments/commercial-contracts/upicc-model-clauses.

[96] Alexander S. Komarov, 'Reference to the UNIDROIT Principles in International Commercial Arbitration Practice in the Russian Federation'. *Uniform Law Review* 16 (2011), pp. 657–67.

[97] Takashi Uchida, 'Contract Law Reform in Japan and the UNIDROIT Principles'. *Uniform Law Review* 16 (2011), pp. 705–17.

[98] Solène Rowan, 'The New French Law of Contract'. *International & Comparative Law Quarterly* 66.4 (2017), pp. 805–31.

[99] School of International Arbitration of Queen Mary University of London (2010); Michaels (2014). According to Sippel and Duggal, 'neither author has yet come across a contract that contained such agreement [choosing the UPICC to govern the contract] except for a few reported cases': Harald Sippel and Kabir Duggal (eds.), *Force Majeure and Hardship in the Asia-Pacific Region* (Juris, 2021), p. xix.

Recommending Consideration of UNIDROIT Principles of International Commercial Contracts 2016 As Important Option for International Lawyers and Clients.[100] This may contribute to an increased use of the UPICC in contract practice.

(v) The restatements of principles might be useful for arbitrators, especially when deciding a dispute on the basis of the transnational law: rather than having to search for what could constitute international usages of trade or other sources of the transnational law that are difficult to identify, arbitrators could rely on a readily available set of rules.

(vi) The restatements of principles aspire to be used by courts or arbitrators, instead of the governing law, should the content of the law be impossible or extremely difficult to establish.

(vii) In practice, the UPICC enjoy a high degree of recognition as an authoritative collection of principles for commercial contracts. This reputation is at the basis of the widespread use that is made of the UPICC as a corroboration of the applicable law. This is a use that can be seen not only in commercial arbitration, but also in litigation before state courts[101] and in investment arbitration. In investment arbitration, the UPICC are sporadically used not only to corroborate the result flowing from a state law,[102] but even to corroborate the existence of principles of international law.[103]

(c) Use of the UPICC to Interpret the CISG?

It is held[104] that the UPICC may be useful for solving ambiguities or for filling gaps in the CISG, because both instruments deal with many of the same issues (though the CISG only with regard to contracts of sale, whereas the UPICC regulate all kinds of contracts). The link between the two instruments is promoted by highly recognised databases such as the CISG database established at the Pace Law School.[105] This database contains a rubric, in the guide to various articles, devoted to the 'Use of the UNIDROIT Principles to help interpret CISG', containing 'match-up' of the CISG Articles with the corresponding Articles of the UPICC.

[100] www.unidroit.org/uia-signs-resolution-recommending-consideration-of-unidroit-principles-of-international-commercial-contracts-2016/.

[101] *Kabab-Ji SAL (Lebanon)* v. *Kout Food Group (Kuwait)* [2020] 1 Lloyd's Rep 269, paras 72 to 75; *Rock Advertising Ltd* v. *MWB Business Exchange Centres Limited* [2018] UKSC 24.

[102] Giuditta Cordero-Moss and Daniel Behn, 'The Relevance of the UNIDROIT Principles in Investment Arbitration'. *Uniform Law Review* 19.4 (2014), Section V(1).

[103] Cordero-Moss and Behn (2014), Section IV(2).

[104] Michael Joachim Bonell, 'The UNIDROIT Principles as a Means of Interpreting and Supplementing Uniform Law in International Arbitration Practice'. *ICC International Court of Arbitration Bulletin* Special Supplement (2002), pp. 29–38.

[105] http://iicl.law.pace.edu/cisg/cisg.

In 2021, the so-called Tripartite Guide was issued by the UNCITRAL, the UNIDROIT and the Hague Conference,[106] with the aim of clarifying the relationship among three uniform texts: the UPICC, the CISG and the HCCH Principles on Choice of Law in International Commercial Contracts.[107] The ultimate goal of the guide is to promote a uniform legal environment for cross-border transactions.

However, the ability of the UPICC to explain or supplement the CISG is not uncontroversial.[108]

An example serves the doctrinal debate that followed two decisions by Belgian[109] and French[110] courts which applied the UPICC to interpret and supplement the CISG. The debate concerned particularly the issue of renegotiation of terms of contract due to unforeseen supervening circumstances that rendered performance under the original terms more onerous, so-called hardship. The CISG does not mention hardship, but the UPICC do. These courts applied the UPICC principle of hardship to contracts governed by the CISG. This prompted a doctrinal debate with opposing views.[111]

The CISG has a provision on autonomous interpretation, that incidentally served as a model for Article 1.6 of the UPICC, see Section 2.3.4. Article 7(2) provides that issues falling within the scope of the CISG and not expressly regulated therein 'are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law'.

The question is whether the UPICC may be deemed to express the principles on which the CISG is based.

An area on which the correspondence does not seem complete is that of the role played by the principle of good faith.

[106] UNCITRAL, HCCH and UNIDROIT (2021).

[107] The Principles on Choice of Law in International Commercial Contracts, issued by the Hague Conference on Private International Law in 2015, available at www.hcch.net/en/instruments/conventions/full-text/?cid=135.

[108] See, for example, Franco Ferrari, Clayton P. Gillette, Marco Tosello and Steven D. Walt, 'The Inappropriate Use of the PICC to Interpret Hardship Claims under the CISG'. *Internationales Handelsrecht* 3 (2017), 97–102, with further references in footnote 14; Rodrigo Momberg Uribe, 'Change of Circumstances in International Instruments of Contract Law. The Approach of the CISG, PICC, PECL and DCFR'. In Franco Ferrari and Clayton P. Gillette (eds.), *International Sales Law* (Edward Elgar, 2017), pp. 233–66.

[109] Belgian Supreme Court *Scafom International* v. *Lorraine Tubes S.A.S.*, 19 June 2009.

[110] French Cour de Cassation, 17 February 2015, n° 13–18.956, n° 13–20.230.

[111] Among the voices favouring the use of the UPICC to supplement the CISG in respect of hardship, see Anna Veneziano, 'UNIDROIT Principles and CISG: Change of Circumstances and Duty to Renegotiate According to the Belgian Supreme Court'. *Uniform Law Review* 15 (2010) pp. 137–49. Among the voices criticising it, see Ferrari et al. (2017); Christina Ramberg, 'The Duty to Renegotiate an International Sales Contract under CISG in Case of Hardship and the Use of the UNIDROIT Principles'. *European Review of Private Law* 19.1 (2011), pp. 117f. Ramberg fiercely criticises the Belgian decision. However, it seems that criticism is directed against the applicability of the principle of hardship to the particular facts, rather than against the use of the UPICC to supplement the CISG.

As Section 2.2.5(f) will show, the UPICC give the principle of good faith a central role as a source of obligations between the parties, corrective of the contract language and restriction to contract rights.

The CISG, in turn, requires in Article 7 that the Convention be interpreted as having regard to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade. It is not a source of obligations between the parties. Rather, it is a source of inspiration for the interpretation of the Convention.

The role of good faith in the CISG, therefore, is more modest.[112] This can in part be explained in light of the non-binding character of the UPICC. The working group that drafted the UPICC could agree to rules and formulations more easily than if it were drafting a convention destined to become binding. As opposed to a convention, the UPICC are subject to mandatory rules or principles of the governing law.

Moreover, the work did not require unanimity, and controversial matters could be regulated more easily than if a large consensus was expected – as happens when drafting a convention. These two aspects render it easier to codify the 'best rules' in a restatement rather than in binding instruments; however, these same aspects render such a restatement less representative than an instrument based on a larger consensus and to which most members are committed. Because of the common law tradition's reluctant approach to good faith, the final text of the CISG is silent on the question of good faith as a duty between the parties or as a correction to the terms of the contract. This silence is not due to carelessness, but is a conscious choice taken during the drafting. The main arguments against the inclusion of good faith as a duty of the parties were that the concept is too vague to have specific legal effects and that it would be redundant if mention thereof was only to be understood as a moral exhortation.[113]During the drafting of the Convention, various delegations had repeatedly requested that the text expressly included a provision stating a duty for the parties to perform the contract according to good faith. Specific proposals were presented on good faith in the pre-contractual phase, as well as general proposals dealing with the requirement of good faith. The specific proposals relating to pre-contractual liability were rejected, and the generic proposals on good faith were incorporated into the abovementioned Article 7. Article 7, however, does not formulate a rule directed to regulate the parties' conduct in the contract; it states a rule instructing the interpreter of the Convention. The Convention shall be interpreted having regard to the need to promote the observance of good faith in international trade. Whether this good faith interpretation of the Convention entails a duty for the

[112] See Steven D. Walt, 'The Modest Role of Good Faith in Uniform Sales Law'. In Franco Ferrari and Clayton P. Gillette (eds.), *International Sales Law* (Edward Elgar, 2017).

[113] See, extensively on the background for the limited role of good faith in the CISG, Goode et al. (2015), pp. 278ff. and 528.

parties to act in good faith towards each other is an open question.[114]

The different character of the UPICC and the CISG (the former a soft law source, the latter a binding convention) explains why the UPICC have an overarching principle of good faith, while the CISG ended up, after extensive negotiations, without a provision creating a duty of good faith on the parties.[115]

The Tripartite Guide recognises that the UPICC set forth a general and far-reaching duty of the parties to act in good faith that exceeds the role for good faith recognised in the CISG.[116] Therefore, the ability of the UPICC to represent the principles underlying the CISG, and thus to automatically give a basis to interpret and supplement the CISG, does not seem to be fully recognised by the UNIDROIT or the UNCITRAL.

In the document on model clauses, the UNIDROIT says that the 'general principles on which [the Convention] is based' referred to in Article 7(2) of the CISG are as such not identical with the UNIDROIT Principles.[117] Moreover, the UNIDROIT assumes that the use of the UPICC to interpret or supplement the CISG is not automatic but depends on the parties choosing it. Therefore, it recommends a model clause to obtain that purpose.[118]

[114] For an extensive evaluation on this matter, as well as references to the literature and to the legislative history in this respect, see John Felemegas, 'Comparative Editorial Remarks on the Concept of Good Faith in the CISG and the PECL'. *Pace International Law Review* 13 (2001), p. 399; Lisa Spagnolo, 'Opening Pandora's Box: Good Faith and Precontractual Liability in the CISG'. *Temple International and Comparative Law Journal* 21.2 (Fall) (2017), pp. 261–310; Albert H. Kritzer, 'Pre-Contract Formation'. Editorial Remark on the Internet Database of the Institute of International Commercial Law of the Pace University School of Law, *CISG Database*, https://iicl.law.pace.edu/cisg/cisg (2008), pp. 2ff., with extensive references also to the Minority Opinion of M. Bonell, who was representing Italy during the legislative works. According to Bonell, an extensive interpretation of the CISG would justify application of both the concepts of pre-contractual liability and of good faith: see Michael Joachim Bonell, 'Formation of Contracts and Precontractual Liability under the Vienna Convention on International Sale of Goods'. ICC (ed.), *Formation des contrats et responsabilité précontractuelle* (1990). Affirming that it is commonly acceptable that Article 7 of the CISG applies also to the interpretation of the contract and the relationship between the parties, see Ulrich Magnus, 'Comparative Editorial Remarks on the Provisions Regarding Good Faith in CISG Article 8(1) and the UNIDROIT Principles Article 1.7'. In John Felemegas (ed.), *An International Approach to the Interpretation of the United Nations Convention on Contracts for the International Sale of Goods (1980) as Uniform Sales Law* (Cambridge University Press, 2007), pp. 45–8. For a skeptical view, see Goode et al. (2015), paras 8.37ff. Schlechtriem and Schwenzer's recognised commentary on the CISG clearly affirms that Article 7 of the CISG only applies to the interpretation of the Convention and does not extend to interpretation of contracts, nor does it create duties between the parties: Ingeborg Schwenzer and Ulrich Schroeter (eds.), *Schlechtriem & Schwenzer Commentary on the UN Convention on the International Sale of Goods (CISG)*, 5th ed. (Oxford University Press, 2022), Article 7, para 17.

[115] See, extensively, Goode et al. (2015), paras 16.07ff. and 16.43ff. See also McKendrick (2006), p. 28.

[116] UNCITRAL, UNIDROIT and HHC (2020), para 394.

[117] www.unidroit.org/instruments/commercial-contracts/upicc-model-clauses/, Section 4.3, in the context of a clause that chooses the UPICC to supplement domestic law, and explaining how this choice may impact the application of the CISG as part of that law.

[118] Ivi, Section 3, General remarks, 4: 'Parties wishing to ensure that, if the CISG governs their contract, it will be interpreted and supplemented by the UNIDROIT Principles should expressly stipulate this in their contract or in a separate agreement.'

That principles in the CISG and in the UPICC are not identical puts limits on the ability of the UPICC to supplement the CISG.

Hence, it is difficult to use the UPICC as a tool to interpret or supplement the CISG, as the central position of the principle of good faith in the UPICC is pervasive and affects all stages of contract negotiation, interpretation and fulfilment, as well as the exercise of contract remedies.

Other authors, in contrast, argue that the principle of good faith plays the same role in both instruments: 'The differences between the CISG and the Principles can be nearly neglected as far as the general concept of good faith in international contracts is concerned. Some textual differences do not matter in essence.'[119]

(d) Use of the UPICC to Correct National Law in Investment Arbitration?

It has been suggested that, in investment arbitration, national law could be replaced by soft law (in particular, by the UPICC), when the state does not participate in the proceeding.[120] The UPICC have, sporadically, also been considered as part of international law, and as such, applicable in investment arbitration.[121]

In investment arbitration, the ambition to create a unitary, transnational law may be more easily attained than in commercial law. The body of investment protection law is, admittedly, based on fragmented sources such as the different investment treaties giving jurisdiction to the tribunals. However, the dimension of public international law and the high degree of transparency in investment arbitration give a basis from which converging principles and practices may emerge,[122] thus creating a promising habitat for transnational law.

The question I would like to address here is whether the features that prevent the UPICC from replacing national law in commercial arbitration also have significance in investment arbitration – in other words, whether the characteristics of investment arbitration may lead to a larger field being given for the application of the UPICC than is the case for commercial arbitration.

[119] Ulrich Magnus, 'Remarks on Good Faith: The United Nations Convention on Contracts for the International Sale of Goods and the International Institute for the Unification of Private Law, Principles of International Commercial Contracts'. *Pace International Law Review* 10 (1998), p. 89. Final remarks. See also Christoph Brunner and Benjamin Gottlieb (eds.), *Commentary on the UN Sales Law (CISG)* (Kluwer Law International, 2019), Article 7, para 5.

[120] Jarrod Hepburn, 'The UNIDROIT Principles of International Commercial Contracts and Investment Treaty Arbitration: A Limited Relationship'. *International & Comparative Law Quarterly* 64.4 (2015), pp. 913ff.

[121] For references, see Cordero-Moss and Behn (2014), Sections III and IV(1).

[122] Giuditta Cordero-Moss and Daniel Behn, 'Arbitration and the Development of Law'. In Stephan Kröll, Andrea Bjorklund and Franco Ferrari (eds.), *Cambridge Compendium of International Commercial and Investment Arbitration* (Cambridge University Press, 2023), Section 3.1.2.

In investment arbitration, the tribunal is called upon to apply state law *and* rules of international law.[123] This is usually interpreted as giving rules of international law a corrective function: where the applicable state law would lead to a result that infringes the investment protection to which the host state has committed itself, it will be corrected or supplemented by rules of international law.[124]

But which rules qualify as rules of international law, and does this have an impact on the applicability of the UPICC to the incidental questions of contract law?[125]

An important basis for identifying sources of public international law is Article 38 of the International Court of Justice (ICJ) statutes. Article 38 of the ICJ Statutes lists the authoritative sources of international law, and this list includes under letter (c), 'the general principles of law recognized by civilized nations'.[126]

According to the prevailing theory and practice, general principles of law are established through 'comparative law whereby features common to domestic legal systems are established'.[127] Therefore, general principles of law in international (investment) law do not derive their existence from international sources: they are principles found in national legal systems. Hence, the application of general principles of law as 'rules of international law' under the second sentence of Article 42(1) of the ICSID Convention requires a comparative analysis of national systems of law.

That general principles are established mainly through comparative analysis seems to open the door for the UPICC (to the extent they may be considered as an expression of generally recognised principles) as a source of international law. A further requirement, however, is that principles deriving from national law must be adapted to become 'suitable for application on the level of public international law'.[128]

What should be ascertained is whether the UPICC may qualify as general principles and, in case of an affirmative answer, whether general principles of contract law fall within the category of general principles in the sense that is relevant in the context of investment protection. As will be seen, both questions will be answered in the negative.

Regarding the ability of the UPICC to represent generally recognised principles, it should be kept in mind that the UPICC are not only a collection of generally

[123] For ICSID arbitration, this is set forth in Article 42(1) of the ICSID Convention. The same applies to the other arbitration types that may be used for investment disputes, see Cordero-Moss and Behn (2014), Section II.

[124] Cordero-Moss and Behn (2014), Sections II(1) and V(2).

[125] For a more extensive reasoning see Giuditta Cordero-Moss, 'Soft Law as a Replacement or Corrective of National Law in Investment Arbitration?' *European International Arbitration Review* 7.2 (2019), pp. 201–16.

[126] Statute of the International Court of Justice, 59 Stat. 1031; T.S. 993; 39 AJIL Supp. 215 (1945).

[127] Christoph Schreuer, Loretta Malintoppi, August Reinisch and Anthony Sinclair, *The ICSID Convention: A Commentary*, 2nd ed. (Cambridge University Press, 2010), Article 42, para 178.

[128] *El Paso Energy* v. *Argentina*, ICSID Case No ARB/03/15, Award, 31 October 2011, at para. 622. For further references, see Cordero-Moss and Behn (2014), Section V(2).

recognised principles of contract law, but also a collection of best rules, as explained in Section 2.2.5(e).

However, many of the provisions contained in the UPICC do represent generally recognised principles. To the extent the UPICC correspond to general principles, it must be ascertained whether they are general principles in the sense relevant to investment protection – that is, whether their infringement would represent a violation of public international law.

Regarding the question whether general principles of contract law may be deemed to represent rules of international law in the sense relevant to investment arbitration, it should first be pointed out that state law and international law each have a different role and ambit.[129] State law is an emanation of the sovereignty of states and sources external to the state shall not interfere with it, unless it violates obligations or principles that bind the state on an international level. Within a particular legal system, rights and obligations of the parties to commercial agreements are regulated by state law. How state law allocates risks between contractual parties, which formal requirements a contract must meet to be enforceable under that state's law, how many years have to lapse before a claim is time barred, just to name a few examples, are matters of internal state law. Each state may have a different regulation of these matters without infringing international commitments. International commitments will be violated if a state is bound by an international convention regulating these issues, and yet its internal legislation regulates the same issues in a different way, even though they fall within the scope of application of the convention. If a state is bound by the CISG or by the Limitation Convention,[130] for example, it would violate its international commitments flowing from these international law instruments, if its internal law provided that there shall be no excuse for *force majeure* in sales contracts that are subject to the CISG (thus contradicting Article 79 of the CISG), or if it allowed claims that are older than four years in sales contracts that are subject to the Limitation Convention (thus contradicting Article 8 of the Limitation Convention). Outside of these direct breaches of specific international law commitments, however, how a state regulates rights and obligations of contract parties is an internal matter with no relevance to public international law. As long as international obligations or principles are not infringed, international law has no saying on how a state shall regulate activity within its legal system. International law becomes relevant if a state's conduct violates investment protection standards – for example, if a state modifies its contract law retroactively with the purpose of depriving the investor of a contractual remedy. The relevant principle of international law will be the principle that

[129] For references to investment case law and literature acknowledging the distinct roles of state and international law in investment arbitration, see Cordero-Moss and Behn (2014), footnotes 35 to 42 and 214 to 232.

[130] 1974 New York Convention on the Limitation Period in the International Sale of Goods, UNTS 1511 No 26119.

determines the standard of protection (the prohibition of abuse of power, the obligation to grant fair and equitable treatment, etc.) – not a principle of contract law.

An example of a domestic law rule that can be transposed to the level of public international law was given in Section 2.2.3(a), regarding the substantive approach in labour law.

An example of a principle that cannot be transposed was given in Section 2.2.3(b). The principle of good faith in public international law does not necessarily coincide with the principle of good faith in the contract law of a specific state: while the ICJ found that the principle of good faith in public international law requires that unilateral promises made by a state to another state are deemed to be binding, as a general rule unilateral promises lacking a consideration are not enforceable under English contract law. That contracts or unilateral promises are not enforceable if there is no consideration is a rule of domestic law that does not reach the level of international law. It is not the function of international law to regulate the criteria according to which a contract is binding. Even though, according to the ICJ, unilateral promises made by a state to another state are binding, and even though the UPICC do not require that there is a consideration for a contract to be binding, neither international law nor the UPICC may override the common law doctrine of consideration in the context of a contract dispute governed by English law.

The 'rules of international law' in the sense relevant to investment arbitration are meant as a reference to international minimum standards that restrict abusive conduct by sovereigns, and therefore are relevant only to specific elements or aspects of national law; they are not intended to substitute the details of domestic law with other detailed rules regulating the contractual aspects of the relationship between the parties.

The function of this correction is to preserve the international commitments among states (for example, ensuring that a state does not expropriate without paying compensation), not to override an internal rule of national law and substitute it with another rule having the same function but a different content[131] (for example, overriding the English law rule of contract law according to which contracts require a consideration to be binding, and replacing it with a rule according to which unilateral promises without consideration are binding).

As a further argument regarding the different spheres of investment law and contract law, it has been suggested that general principles of contract law

> assume a relation of equality between the two parties, whether two individuals or two States. It is now well recognized, though, that investment law does not display this equal relation. The primary rules of investment treaties establish the obligations of States towards private parties. Investment treaty disputes are more akin to systems of human rights law or administrative law, where claimants are always private entities and States are always respondents, than to the

[131] Schreuer et al. (2010), Article 42, para 211.

> classic private law areas of tort or contract. For this reason, it might not be expected that general principles will be useful to the essentially public law context of an investment treaty's primary rules.[132]

Even if the notion of international law in the context of Article 42(1), second sentence of the ICSID Convention, extended to contract law (which, as seen, is doubtful), it is questionable whether the UPICC (to the extent they may be considered to reflect generally recognised principles) are designed to have such a corrective function.

The UPICC may be used to fill gaps in the applicable national law. However, it is more uncertain whether the UPICC may be used to override a rule of national law. According to their preamble, the UPICC 'may be used to interpret or supplement domestic law'.[133] This is quite a different function from the corrective function of international law under Article 42(1), second sentence. Moreover, the UPICC themselves explicitly exclude the possibility that they can restrict the application of mandatory rules that are applicable according to conflict of laws rules.[134]

It seems therefore that it is not the UPICC's function to override a rule of national law in case of contrast between the regulation contained in the law and in the provisions of the UPICC.

(e) Also Best Rules

The UPICC are often praised for being the result of an extensive comparison of the most important legal systems. However, legal systems may diverge on a series of matters, for example, in respect of the issue of the battle of the forms (Section 2.2.2) or on the role of good faith (Sections 3.1 to 3.3). A further example is the issue of interest for late payment.

Some of the principles collected in the UPICC are the result of a comparison of principles underlying the regulations in the major legal systems. Where there are no common underlying principles, however, the UPICC have proposed rules that the authors of the UPICC reckoned represented the best regulation.[135] As seen this has led the UPICC to formulate, as the most important principle of all, the principle of good faith. This principle of good faith, however, is not recognised in all legal systems, at least not with the same scope and effects, see Sections 3.1 to 3.3.

[132] Hepburn (2015), p. 928. The author seems to think, at p. 908, that his position on the applicability of the UPICC as a corrective of state law in investment arbitration is more restrictive than the position expressed in Cordero-Moss and Behn (2014). However, the two positions seem to coincide in substance.

[133] Sixth para of the preamble. [134] Article 1.4 of the UPICC.

[135] See the Introduction to the 1994 edition of the UPICC: 'For the most part the UNIDROIT Principles reflect concepts to be found in many, if not all, legal systems. Since however the UNIDROIT Principles are intended to provide a system of rules especially tailored to the needs of international commercial transactions, they also embody what are perceived to be the best solutions, even if still not yet generally adopted.'

Furthermore, the principle of good faith does not even seem to be compatible with contract practice, see Section 1.4. International contracts are usually detailed and exhaustive, and contract practice relies heavily on predictability and an accurate implementation of the contract wording. This seems to suggest that in international trade there is little room for the principle of good faith to interfere with the wording of the contract. The principle of good faith, therefore, although it is one of the fundaments of the entire UPICC, is not only not generally recognised in all the major systems of law, neither is it compatible with contract practice (which, in turn, is one of the sources of international commercial law). Therefore, the mere circumstance that a provision is contained in the UPICC is not sufficient proof that there is a corresponding generally recognised principle – although they could become evidence if they are used consistently and widely in practice.[136]

Positing a best rule implies that the UPICC deviate from the rules prevailing in at least a considerable number of legal traditions, without being able to prove that the content of the best rule is generally acknowledged. In these cases, reference to the UPICC may not be seen as a substitute for proving a generally recognised principle or proving the content of the *lex mercatoria*. This may create an obstacle to applying them in investment arbitration, see Section 2.2.5(d).[137]

(f) The Problematic Central Role of the Principle of Good Faith

The UPICC and the PECL give considerable importance to the principle of good faith, which underlies all of the restatements.[138] For example, the duty of loyalty between the parties manifests itself already in the phase of negotiations: the parties are liable for the unjustified break-off of negotiations. Furthermore, contracts shall be

[136] See Symeonides (2006); Ferreri points out, Section 6a: 'Paradoxically the success of such soft law instruments depends ... on their success': Silvia Ferreri, 'XVII Congress of the International Academy of Comparative Law'. *The Italian National Report Section II-B1* (Private International Law, 2006). See also Goode et al. (2015), paras 16.28 ff.

[137] The ICSID ad hoc annulment committee annulled on 3 May 1985 the award in *Klöckner Industrie-Anlagen GmbH and others* v. *United Republic of Cameroon and Société Camerounaise des Engrais*, ICSID Case No ARB/81/2, because the tribunal applied a principle on duty of full disclosure, simply assuming its existence in the governing law, and this was deemed to be an award based on equity, see Schreuer et al. (2010), Article 42, para. 182. In this context, Schreuer states: '[g]eneral principles of law are not an expression of general feelings of justice or equity but are part of the body of international law which, in a particular case, must be proven and not presumed. This proof must be furnished on the basis of rigorous examination, if not all systems of law at least the most important major representative systems.' See more extensively on the use of the UPICC in investment arbitration, Cordero-Moss and Behn (2014), pp. 1–39, 5f.

[138] See Article 1.7 of the UPICC and Article 1:201 of the PECL. Comment No 1 to Article 1.7 (www.unidroit.org/wp-content/uploads/2021/06/Unidroit-Principles-2016-English-i.pdf, last accessed on 8 November 2022) mentions the following provisions: Articles 1.8, 1.9(2); 2.1.4(2)(b), 2.1.15, 2.1.16, 2.1.18 and 2.1.20; 2.2.4(2), 2.2.5(2), 2.2.7 and 2.2.10; 3.2.2, 3.2.5 and 3.2.7; 4.1(2), 4.2(2), 4.6 and 4.8; 5.1.2 and 5.1.3; 5.2.5; 5.3.3 and 5.3.4; 6.1.3, 6.1.5, 6.1.16(2) and 6.1.17(1); 6.2.3(3)(4); 7.1.2, 7.1.6 and 7.1.7; 7.2.2(b)(c); 7.4.8 and 7.4.13; 9.1.3, 9.1.4 and 9.1.10(1). The PECL, too, have numerous specific rules applying the principle of good faith, for example, in Articles 1:202, 2:102, 2:104, 2:105, 2:106, 2:202, 2:301, 4:103, 4:106, 4:109, 4:110, 5:102, 6:102, 8:109, 9:101, 9:102 and 9:509.

interpreted in good faith, performance shall be made in good faith, remedies shall be exercised in good faith. The general principle of good faith, in other words, is, in these instruments, an overriding principle that functions as a corrective action to the mechanisms regulated in the contract whenever a literal application leads to results that seem too harsh, as applied to one of the parties. In order to apply this principle, the interpreter shall look beyond the wording of the contract. An accurate implementation of the contract according to its terms may be considered to be against the principle of good faith if it amounts to an abuse of a right. An abuse of a right is defined by the official commentary on Article 1.7 of the UPICC as follows:

> It is characterised by a party's malicious behaviour which occurs for instance when a party exercises a right merely to damage the other party or for a purpose other than the one for which it had been granted, or when the exercise of a right is disproportionate to the originally intended result.[139]

This approach does not seem to be very compatible with the self-sufficiency of the contract that seems to be assumed by international commercial practice, as was described in Chapter 1. At first sight, the regime of the UPICC and of the PECL seems to correspond substantially to the civil law tradition and deviate from the common law approach, which will be described in Chapter 3. Harmonisation seems to be sought by embracing one legal tradition.

A more careful analysis of the matter, however, makes the resemblance between the UPICC and the civil law tradition less evident: this is because the standard of good faith, against which the restatements measure pre-contractual liability, interpretation and construction of the contract, performance of the contract and the exercise of remedies is to be established not on the basis of a national legal tradition, but on the basis of the standard generally recognised in international trade.[140]

In the commentary on Article 1.7, the UPICC affirm that the standard of good faith must always be understood as 'good faith in international trade', and that no reference has to be made to any standard that has been developed under any state law.[141] This approach is in line with the requirement of autonomous interpretation of the UPICC contained in Article 1.6, see Section 2.3.4. The UPICC are an instrument with an international character, and it would not serve the purpose of becoming a uniform law if the courts of every state interpreted them each in a different way, in light of their own legal culture. While the requirement of autonomous interpretation of the UPICC, and the corresponding requirement in Article 1:106 of the PECL are understandable in light of the ambitions of harmonising the law of contracts, they do not contribute to creating clarity in respect of the content of good faith as a standard, as will be seen.

[139] Comment No 2 to Article 1.7 (last accessed on 8 November 2022).
[140] See Article 1.6 of the UNIDROIT Principles of International Commercial Contracts and Article 1:106 of the PECL.
[141] Comment No 3 to Article 1.7 (last accessed on 8 November 2022).

Legal standards, or general clauses, are, per definition, in need of a specification of their content that depends to a large extent on the interpreter's discretion. When the general clause belongs to a state system, the interpreter's discretion is restricted or guided by principles and values underlying that particular system – for example, in the constitution, in other legislation or in society at large.[142]

How would the interpreter evaluate the wording of an international contract that seems to provide for and permit the very conduct prohibited by the principle of good faith?

An interpreter belonging to a tradition where there is no general principle of good faith might tend to consider that the clear wording of the contract indicates that the parties had considered all eventualities, made provision for them and accepted the consequences, and that therefore the Articles of the UPICC and the PECL are not applicable.

An interpreter belonging to a legal tradition with a strong general principle of good faith, on the other hand, may consider that consequences of a literal application of the contract must be mitigated if they disrupt the balance of interests between the parties.

To the former interpreter, fairness or good faith interpretation consists of an accurate interpretation of the contract. To the latter, it consists of intervening and reinstating a balance between the parties. There does not seem to be any uniform transnational principles or values that are sufficiently precise to permit a choice between these two approaches.

One of the most important sources of generally acknowledged principles of international trade is international contract practice; and international contract practice, as described in Chapter 1, seems to show that the parties expect their contract to be interpreted solely on the basis of its terms. Therefore, it does not seem correct to construe the principle of good faith in the UPICC or the PECL as if it imposed obligations or duties that are in clear contradiction with contract practice, which is one of the most important sources that is used precisely to establish the content of the principle of good faith.

On the other hand, the principle of good faith is undoubtedly given a central role in the restatements; therefore, it does not seem logical to construe it, albeit in accordance with internationally recognised contract practice, in such a restrictive way that it is deprived of any significant role.

This paradox renders the regime of the restatements quite unpredictable in its application, and therefore not fully adequate in terms of regulating commercial relationships where the foreseeability of the legal positions and of the remedies is deemed to be very important.

[142] See Peter Schlechtriem, 'The Functions of General Clauses, Exemplified by Regarding Germanic Laws and Dutch Law'. Stefan Grundmann and Denis Mazeaud (eds.), *General Clauses and Standards in European Contract Law* (Aspen Publishers, 2006), pp. 49ff (analysing the application of general clauses, with particular, but not exclusive reference to the German system).

The dilemma described in connection with the UPICC will affect the interpretation of the corresponding provision in the PECL.

More recently, the same approach was taken in the already mentioned DCFR[143] and the abandoned proposal for a CESL.[144] These instruments give ample room to the principle of good faith. These instruments define the content of the general principle of good faith for commercial contracts by making reference to 'good commercial practice'. As seen in Section 2.2.1(a)(ii), defining a general clause by reference to another general clause does not seem to bring the interpreter any closer to a specification of the former.

Depending on the development of the process to develop a European contract law, described in Section 2.2.5(a), the PECL may become the basis of a European body of rules that eventually may be subject to interpretation or application by the Court of Justice of the European Union (CJEU). In such a case, over time, a coherent body of case law would be formed and the content of the principle of good faith would be easier to determine.

The UNIDROIT has taken a commendable role in contributing to the development of a body of case law that may enhance a harmonised interpretation and thus the predictability of the UPICC: following the example of CLOUT, a system established by the UNCITRAL for the collection and dissemination of court decisions and arbitral awards relating to UNCITRAL instruments, the UNIDROIT has established Unilex,[145] a database collecting case law and a bibliography on the UPICC and the CISG. In 1992 Unilex started collecting and publishing, *inter alia*, arbitral awards that contain references to the UPICC. Making available the case law that (if at all published) would otherwise be scattered among the publications issued by different arbitral institutions all over the world, is a valuable step in promoting the development of a uniform body of law. When the number of the collected decisions becomes significant and their level of detail is such that they can be used to determine the specific scope of general clauses such as the principle of good faith, the UPICC will be in a position to contribute to the harmonisation of the general contract law – assuming that the decisions do not give contradictory interpretations. As the example of the regulation of Entire agreement clauses in Section 2.2.5(f)(ii) will show, however, for the moment, the body of cases is not sufficient to ensure a harmonised interpretation of the principles.

[143] This is confirmed in UK House of Lords European Union Committee, Social Policy and Consumer Affairs (Sub-Committee G), 12th Report of Session 200809, *European Contract Law: The Draft Common Frame of Reference*, *Report with Evidence* (10 June 2009), Sections 24 ff., and, particularly, 27, 28, 32 and 33. See also Sections 78 and 79, stating the disagreement in principle on a generally interventionist law of contracts as taken by the DCFR, and criticising the generalisation of consumer protection as made in the DCFR. Attached to the Report is a Memorandum by S. Vogenauer, Professor of Comparative Law, University of Oxford, which singles out several areas where the DCFR certainly deviates from English contract law (Section 22) – also including the areas discussed in this book. For similar criticism, see also Eidenmuller et al. (2008).

[144] Point 31 in the preamble and Articles 23, 49, 86 and 170.

[145] www.unilex.info/.

Another possible means to clarify the impact of the UPICC on contract terms are the Comments included in the publication. We will see in Section 2.3.3 how they can contribute to a uniform and commercially oriented construction of the contracts.

We will see how the restatements of principles regulate some of the clauses that were described in Chapter 1. Chapter I indicated that these clauses may have different effects depending on the governing law – this will be discussed more in detail in Section 3.4.1. Here, we will, verify whether this inconsistency can be overcome by subjecting the contract to the UPICC. Does the choice of the UPICC give a uniform regime for these clauses?

(i) Entire Agreement As seen in Chapter 1, a boilerplate clause that often recurs in contract practice is the Entire agreement clause, according to which the document signed by the parties contains the whole agreement and may not be supplemented by evidence of prior statements or agreements.

This clause is recognised in Article 2.1.17 of the UPICC and Article 2:105 of the PECL, with some restrictions: the provisions specify that prior statements or agreements may be used to interpret the contract. This is one of the applications of the general principle of good faith; it is, however, unclear how far the principle of good faith goes in overriding the clause inserted by the parties. If prior statements and agreements may be used to interpret the contract, does this mean that more terms may be added to the contract – because, for example, the parties have discussed certain specifications at length during the negotiations and this has created in one of the parties the reasonable expectation that they would be implied in the contract?

Article 1.8 of the UPICC would seem to indicate that this would be the preferred approach under the UPICC. According to this provision, a party may not act in a way that is inconsistent with the reasonable expectations that it has created in the other party. This is spelled out in respect of the Entire agreement clause in the PECL, which, in paragraph 4 of Article 2:105, states that 'A party may by its statements or conduct be precluded from asserting a merger clause to the extent that the other party has reasonably relied on them'.

According to this logic, a detailed discussion during the phase of negotiations regarding certain characteristics for the products may create the reasonable expectation that those specifications have become part of the agreement, even if they were not written down in the contract; their subsequent exclusion on the basis of the Entire agreement clause may be deemed to be against good faith.

According to the opposite logic, however, the very fact that the parties have excluded from the text of the contract some specifications that were discussed during the negotiations, indicates that no agreement was reached on those matters. Exclusion of those terms from the contract, combined with the Entire agreement clause, strongly indicates the will of the parties not to be bound by those specifications. Their subsequent inclusion on the basis of the good faith principle would run counter to the parties' intention.

The foregoing shows that the application of the UPICC and of the PECL requires a specification of the principle of good faith.

Is it to be intended as an overriding principle, possibly creating, restricting or modifying the obligations that flow from the text of the contract?

Or is it meant to give priority to the contract, ensuring that the obligations contained therein are enforced accurately and precisely as the parties have envisaged them?

This represents the dichotomy between, on the one hand, the understanding of fairness as a principle ensuring balance between the parties notwithstanding the regulation that the parties may have agreed on, and, on the other hand, the understanding of fairness as a principle ensuring predictability, leaving it to the parties to evaluate the desirability of their contract regulation.

To test the ability of the UPICC to harmonise contract law with the help of the abovementioned Unilex database, it may be interesting to examine the case law collected in respect of Article 2.1.17 of the UPICC.

At the date of writing this book, the Unilex database contains five decisions on Article 2.1.17 of the UPICC.[146]

In the first decision, ICC award no 9117 of 1998, the arbitral tribunal emphasises that an Entire agreement clause is to be considered as typical in a commercial contract, and says that 'there can be no doubt for any party engaged in international trade that the clauses mean, and must mean, what they say'.[147] The contract also contained a No oral amendments clause, which is recognised in Article 2.1.18 of the UPICC. This Article contains a provision containing the same restrictions as Article 2.1.17 regarding conduct that has created expectations in the other party. The arbitral tribunal said that 'the explicit integration clause and the written modification clause, as contained in the Contract, operate as a bar against the assumption that a certain behaviour or practice could reach the level of becoming legally binding between the Parties'. Thus, according to this award, the principle of good faith contained in Articles 1.7 and 1.8 of the UPICC, and specified in Articles 2.1.17 and 2.1.18, does not affect a literal application of the contract's language. This approach seems to be consistent with the ideology underlying the drafting style of international contracts, as described in Chapter 1. Consequently, it considerably restricts the applicability of the principles underlying the UPICC.

Another decision mentioned in Unilex under Article 2.1.17 is by the English Court of Appeal.[148] There, Lord Justice Mummery stated that, under English law, extrinsic evidence could be used to ascertain the meaning of a term contained in a written contract if the term was ambiguous or unclear. On the contrary, extrinsic evidence

[146] wwwunilex.info/dynasite.cfm?dssid=2377&dsmid=13621&x=1 (last accessed on 18 November 2022). This page lists six cases, but one of them, ICC award No 9117 of 1998, is listed twice.

[147] The award may be found at wwwunilex.info/case.cfm?pid=2&do=case&id=661&step=FullText (last accessed on 18 November 2022). The paragraphs are not numbered.

[148] *Proforce Recruit Limited* v. *The Rugby Group Ltd* [2006] EWCA Civ 69, www.unilex.info/case.cfm?id=1119 (last accessed on 18 November 2022).

could not be used to ascertain the content of the contract.[149] Lady Justice Arden considered this distinction to be too conservative and argued for a broader use of extrinsic evidence, referring to the UPICC in support of her view.[150]

The narrow use of extrinsic evidence supported by Lord Justice Mummery can be found in another decision listed in the Unilex, rendered on 30 November 2012 by the Sheriffdom of Tayside Central and Fife in Scotland.[151] The dispute arose between a property developer and the buyer of a flat. The parties had entered into a contract relating to a flat then under construction, committing themselves to finalising the sale once the construction was fulfilled. When the construction was completed, the buyer refused to finalise the contract, alleging that the object of the contract had not been sufficiently specified. The developer provided evidence that certain drawings had been provided to the buyer during negotiations, which would make the object of the contract sufficiently determined. The question before the court was whether this kind of extrinsic evidence was allowed, in spite of the presence of an Entire agreement clause. The court affirmed that extrinsic evidence could be used to ascertain the meaning of a term contained in a written contract, and that an Entire agreement clause would not prevent that. It must be noted that the UPICC are not mentioned by the court. They were mentioned by the appellants, alongside numerous English and Scottish authorities, but this reference was not followed by the court.

In addition, Unilex mentions another award,[152] without, however, reproducing its full text. According to the abstract, the tribunal held that an Entire agreement clause simply indicates that there are no binding agreements between the parties other than those contained in the contract but does in no way affect the rules of interpretation established under the applicable law (in the case at hand, Article 1362 of the Italian Civil Code). In reaching this conclusion, the arbitral tribunal expressly referred, along with legal writings, to Article 2.17 (Article 2.1.17 of the 2016 edition) of the UNIDROIT Principles, as well as to the Comments, which state 'the effect of such a clause is not to deprive prior statements or agreements of any relevance: they may still be used as a means of interpreting the written document'.[153]

Finally, Unilex refers to an ICSID award[154] in which the tribunal stated that Article 2.1.17 requires that expectations raised during the negotiations must be reflected in

[149] *Proforce Recruit Limited*, 41. [150] *Proforce Recruit Limited*, 57.
[151] *Scotia Homes (South) Ltd* v. *Mr James Maurice McLean and Mrs Linda Isabella McLean*, www.unilex.info/case.cfm?id=1679 (last accessed on 18 November 2022).
[152] Rendered on 28 November 2002 at the Chamber of Arbitration of Milan, www.unilex.info/case.cfm?pid=2&do=case&id=995&step=FullText (last accessed on 18 November 2022).
[153] www.unilex.info/case.cfm?pid=2&do=case&id=995&step=Abstract (last accessed on 18 November 2022).
[154] *Joseph Charles Lemire* v. *Ukraine*, ICSID Case No ARB/06/18, 14 January 2010.

the text of the agreement.[155]

The Unilex database, in summary, shows two approaches to Article 2.1.17 of the UPICC: one advocating the primacy of the contract's language, and the other assuming that the UPICC provide for the primacy of the real intention of the parties, which, in turn, may lead to restricting considerably the effect of the Entire agreement clause.

Evidently, this is not sufficient to give guidance as to which approach to choose when addressing the conflict between the contract's language and the principle of good faith.

This leaves so much room for the discretion of the interpreter that it seems unlikely that Article 2.1.17 of the UPICC can provide for a harmonised regulation of its subject matter.

(ii) No Waiver We saw in Chapter 1 that one of the typical boilerplate clauses that often recurs in contract practice is the No waiver clause. According to this clause, failure by one party to exercise a remedy to which it is entitled under the contract does not constitute a waiver by that party of that remedy. A literal application of this clause would permit a party entitled to a remedy (for example, the right to terminate the contract) to behave passively, thereby giving the other party the impression that it will not terminate the contract, and then terminating the contract when circumstances make it advantageous for that party. For example, that party could delay the termination until the other party has omitted to enter into other contracts with third parties in reliance on the continuation of this contract, or until prices have changed so much that it will gain by terminating this contract and entering into a corresponding contract with a third party.

As will be seen in Chapter 3, in many civilian systems, this conduct would be considered as being against good faith, and an abuse of the contractual right.

This would also seem to violate the restatements of principles: both the UPICC (Article 1.7) and the PECL (Article 1:201) have a general duty of good faith and specify that it is mandatory. This seems to mean that the duty to act in good faith may not be affected by contract clauses such as the no waiver clause. More recently, the Acquis Principles (Article 7:101) and the DCFR (Article III-1:103), both largely based on the PECL, say that the performance of obligations shall be in accordance with good faith. This entails additional obligations that may be introduced, or even that obligations expressly agreed to by the parties may be modified.[156] Moreover, the Acquis Principles (Article 7:102) and the DCFR (Article III-1:103) say that a right or remedy shall be exercised in accordance with good faith; this means, *inter alia*, that

[155] www.unilex.info/case.cfm?pid=2&do=case&id=1533&step=FullText (last accessed on 18 November 2022).
[156] See Acquis Principles, Part B, Section 3 ('Explanation') in the comments on Article 7:101.

a party may not exercise a right or a remedy that it has according to the contract, if such an exercise violates good faith.

The literal interpretation of the No waiver clause thus may, under some circumstances, be contradicted by the restatements of principles. To what extent the restatements may override the contract text will depend on the interpretation of the principle of good faith. As seen with regard to the Entire agreement clause, this may create uncertainty in the application of the UPICC and the PECL. This prevents the most important goal of these restatements; namely, that of harmonising the law.

(iii) Subject to Contract We saw in Chapter 1 that one of the purposes of letters of intent is to stipulate that a break-off of the negotiations is permitted and that under no circumstances shall this expose any of the parties to liability. This seems to coincide with the approach taken in English law, as will be explained more in detail in Chapter 3. According to this logic, expecting that a party takes into consideration the needs and expectations of the other party while negotiating a contract runs counter to the very essence of a negotiation, where each of the parties positions itself, opens alternative possibilities and plays the various possibilities against each other to achieve the best economic result for itself. The lack of a duty to act in good faith during the negotiations permits a party to conduct negotiations even without having the intention of concluding an agreement with the other party (for example, for the sole reason of preventing the other party from negotiating with a third party, or for obtaining business information, etc.).

Contrary to this approach, the UPICC and the PECL seem to have adopted the opposite civilian approach. The restatements of principles provide that parties must negotiate according to good faith and fair dealing, impose liability for having negotiated contrary to good faith and affirm a duty of information during the pre-contractual phase. These rules may be found in the UPICC (Articles 1.7 and 2.1.15), the PECL (Articles 1:201, 2:301 and 4:106) and the Acquis Principles (Articles 2:101, 2:103 and 2:201).

The DCFR has a more moderate approach without, however, avoiding challenges similar to those just mentioned. The DCFR does not state a general duty of good faith; however, it states the duty to negotiate in good faith (Article II-3:301) and to inform during the pre-contractual phase (Article II-3:101). This latter duty is mitigated, in respect of commercial contracts, by a reference to good commercial practice. As seen in Section 2.2.1(a)(iii), however, the exception for good commercial practice does not seem to constitute a sufficiently precise regime.

The discrepancy between contract practice and the restatements of principles, as well as the different approach taken in the common law system and in these restatements, does not ensure a uniform interpretation of the standard of good faith, as we have seen.

(iv) Termination Other examples may be given of contractual mechanisms that, if used literally, may give permitted results under English law, but lead to results that would be considered to be against good faith under some civilian laws and under the restatements of principles.

Under English law, as will be seen in Chapter 3, the parties may regulate in their contract that certain terms are fundamental and that any breach thereof will be treated as a fundamental breach and entitle the other party to termination and reimbursement of the full value of the contract. It is possible to envisage situations where this mechanism may be misused. A contract, for example, may provide that a party has a right to terminate in case of the breach of specific obligations by the other party. If the breach has actually occurred, but only in an immaterial manner, and so that it has no significant consequences, it might be contrary to good faith to invoke this right of termination. The terminating party might wish to take advantage of the right of termination for other reasons, for example, because the market has changed, and a new contract would be more profitable than continuing to be bound by the old contract. Depending on the interpretation of the underlying principle of good faith, this would be prohibited under the restatements of principles according to Article 7.3.1 of the UPICC and Article 9:301 of the PECL. The lack of a clear standard of good faith, as we have seen, prevents the restatements of principles from harmonising the different legal traditions.

(g) An Autonomous Principle of Good Faith?

As explained in Section 2.2.5(f), the principle of good faith in the UPICC has to be understood not under specific legal traditions, but as good faith in international trade. It remains to ascertain how the principle of good faith is understood in international trade.

Assistance in interpreting autonomously the principle of good faith might be sought in a highly recognised database on transnational law, organised by the University of Cologne under the direction of Professor Klaus Berger: the Trans-Lex Principles Database. The idea behind this database is to enhance the 'creeping codification of the *lex mercatoria*'[157] by creating a comprehensive digest of principles and rules of the transnational commercial law, based on a variety of sources such as 'international arbitral awards, domestic statutes, international conventions, standard contract forms, trade practices and usages, other sample clauses and academic sources'.[158]

It may be interesting here to verify to what extent the use of the Trans-Lex database may succeed in specifying the principle of good faith and thus offer a harmonised standard that is capable of rendering the UPICC and the PECL operative. This would

[157] The idea was introduced in Berger (2010). [158] www.trans-lex.org.

permit the achievement of a uniform application of the clauses discussed in Section 2.2.5(f)(i) to (iv).

The Trans-Lex database lists the principle of good faith and fair dealing as one of the main principles of international contract practice and refers to various sources upon which the principle is said to rely: legal literature, arbitral awards, court decisions, international instruments, model laws and contract terms.[159]

A brief consideration of these sources follows:

(i) The Trans-Lex list of legal literature dealing with the principle of good faith and fair dealing is long and impressive, and it reflects the large variety of positions in respect of the subject, also including those that deny the existence of an international legal standard for good faith and fair dealing.[160] No uniform opinion arises from the doctrine quoted in the Trans-Lex list. From this source, therefore, it is not possible to clarify and specify the content of the standard in international trade.

(ii) Among the twenty arbitral awards listed in the Trans-Lex database in support of the principle, six awards seem to have applied the standard of good faith of a state law,[161] and the remaining awards refer mainly to the principle in general terms, as a moral rule of behaviour. On the basis of these awards, it seems difficult to conclude whether the standard of good faith and fair dealing in international trade is to be interpreted as a moral rule that does not require an active duty of loyalty (such as the standard would be interpreted in common law); as a rule that must ensure that the contract is interpreted and performed accurately (as it would be interpreted in Italian law); as a rule that permits integrating the contract and balancing the interests of the parties (as it would be interpreted in German law); or as a rule that permits correcting the contract and that requires each party to actively take into consideration and also to protect the interest of the other party (as it would be interpreted in Norwegian law), or in another way, that is characteristic only of international trade.

(iii) Ten court decisions are listed, which discuss the principle of good faith from the perspective of national law and therefore are not supposed to be taken into consideration according to Article 1.7(1) of the UPICC. Regarding the international court decisions, their relevance to contract law is doubtful, see Section 2.2.3(b).

(iv) The international conventions mentioned in the Trans-Lex database are the CISG, the UNIDROIT Convention on International Factoring of 1988, the

[159] www.trans-lex.org/901000, last accessed on 8 November 2022.

[160] For example, Peter Schlechtriem, *Good Faith in German Law and in International Uniform Laws* (Pace Law School Institute of International Commercial Law, 1997).

[161] ICC Award No 5832 of 1988 applies Austrian law, ICC Award No 6673 of 1992 applies French law, ICC Award No 8908 of 1999 applies Italian law (corroborated by the UNIDROIT Principles), ICC Award No 9593 of 1999 applies the law of the Ivory Coast, ICC Award No 9839 of 2004 applies US law and CRCICA Award No 154/2000 applies Egyptian law.

Vienna Convention on the Law of Treaties of 1969, the 1965 Washington Convention on the Settlement of Investment Disputes between States and National of Other States (ICSID) and the 2010 Organization for the Harmonization of Business Law in Africa (OHADA) Uniform Act Relating to General Commercial Law. The usefulness of these references is questionable, as will be seen.

(a) The CISG is silent on the question of good faith as a duty between the parties or as a correction to the terms of the contract. As seen in Section 2.2.5(c), this silence is not due to carelessness, but is a conscious choice taken during the drafting. Article 7 is the only provision that makes reference to good faith. Article 7, however, does not formulate a rule directed to regulate the parties' conduct in the contract; it states a rule instructing the interpreter of the Convention. The text and the drafting history of the CISG, therefore, do not seem to cast useful light on the question of specifying the legal effect of a general principle of good faith in international trade.

(b) The Factoring Convention contains, unlike the CISG, a rule prescribing good faith between the parties, in addition to the rule on the interpretation of the Convention present also in Article 7 of the CISG. Incidentally, the presence of a rule on good faith between the parties in addition to a rule on good faith in the interpretation of the Convention seems indirectly to confirm that the rule contained in Article 7 of the CISG is not sufficient to create a duty of good faith between the parties – otherwise, it would not have been necessary to add this rule in the Factoring Convention. The Factoring Convention regards a very specific kind of contract; therefore, it is not evident that its provisions may be extended to all branches of international trade.[162] Even if such an extension was possible, however, the rule on good faith is written in a general way and does not give criteria that could be useful for clarifying its scope.

(c) The Vienna Convention on the Law of Treaties is a convention on how states are supposed to perform the treaties that they have ratified; it does not seem to have direct relevance to the standard between private parties in international commerce, see Section 2.2.3.[163]

(d) The ICSID Convention, in the part highlighted in Trans-Lex, regulates the proceedings of conciliation that may be initiated at the request of a party. A Conciliation Commission shall clarify the issues in dispute and

[162] At the moment of writing this chapter, thirty-five years after its conclusion, the Convention has been ratified by nine countries, see www.unidroit.org/instruments/factoring/status/. Therefore, it cannot be deemed to enjoy a significant scope of application.

[163] On the impossibility of assuming an automatic interchangeability between the fields of public international law and of international commercial law, see Section 2.2.3.

recommend terms of settlement. The parties are under the obligation to cooperate in good faith with the Commission (Article 34). This provision does not clarify what standard of good faith applies to a contract.

(e) The OHADA Uniform Act contains a provision, Article 237, according to which parties to contracts of sale must comply with the principle of good faith. The provision is interesting because it also provides that sales contracts shall be subject to the rules of common law, unless they are contrary to the Uniform Act. As the principle of good faith is not a general principle of common law (see Sections 3.1 and 3.3) the application of the rules of common law will need to be quite selective. This Uniform Act, therefore, does not seem to contribute to the specification of the principle of good faith.

(v) Four restatements of state law are listed as references: the Contract Code drawn by the English Law Commission, the Principles of Latin American Contract Law, the draft Civil Code for Israel and the Uniform Commercial Code of the United States. Being the expression of the legal tradition in the respective states, these instruments cannot be used to support an autonomous interpretation of the standard in international trade. The Trans-Lex database also mentions various other state laws and court decisions: however, as seen, these sources have been expressly excluded by the assessment of the standard of good faith and fair dealing under the UPICC or the PECL, as interpretation is to be made autonomously on the basis of sources within international trade. Moreover, the selection of domestic acts and decisions of states that are in favour of an active rule on good faith, and disregarding acts and decisions of states that restrict the rule (or vice versa), would be arbitrary.

(vi) The Trans-Lex database lists one model contract: the General Conditions of Contract for the Standard Contracts for the UK Offshore Oil and Gas Industry. One clause is highlighted as the main reference to the general duty to act in good faith: Clause 33 on business ethics. This clause contains a commitment to not engage in undue influence or corrupt activities, and does not, therefore, seem to be helpful in substantiating the content of the general duty of good faith. The links to other clauses of the General Conditions (on *Force majeure* and Liquidated damages) are relevant to other principles of the database, and not to the principle of good faith.

(vii) Five transnational instruments are listed in the Trans-Lex database: the already mentioned UPICC, PECL and Acquis Principles; the IBA Rules on Taking of Evidence in arbitration and the principles adopted by arbitral tribunals under the auspices of the Cairo Regional Centre for International Commercial Arbitration. The instruments on procedural issues do not have relevance to the principle of good faith in contracts. The restatements of principles of contract law assume an autonomous interpretation that has to be based on

the standard applied in international trade. When the Trans-Lex refers to the UPICC and the PECL to support a principle of good faith in international trade, it creates a vicious circle, because the UPICC and the PECL, in turn, make reference to international trade practice to substantiate this principle.

In conclusion, digests of principles do not seem to succeed in specifying the content of the principle of good faith in international trade. However, this specification is necessary in order to make restatements such as the UPICC, the PECL or the DCFR operative.

2.2.6 Soft Sources Harmonising Specific Sectors

Transnational sources have proven to be particularly successful in harmonising specific areas of international commercial law – as opposed to the general contract law, which was examined in Section 2.2.5. Harmonisation of specific areas can be achieved in various ways: (i) through binding instruments such as the 1980 Vienna Convention (CISG), which creates a uniform law for certain aspects of sale contracts; (ii) through instruments issued by international bodies but without binding effect, such as the 1985 UNCITRAL Model Law on International Commercial Arbitration, revised in 2006 and meant to be a model for legislators[164] or the UNCITRAL Arbitration Rules of 1976, revised in 2010 and meant to be adopted by the parties as an integration of the arbitration agreement;[165] (iii) through instruments issued by private organisations such as the ICC or the IBA, and without binding effect unless the parties to the contract adopt them – such as the International Commercial Terms (INCOTERMS) or the Uniform Customs and Practice for Documentary Credits (UCP) 600 (formerly 500), the IBA Guidelines on Conflict of Interests, the IBA Guidelines on Taking of Evidence and the Prague Rules; (iv) through model contracts issues by branch associations such as the ISDA Model Swap Agreement; (v) through principles and guidelines issued by international bodies, such as the UN Global Compact and the OECD Guidelines for Multinational Enterprises.

Common to these instruments is the fact that they have a specific scope of application: certain aspects of the contract of sale for the CISG, the procedural aspects of arbitration for the UNCITRAL Model Law on Arbitration and the UNCITRAL Arbitration Rules, the passage of risk from seller to buyer and other specific obligations between the parties for the INCOTERMS and the mechanism of documentary credits for the UCP 600 and so on. These instruments do not have the goal of regulating all aspects of the relationship between the parties, such as the validity of the contract, its interpretation or all remedies for breach of contract.

[164] This instrument is not binding, as it is a model for legislators. If adopted, it will have the force of law in the system that has enacted it.

[165] This instrument is not binding, as it is a model for regulating the arbitral proceeding that the parties to the dispute may decide to adopt. If adopted by the parties, the Arbitration Rules will have the same status as a contract between them.

Thanks to this specific scope of application, the enforceability of these instruments is easy to predict and achieve. As their scope of application is specified and usually well within the scope of the freedom of contract, they are generally enforced without any difficulties, as long as they are adopted by the parties or enacted by the legislator. However, as some examples will show, the soft sources incorporated by the parties have the same force as that of contract terms. Soft law can be considered an extension of the contract and will therefore, together with the contract, be subject to the applicable law.

If the instruments are not incorporated into the contract by the parties, they may nevertheless be applicable as an expression of trade usages. In spite of the undeniably wide recognition of some of these sources, however, they are not always unanimously considered trade usages; in some countries, they are considered standard terms of contract that become effective between the parties only if they have been expressly incorporated.[166] Furthermore, not all publications issued, for example, by the ICC, enjoy the same degree of recognition as the INCOTERMS and the UCP 600; thus, the simple fact that there is an ICC publication is not sufficient evidence that there is a corresponding trade usage.

Some examples of instruments that harmonise specific sectors are given in the following section.

(a) INCOTERMS

The INCOTERMS, a publication by the ICC, illustrate how transnational sources may reach harmonisation by supplementing national law. The INCOTERMS apply to the cross-border delivery of goods, and are divided into eleven different terms, all expressed by three-letter acronyms (such as FOB, CIF, etc.). Each of these abbreviations is a term that allocates specific obligations between the seller and the buyer – primarily, the responsibility for customs clearance, as well as the arrangements and payment for transportation and insurance. In addition, each abbreviation defines where delivery is deemed to have been made, and the consequent passage of risk from the seller to the buyer. By writing the abbreviation in the contract and specifying the place of delivery, the parties incorporate the corresponding allocation of obligations, and do not need to regulate all these matters in the contract. For example, writing that delivery has to be made FOB at a named port, means that the seller has to clear the goods for export, transport the goods to the named port and have them loaded on the ship organised by the buyer. The goods are deemed to be delivered when they are loaded on the ship, and any damage to the goods occurring after the delivery will be at

[166] See for references, see Hans van Houtte, *The Law of International Trade*, 2nd ed. (Sweet & Maxwell, 2002), Section 8.15. On the challenges that courts may face in applying the UCP in spite of their general acknowledgement, see Christian Twigg-Flesner, 'Standard Terms in International Commercial Law: The Example of Documentary Credits'. In Reiner Schulze (ed.), *New Features in Contract Law* (Sellier European Law Publishers, 2007), pp. 325–39.

the risk of the buyer. The buyer is responsible for arranging the ship and the rest of the transportation to the destination and arranging insurance and import clearance.

A dispute over whether the seller is obliged to clear the goods for export, who bears the risk of loss until delivery or who was supposed to pay for the insurance during transportation will be easily solved by verifying which term of the INCOTERMS the parties have chosen.[167] Other disputed matters, such as the validity of the contract or what remedies are available in case of default, are not regulated by the INCOTERMS. For these matters, it will be necessary to consult the governing law. Even matters that are within the scope of the INCOTERMS may be subject to different regulation by the governing law. For example, the question of liability for damages to the goods under transportation, normally directly regulated by the INCOTERMS, may be decided differently under the governing law in the case of exceptional circumstances beyond the parties' control, discharging the seller from the obligations that the contract has imposed on it. Thus, the INCOTERMS are based on the principle that the buyer bears the risk for loss of the goods if the loss occurs after the goods were delivered or were deemed to have been delivered. If the goods are lost after the risk has passed to the buyer, the buyer still has to pay the price to the seller. This, however, may be affected by the governing law. Assuming, for example, that both parties belong to countries that have ratified the CISG, the sale will be subject to the Convention's provisions. Article 66 of the CISG states that, in cases where the goods are lost due to an act or omission by the seller, the buyer is not bound to pay the price to the seller, even if the loss occurred after the risk had passed to the buyer. In a sale that incorporates the INCOTERMS and is subject to the CISG, both rules are applicable. The apparent contradiction may be explained in view of the limited scope of application of the INCOTERMS: this instrument is not concerned with questions regarding the validity of the contract, negligence of the parties, criteria for determining whether the delivery conforms to the specifications and so on. These aspects are left to the general contract law to govern. The general rule of the CISG actually confirms the allocation of risk made in the INCOTERMS (Article 66); however, the CISG also regulates the eventuality of negligence by the seller, which is not regulated in the INCOTERMS, hence, the difference between the two rules.

[167] The eleven terms are divided into seven rules for any mode of transport and four rules for sea and waterway transport. Until 2010, the terms were divided into four groups. This division was abandoned in the 2010 and the 2020 versions, but it is still useful and applicable: the so-called E-terms (such as Ex Works), determining that delivery is made at the place of departure and the goods need not be cleared or loaded; the F-terms (such as Free on Board, FOB), determining that the main carriage is unpaid by the seller, but the goods must be cleared for export; the C-terms (such as Cost Insurance Freight, CIF), determining that the risk passes, although the main carriage is paid by the seller; and the D-terms (such as Duty Delivery Paid, DDP), determining that delivery is made on arrival of the goods to the destination.

(b) UCP 600

The UCP 600, a publication by the ICC regulating the payment mechanism of letters of credit (L/C, also called documentary credits) are another example of soft law that supplements the governing law. Like the INCOTERMS they regulate a specific mechanism and do not have the goal of covering general matters of contract law. However, they have a larger scope of application and in some situations, they may conflict with mandatory rules of the governing law, as will be seen in Section 2.3.2(a).

Letters of credit are a widely used method of payment, applied when the creditor does not intend to take the commercial risk connected with the creditworthiness of the debtor. Modern technology, particularly the use of blockchain, is gradually taking over, thus reducing the share of payments made by letters of credit.[168] However, the mechanism of a traditional letter of credit and that of a payment through blockchain are comparable.

Letters of credit are mainly used as a method of payment in sale contracts. In this case, it is the buyer who is requested to open a letter of credit in favour of the seller. However, letters of credit may be used in any situation where a party owes a determined amount of money to another party. Often, for example, letters of credit are used to support payment under performance guarantees – for example, in a long-term supply contract the buyer may request the supplier to guarantee that the supplies will comply with the agreed time schedule and quality specifications. In case of noncompliance, the supplier will have to make payment under the guarantee. In this case, it will be the seller who is required to open a letter of credit in favour of the buyer.

A letter of credit is structured as follows: the debtor (called the applicant) requests a bank (called the issuing bank) to issue a letter of credit in favour of the creditor (called the beneficiary). The application contains the instructions for the issuing bank and must state the precise amount of money that has to be paid, as well as the documents, upon the presentation of which the bank has to effect payment. This is the main characteristic of a letter of credit: the bank has to effect payment upon presentation of the documents that are named in the instructions. The bank simply has to verify the conformity on the face of the presented documents and is not requested to assess the proper performance of the underlying transaction, or any other matter. Presentation of the documents is necessary and sufficient to trigger payment by the bank (which explains why letters of credit are also known as documentary credits); the obligation to pay is the bank's own obligation, which means that the beneficiary bears the commercial risk connected with the creditworthiness of the bank, and not of the applicant. An implication of this fact is that the bank's obligation is autonomous, as the bank does not have any dealings with the

[168] Agatha Brandão, Lauro Gama and Geneviève Saumier, 'The Effectiveness of International Legal Harmonization Through Soft Law (With a Focus on the UCP 600)'. *General Report presented at the XXI Congress of the International Academy of Comparative Law* (Intersentia, Forthcoming 2024).

underlying transaction upon which the beneficiary's credit towards the applicant is based. The bank's obligation to pay is based on the letter of credit alone. Therefore, the bank cannot invoke defences arising out of the underlying transaction to withhold payment, as long as the listed documents have been presented for payment. The autonomous character of the bank's payment obligation is one of the most characteristic aspects of a letter of credit, and is codified in the UCP 600, Articles 4 and 5.

The UCP 600 enjoy, as already mentioned, a general recognition as regulations for letters of credit; they are, at the same time, a source of regulation and a codification of generally acknowledged practices within that area. In particular, the two aspects mentioned – the autonomy of the payment obligation and the implication of the roles as the advising or corresponding bank – are uniformly applied in letters of credit, irrespective of the fact that the particular letter of credit may or may not make express reference to the UCP 600.

(c) Model Contracts

Perhaps the most successful model contract, that has been enjoying a de facto monopoly for nearly forty years, is the ISDA Master Swap Agreement. This is a model contract for Swap agreements – financial agreements according to which the parties exchange each other's credit or debit positions (floating interest rate against fixed interest rate, or a currency against another currency).

The rationale of these agreements is either hedging an interest or currency risk (if a party has income in one currency but expenses in another currency, it is exposed to the risk that one currency loses its value in respect of the other, and that the expenses become higher. By swapping one of the currencies into the other, it excludes this risk), or speculation (if a party believes that the value of a certain currency or the interest rates will fluctuate in a certain way, it may swap its exposure in other currencies or other rates to gain from the fluctuations).

Swap agreements are one of the most standardised types of contract: from the very beginning of the development of this kind of contract, in the 1980s, the ISDA has published and periodically updated a Master Swap Agreement. Practically all swaps carried out between professional parties incorporate the ISDA Master Agreement.

Operators on the financial market know by heart the various provisions of the Master Agreement and refer to them by their numbering, immediately understanding each other irrespective of whether they are located in England, Japan or Brazil. The Master Agreement is extremely detailed and very systematic, and it is supplemented by Codes of Conduct, Definitions and various publications and initiatives of the ISDA.

The Master Agreement goes as far as it is thinkable in creating a self-sufficient, closed world for Swap agreements.

Notwithstanding the systematicity and exhaustiveness of the Master Agreement, however, it is customary for banks to request that the contract is accompanied by

a legal opinion rendered by a law firm active in the place where the counterparty is located, as well as, if it is different, by a law firm active in the jurisdiction the law of which is applicable to the Swap agreement. The purpose of the legal opinion is to make sure that the terms of the Master Agreement can be enforced and that the applicable law is complied with. Nevertheless, there is a large amount on litigation on Swap agreements, among others, regarding the influence of the law governing the capacity of the parties, see Section 4.5.2(d).

(d) The UNCITRAL Model Law on International Commercial Arbitration

Soft law also covers procedural matters.

A very successful source of soft law is the 1985 UNCITRAL Model Law on International Commercial Arbitration, revised in 2006.[169] This Model Law has been adopted in over eighty states,[170] and has been largely followed or used as a term of reference in a series of other states. For example, Sweden and England have Arbitration Acts that follow their respective legislative tradition and cannot be considered as having adopted the Model Law. However, the Model Law has consistently been taken into consideration in the drafting work.

(e) IBA Guidelines on Conflict of Interests

Another instrument of soft procedural law is the International Bar Association (IBA) Guidelines on Conflicts of Interest in International Arbitration.[171] They are a source of soft law meant to provide specific content to the principle of independence and impartiality of adjudicators – a principle widely recognised in all forms for adjudication, but in need of concretisation.[172]

The IBA Guidelines contain three lists of types of relationships between the adjudicator and the dispute. The lists are divided according to the impact that the relationship is likely to have on the outcome of the decision.

The red list contains examples of connections that are so close that an adjudicator cannot be deemed to be impartial or independent. When there is a relationship as described in the red list, an adjudicator is conflicted and cannot serve as an arbitrator. The red list is divided into two: a waivable list of situations where the arbitrator may serve on the condition that the parties expressly accept the appearance of lack of independence and impartiality, and a non-waivable list of situations where the

[169] The text of the Model Law can be found at https://uncitral.un.org/en/texts/arbitration/modellaw/commercial_arbitration.

[170] The list of states that have adopted the Model Law can be found at https://uncitral.un.org/en/texts/arbitration/modellaw/commercial_arbitration/status.

[171] www.ibanet.org/MediaHandler?id=e2fe5e72-eb14-4bba-b10d-d33dafee8918.

[172] For references, see Giuditta Cordero-Moss, 'Independence and Impartiality of International Adjudicators'. *General Report presented at the XXI Congress of the International Academy of Comparative Law* (Intersentia, Forthcoming 2023).

arbitrator may not serve – not even if it is accepted by the party to whose disadvantage the conflict may have effect. This shows that certain safeguards provided by the principle of independence and impartiality are so fundamental to the credibility of arbitration as a method to settle disputes, that they may not be waived by the parties. The non-waivable red list includes close connections between the arbitrator and one of the parties, while the waivable red list includes the arbitrator's prior involvement in the dispute, as well as close relationships with the parties or their counsel. Examples of non-waivable circumstances are that the arbitrator is a representative of one of the parties, has a significant interest in one of the parties or in the outcome of the dispute or regularly advises one of the parties and derives significant income therefrom. Examples of waivable circumstances are that the arbitrator has been involved in an earlier stage of the dispute, or that the arbitrator or a member of the arbitrator's family has interest in the outcome of the dispute or has a close relationship with one of the parties.

The orange list contains situations where doubts about the arbitrator's independence and impartiality are justifiable. These situations must be disclosed by the arbitrators, and the arbitrator may serve if the parties do not raise objections. Examples are: having repeatedly been appointed by one of the parties, having acted for or against one of the parties or having advocated an opinion on the case in dispute.

The green list contains situations that are deemed not to raise doubts about the arbitrator's independence and impartiality – such as having expressed an opinion on a legal issue that also arises in the dispute, having academic contacts with other arbitrators or with counsel or participating in the same professional alliance.

The IBA Guidelines are widely used in international arbitration.[173] Furthermore, they are generally considered also to be useful for other types of adjudication, although this is not uncontroversial.[174]

(f) IBA Rules on Taking of Evidence and Prague Rules

Another successful instrument of soft procedural law issued by the IBA are the IBA Rules on the Taking of Evidence in International Commercial Arbitration. This instrument contains guidelines about how evidence is to be produced before arbitral tribunals.

The technicalities on production of evidence are usually not regulated in arbitration law or in arbitration rules, and for a good reason: arbitral proceedings should not be burdened by too detailed procedural rules, and the arbitral tribunal should have the flexibility to determine, on the basis of the circumstances of the specific case, how the parties are to produce evidence. However, such flexibility is not compatible with

[173] School of International Arbitration of Queen Mary, University of London and White & Case. 2015 *International Arbitration Survey Improvements and Innovations in International Arbitration* (2015): 71% of the participants in the survey have seen the Guidelines used in practice, and 60% consider them effective.

[174] Makane Moïse Mbengue and Damien Charlotin, 'The Independence and Impartiality of Adjudicators in the International Court of Justice and the International Tribunal for the Law of the Sea'. In Cordero-Moss (ed.), 'Independence and Impartiality' (Intersentia, Forthcoming 2023).

predictability, which is another important interest in need of protection. In international arbitration, where each member of the arbitral tribunal and each of the parties may have legal backgrounds from different legal families, there may be various conflicting expectations about how the proceedings are to be organised and how evidence is to be produced.

For the purpose of guiding the tribunal's discretion and thus creating some predictability, the IBA Rules were created and published. They were first issued in 1999 and recently updated in 2020, and are a widely accepted guide containing procedural suggestions to enhance efficiency in arbitral proceedings.[175] Arbitrators often suggest adopting them in the specific proceedings – although, in my own experience, parties usually decline to incorporate the IBA Rules and thus make them binding; they prefer to make some loose reference such as that the arbitral tribunal may use them as a guideline, in case the parties have not agreed otherwise.

As a reaction to the IBA Rules, the Inquisitorial Rules on the Taking of Evidence in International Arbitration, otherwise known as the Prague Rules, were introduced. The Prague Rules were published in 2018 and are intended to offer an alternative basis for dealing with evidence in arbitration as an alternative to the IBA Rules, which the Prague Rules criticise for being too heavily influenced by common law traditions and for not sufficiently reflecting civil law traditions.

There are, therefore, two competing compilations of soft law regulating the same issue. This makes it difficult to assert that soft law represents generally acknowledged principles or usages in this area.

(g) Corporate Social Responsibility

An area in which soft law exercises a considerable impact, both on contracts and on legislation, is that of so-called Corporate Social Responsibility.

The issue of companies' accountability for the whole value chain is raised with increased frequency,[176] particularly as far as concerns the violation of human rights, labour law or environmental law incurred abroad by subsidiaries or suppliers.

[175] School of International Arbitration of Queen Mary and White & Case (2015): 71% of the participants in the survey have seen the Rules used in practice, and 69% consider them effective.

[176] Literature on the issue is vast, and there is a growing case law in various countries. For an overview and references, see Catherine Kessedjian and Humberto Cantú Rivera (eds.), *Private International Law Aspects of Corporate Social Responsibility* (Springer, 2020); Lise Smit, Claire Bright, Robert McCorquodale, Matthias Bauer, Hanna Deringer, Daniela Baeza-Breinbauer, Francisca Torres-Cortés, Frank Alleweldt, Senda Kara, Camille Salinier and Héctor Tejero Tobed, *European Commission Study on Due Diligence Requirements Through the Supply Chain: Final Report* (Publications Office, 2020), https://data.europa.eu/doi/10.2838/39830; Anne Peters, Sabine Gless, Chris Tomale and Marc-Philippe Weller, *Business and Human Rights: Making the Legally Binding Instrument Work in Public, Private and Criminal Law*. Max Planck Institute for Comparative Public Law and International Law Research Paper Series No 2020–06 (2020); Hans van Loon, 'Strategic Climate Litigation in the Dutch Courts: A Source of Inspiration for NGO's Elsewhere?' *Acta Universitatis Carolinae Iuridica* 66.4 (2020), pp. 69–84.

One of the effects of the (at least, until recently) ever-increasing internationalisation of business since the middle of the last century has been a growing openness between the world's economies, cultures and populations. Increased international cooperation has had numerous and important positive aspects but has also had undesirable consequences which are reflected in the growth of a widespread political criticism against globalisation.

One of the effects of globalisation is that enterprises increasingly move their production or part of their activity to countries with a lower operations cost. This race to reduce costs is mainly dictated by the need to remain competitive in a market in which low-cost products threaten the survival of enterprises who are subject to higher production costs. Enterprises thus reduce their activity in their home country and move it to low-cost countries (such as, in our example, the fictional country of Ruritania).

Among other consequences, this implies that their activity no longer needs to comply with the home country's standards – for example, in the field of labour law, safety or environmental protection. Instead, the activity complies only with Ruritania's local standards.

If the local standards are less stringent than those prevailing in the home country, this would be reflected in correspondingly lower production costs: employees would work longer hours for less pay, payments to welfare and social security would be low, procedures and practices ensuring safety at work would be less demanding, investment to ensure environmental protection would be modest and so on. While all this ensures low production costs and thus the possibility of remaining competitive on the home market, it does not contribute to improving the local social and environmental conditions in Ruritania.

For a long time, this has been deemed to be perfectly in compliance with the legal structure applied to organise commercial activity.

A company would establish local subsidiaries in Ruritania, who would be independent legal entities with limited liability, and the subsidiaries' activity would be treated as separate from the parent company's own activity.

Alternatively, a company might have outsourced parts of its activity to third parties in Ruritania, thus enhancing even more the separation of its own activity and that of third-party suppliers.

The principle of limited liability is one of the pillars of economic activity and permits the circumscription within the local subsidiary or within the supplier of any liability in respect of labour, safety or environmental standards. The parent company or the principal cannot be blamed for having breached its home country's standard, because the activity is not carried out by that company directly, and furthermore the home country's standards do not apply outside of the home country's territory. Therefore, companies can take advantage of the low level of costs in Ruritania, without being held to be in breach of standards that are not applicable there.

Increasingly, this state of things has been found to be unsatisfactory.[177]

Instruments have been developed[178] to induce a responsible corporate and commercial activity, in particular, specifying expectations of due diligence when a company relies on a production chain or value chain. Among the instruments that received considerable international attention are the UN Global Compact[179] and the Ruggie principles,[180] which were followed by the OECD Guidelines for Multinational Enterprises[181] and the OECD Due Diligence Guidance for Responsible Business Conduct.[182] National plans have been to implement these guidelines in several countries.[183]

All these initiatives are non-binding instruments that primarily rely on voluntary compliance. They represent, therefore, an example of soft law.

However, as will be briefly explained, soft law is hardening: in part through codification by the national legislator or at the regional or international level; in part by operation of commercial parties who refer to soft law standards in their contracts thus agreeing to be bound by them; and in part through case law that increasingly recognises that breach of the duties of care and diligence may be a basis for tort liability.

Regarding the first-mentioned method to harden soft law, it can be pointed out that the OECD Guidelines and Guidance are increasingly being implemented in domestic legislation, in, among others, France and Germany.[184]

The EU is working on extensive regulation of the matter – most recently, on 23 February 2022 the Commission adopted a proposal for a Directive on Corporate Sustainability Due Diligence.[185]

The hardening of soft law through *contractual means* was initially promoted by multinational companies who imposed duties of diligence on their contractual parties and requested that they in turn imposed corresponding duties on their contractual parties.[186] Increasingly, these contractual mechanisms rely not only on the parties'

[177] For an early emphasis on the advisability to take into consideration sustainability in the corporate and commercial law discourse, see Beate Sjåfjell, www.jus.uio.no/ifp/english/people/aca/beatesj/.

[178] For an overview, see Peters et al. (2020).

[179] An initiative launched in 2000 and supported by the UN, based on the voluntary commitment by CEOs to implement sustainability, www.unglobalcompact.org/about.

[180] UN Guiding Principles on Business and Human Rights, www.business-humanrights.org/en/big-issues/un-guiding-principles-on-business-human-rights/.

[181] www.oecd.org/daf/inv/mne/48004323.pdf.

[182] www.oecd.org/investment/due-diligence-guidance-for-responsible-business-conduct.htm.

[183] For an overview, see www.ohchr.org/en/special-procedures/wg-business/national-action-plans-business-and-human-rights.

[184] See Fabienne Jault-Seseke (forthcoming).

[185] COM(2022) 71 final. For an analysis of the legislative process see European Group for Private International Law (GEDIP/EGPIL). *Recommendation of the European Group for Private International Law (GEDIP/EGPIL) to the European Commission concerning the Private international law aspects of the future Instrument of the European Union on* [Corporate Due Diligence and Corporate Accountability], adopted on 8 October 2021 and updated in 2022, https://gedip-egpil.eu/wp-content/uploads/2021/02/Recommandation-GEDIP-Recommendation-EGPIL-final-1.pdf, p. 19f.

[186] See, for references, Peters et al. (2020), p. 12f.

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voluntary compliance with soft law, but on the necessity to comply with the above-mentioned applicable legislation.

As will be seen in Section 2.3.2(c), the hardening of soft law through *case law* has in recent years moved away from the traditional approach, which was based on company law mechanisms, towards an approach based on tort liability.

2.2.7 Summing Up

Transnational rules regulating specific aspects of a legal relationship are a useful complement to the governing law and are enforceable if they are incorporated into the contract by the parties and do not violate the mandatory rules of the governing law. If these rules represent trade usages, they will be applicable even without incorporation by the parties since most of the legal systems refer to trade usages.

Even if they are incorporated by the parties into the contract, however, these sources do not replace the governing law. They cannot replace the governing law because they only regulate specific aspects of the legal relationship. Any issues that fall outside of their narrow scope will be regulated by the governing law. Furthermore, both the contract and the incorporated sources will be subject to the applicable law, as will be seen in Section 2.3. If these rules are enacted in binding instruments, such as national laws or international conventions, they may also have the ability to prevail over mandatory rules.

2.3 No Replacement of the Governing Law

As seen in Section 2.2.1, the spontaneous development via market forces as well as a restatement of European law (without enactment or legal basis within private international law) were described as insufficient to replace state law by two of the most transnational law-friendly entities: the authors of the PECL and the ICC.

Even stronger doubts apply in respect of the other sources of transnational law previously mentioned, which (apart from the UPICC, that in this respect can be compared to the PECL) do not even have the goal of being comprehensive or of restating the law, but simply provide a regulation of specific types of contract or of specific areas.

As already mentioned throughout this chapter, several of the compilations of soft law that proliferated in the past decades are widely recognised and are often extremely useful. There are many reasons to hold them in high regard. However, they should be regarded for what they can achieve: to complement the governing law. They should not be expected to replace it.

The following analyses the ability of transnational law to govern a contractual relationship to the exclusion of any national law.

2.3.1 Can Transnational Law be Chosen as the Only Governing Law?

I have already mentioned that sources of soft law do not regulate the totality of legal effects that may arise in a legal relationship. This applies not only to the sources with a narrow scope of application, such as the INCOTERMS or the UCP 600, but even to the sources that aim at regulating the generality of contract law, such as the UPICC. The contractual law effects will have implications in other areas of the law, such as property or company law, see Section 4.4. It is, therefore, evident that transnational law, which mainly covers contract law issues, cannot exclude application of state law for the issues that fall within other areas.

However, there is another question that needs to be addressed. It relates not to the areas that are not covered by the transnational law, but to the areas that are covered by it.

What is the legal basis for claiming that transnational sources may govern a contract to the exclusion of any other governing law?

If they are to replace the governing law, they will not be subject to any mandatory rules or principles of the otherwise applicable law, with the exception of overriding mandatory rules, as explained in Chapter 4. Additionally, in the case of gaps or a lack of clarity, there will be no governing law to fall back on.

If, on the contrary, transnational sources are simply incorporated into the contract and become contract terms, they remain subject to any mandatory rules of the applicable law, and they will be interpreted according to the governing law's underlying principles and integrated by the governing law's default rules.

The wording of Article 1.4 of the UPICC seems to suggest the latter alternative: 'Nothing in these Principles shall restrict the application of mandatory rules, whether of national, international or supranational origin, which are applicable in accordance with the relevant rules of private international law.'

This restrictive approach is reflected in the private international law systems, as will be seen in Section 4.3.3.

The distinction between choosing non-state law as a governing law (which is not allowed) and incorporating non-state law as a term of contract (which is allowed) is reflected in both US[187] and EU private international law.

Under EU law, the Rome I Regulation on the Law Applicable to Contractual Obligations excludes that the parties may select, to govern their contract, sets of rules that are not national laws (with an exception for possible future European instruments of contract law).[188] The Rome I Regulation is a conversion of the

[187] Restatement (Second), § 187. For comments and further references, see Eckart Gottschalk, Ralf Michaels, Giesela Rühl and Jan von Hein (eds.), *Conflict of Laws in a Globalized World* (Cambridge University Press, 2007), pp. 153–83. Also available as CLPE Research Paper 4/2007 at http://comparativeresearch.net/ and at http://ssrn.com/abstract=921842.

[188] Council Regulation No 593/2008, 4/7/2008, OJ L 177/6, Article 3. The Preamble, in item 13, confirms that nothing prevents the parties from incorporating into the contract transnational instruments of soft law; as a consequence of such an incorporation, however, the soft law is given the status of a term of contract, not of governing law. See also Goode et al. (2015), paras 14.18 ff.

previous 1980 Rome Convention on the Law Applicable to Contractual Obligations. According to the prevailing opinion, the Rome Convention permitted the parties to choose, as governing law, a national law, but not transnational sources. In connection with its conversion, proposals were made to extend the scope of party autonomy to transnational sources;[189] however, these proposals were not accepted and the adopted text of the Rome I Regulation has finally clarified that the parties may only choose a national law with which to govern their contract.

Incidentally, an extension of party autonomy would only have provided a partial solution: the parties' choice would have had effect only within the scope of party autonomy, thus leaving unaffected the areas where other conflict rules are applicable. As will be seen in Section 4.4, whenever the legal relationship has implications that go beyond the mere contract law, party autonomy does not apply and other conflict rules step in to select the governing law. Thus, if the contract has implications in terms of property law (a pledge as security for a party's obligations), of company law (a Shareholders agreement regulating the competence of corporate bodies) or of insolvency law (a Loan agreement with an Early termination clause that would affect the solvency of the debtor), just to name some common situations, the law applicable to those aspects will be selected on the basis of specific conflict rules, and not on the basis of the choice made by the parties.

Another instrument of private international law has a more generous approach: the 2015 Hague Principles on Choice of Law in International Commercial Contracts allow, in Article 3, for the possibility that the parties choose transnational sources as a governing law.[190] The Hague Principles are an instrument of soft law, and they are thus not intended to be binding. However, they have already been used as a model for state legislation,[191] and they may gain more importance with time. Considering the unclear relationship between arbitration and private international law described in Section 4.5, it seems that this instrument may be particularly useful within international arbitration.

Transnational sources, thus, may be incorporated into the contract by the parties, but traditionally may not be selected to govern the contract to the exclusion of any national law, not even in mere contractual matters.

In commercial arbitration, in contrast, arbitration laws and arbitration rules often give the parties the possibility of choosing 'rules of law' to govern the dispute; these

[189] The Green Paper on the conversion of the Rome Convention, COM (2002) 654 final, Section 3.2.3, asked whether the rule on party autonomy should be changed so that the parties are allowed to choose an international convention or general principles of law instead of a national law. The original proposal by the Commission, COM (2005) 0650 final, contained rather restrictive access to do so, but this formulation was deleted in the finally approved text of the Regulation.

[190] For an analysis of the history of this provision, see Michaels (2014), Section III.C.

[191] The 2015 Paraguay Act on the law applicable to international contracts is said to be modelled on the Hague principles, see Thomas Kadner Graziano, 'The Hague Solution on Choice-of-Law Clauses in Conflicting Standard Terms: Paving the Way to More Legal Certainty in International Commercial Transactions?' *Uniform Law Review* 22.2 (2017), pp. 351–68, footnote 16.

words, as opposed to 'law', are interpreted as extending beyond national laws and to also covering transnational sources, as will be explained in Section 5.6.7.

The UNIDROIT, in its Comments on the Model contract clauses it recommends as reference to the UPICC, confirms the point of view that the UPICC are simply incorporated into the contract when the dispute is decided by a court, whereas they, under some circumstances, may be chosen as governing law when a dispute is submitted to arbitration.[192]

This does not necessarily mean that the parties enjoy much more flexibility during arbitration: the following sections will show that transnational law does not have the necessary systematicity to govern a relationship to the full exclusion of national laws.

State law is still applicable to a certain extent even though a contract is governed by the UPICC. Where there are gaps in the UPICC, and where an autonomous interpretation is not possible, where there are issues that are not covered by the UPICC, or where there are overriding mandatory rules, it will be necessary to apply a state law.

For this reason, the UNIDROIT recommends that the parties specify, in the clause with which they choose that the contract shall be governed by the UPICC, which state law will supplement the UPICC.[193]

Moreover, even in areas where the issue falls within the scope of the UPICC and the UPICC contain a regulation, the interpreter's legal tradition may have a considerable influence on how the UPICC are applied. Although the UPICC posit that they shall be interpreted autonomously (see Section 2.2.5(f)), and although arbitration enjoys a relative autonomy from national laws, there is not always a unitary, transnational regime that can be used to substantiate or specify the UPICC.

In particular, as I have explained in Section 2.2.5(f), the UPICC contain an overarching principle of good faith. It is doubtful that a uniform interpretation may actually be achieved in areas where value-based principles such as the principle of good faith need concretisation, see Section 2.2.5(g). Particularly challenging is the relationship between contract terms agreed by the parties on one hand, and UPICC provisions based on the good faith principles, on the other hand.

The good faith-based provisions aim at preventing a literal application of the contract terms, where this may allow one party to reach speculative results. But should arbitrators apply the contract accurately, or should they override the agreed terms in the name of the good faith principle? In Section 3.7.2, I will refer to a seminar held some time ago that showed that, in a room with twenty-one prominent arbitrators, six different approaches were represented, ranging from the accurate application of the contract wording, even though this means disregarding the governing law, to the accurate application of the law, even though this means disregarding the contract wording.

[192] UNIDROIT, Model Clauses for the Use of the UNIDROIT Principles of International Commercial Contracts, www.unidroit.org/instruments/commercial-contracts/upicc-model-clauses/, Model Clause No 1, General remarks, § f.

[193] In the document containing model clauses, at clause 1.2.

Given that the UPICC are prone to being applied differently depending on the interpreter's understanding of where the balance should be struck between accurate application of the contract and the equilibrium between the parties' interests, arbitration does not seem to ensure a uniform application of the UPICC.

A uniform application of the UPICC is rendered particularly difficult by the evident tension between two opposed interests that inform, respectively, contract practice and the UPICC. In contract practice, predictability is of the essence, see Chapter 1. In the UPICC, the main goal is to give the interpreter the means to ensure a reasonable and balanced relationship between the parties – even when this means interfering with the agreed contract terms, and thus affecting predictability.

In keeping with the central role of the agreed terms, international arbitration is a system based on the will of the parties. Arbitrators are expected to abide by the will of the parties and not apply undesired sources that bring unexpected results. Moreover, arbitral awards enjoy broad enforceability and the possibility of courts interfering with them is extremely limited, as will be seen in Chapter 5. The court's opinion on the legal effects of the contracts, therefore, becomes largely irrelevant. However, so far it does not seem that the autonomy of arbitration has led to a uniform application of the principle of good faith in the UPICC. It can be assumed that arbitrators will take the approach that they consider most reasonable, which will often coincide with the principles of their legal traditions.

Therefore, there is little difference between incorporating the transnational law as if it were the terms of the contract, and choosing it as a governing law: ultimately, a national law will necessarily be applicable – either directly, or indirectly by exercising influence on the interpretation of the soft law instruments.

2.3.2 When the Transnational Law Conflicts with the Governing Law

In many situations, transnational sources will be applied as a supplement to the governing law – either because they regulate details that are not regulated by the governing law, or because they regulate matters that are not regulated by the mandatory rules of the governing law.

Generally, within the field of contract law, the law permits the parties to regulate their interests in a way that differs from the regulation contained in the law itself. The law, in other words, is generally not mandatory, but applied as default rules, in case the parties have not agreed on a specific regulation. The parties may agree on specific terms of contract, or they may refer to sources of soft law, thus incorporating the soft law into their contract. In either case, the terms negotiated by the parties or incorporated by them can integrate or deviate from the governing law.

In some situations, however, transnational sources might conflict with the mandatory rules of the applicable law. The relationship between contractual terms and transnational law on one side, and state law on the other side, then becomes apparent. In the following sections are some examples where the UCP 600, the ISDA Master

Swap Agreement, the UPICC and the IBA Guidelines on Conflict of Interests cannot deviate from the mandatory rules of the governing law.

(a) The UCP 600

As seen in Section 2.2.6(b), the UCP 600 are a successful source of soft law regulating letters of credit. In some cases, the mechanism of the letter of credit has been considered to conflict with the rules of the governing law and has been overridden by state law.

In particular, the two aspects mentioned – the autonomy of the payment obligation and the implication of the roles as the advising or corresponding bank – are uniformly applied in letters of credit, irrespective of the fact that the particular letter of credit may or may not make express reference to the UCP 600.

However, in some cases, these principles of the letters of credit have been considered to conflict with the rules of the governing state law and have been overridden by state law. Some of these cases will be examined further. For the sake of completeness, it must be recognised that the cases discussed represent the exception rather than the rule. Some have implications of a political nature and others may be criticised for being wrong. The purpose of highlighting these cases is not to question the ability of the UCP 600 to properly regulate letters of credit – a task that the UCP 600 actually carries out very well. The purpose is to show that there may sometimes be tension between transnational sources and the governing law; and that, in these cases, the governing law will prevail.

(i) Case 1 Case 1[194] presented the following scenario. The beneficiary of a letter of credit presents documents to obtain payment under the letter of credit. The bank refuses payment, because not all of the documents listed in the instruction have been presented. In particular, a 'Receipt signed and proving delivery of the goods' was listed as one of the documents to be presented but is not. The beneficiary claims that payment is due in spite of the lack of these documents, because the delivery can be proven by other means. Is the beneficiary entitled to obtain payment under the letter of credit?

According to the principles that rule documentary credits, as seen, the obligation of the bank to pay is strictly dependent on the instructions that it has received. If the instructions provide for payment upon presentation of specific documents, then payment has to be effected upon presentation of those documents (irrespective of any supervening circumstance), and only upon presentation of exactly those documents. Payment on presentation of documents different from those listed in the instructions can expose the bank to liability towards the applicant.

[194] *Société de Banque Suisse* v. *Société Generale Alsacienne de Banque* [1989] BGE 105 II 67.

In the case described here, the receipt was one of the listed documents, and was not presented.[195] An application of the principles governing the documentary credits, therefore, should lead to the conclusion that payment was not to be effected by the bank. The creditor maintains its claims towards the debtor, but the bank cannot effect a payment in violation of the instructions. The creditor will have to satisfy its claim directly with the debtor.

However, the Swiss Supreme Court, in the analysed case, decided in the opposite way. The reason for deciding that the bank had to effect payment was that, by not effecting payment by invoking the instructions, and in spite of the presence of other documentation showing that payment was due, the bank would abuse its rights. This abuse of rights would be in contrast with Article 2 of the Swiss Code of Obligations, which is mandatory. We have here an example of a conflict between a principle of transnational law (the irrelevance of the underlying obligation to a letter of credit) and the mandatory rules of the national governing law, whereby the state law prevailed.

(ii) Case 2 Case 2[196] presented the following scenario. A letter of credit is issued by a Ugandan bank. Citibank of New York acts as an advising bank. In 1972, the Ugandan government prohibits the Ugandan bank from making a foreign exchange payment to the Israeli beneficiary. Consequently, the issuing bank instructs the advising bank to cancel the letter of credit. The beneficiary claims payment under the letter of credit from Citibank. Is the beneficiary entitled to payment in accordance with the letter of credit?

As we have seen, there is a clear distinction between the role of an advising bank and the role of a confirming bank. An advising bank does not assume obligations in its own name; it just acts on behalf of the issuing bank. If the issuing bank instructs the advising bank not to effect payment, the advising bank is obliged not to effect payment. If it nevertheless does, then it will not be in a position to obtain reimbursement from the issuing bank, because it did so in violation of the agreement between them.

In the case mentioned here, Citibank was an advising bank, and it had received instructions from the advising bank not to effect payment; therefore, Citibank was not obliged to effect payment.

However, the Court of Appeal of New York found that the bank had to pay. The reasoning was as follows: New York is the financial capital of the world, and if it wants

[195] The inclusion of a signed receipt among the documents to be presented is a rather inefficient means: if the receipt has to be signed by the buyer, who is also supposed to make the payment, it will easily be able to stop any possibility of effecting payment by withholding the signature on the receipt. It is an important principle that the production of none of the listed documents should be in the power of none of the parties. Otherwise, the parties may influence the circumstances that trigger payment, and the neutrality and independence that a letter of credit should provide is seriously undermined.

[196] *J. Zeevi & Sons* v. *Grindlay's Bank (Uganda)*, 37 NY2d 220, 333 NE2d 168, 371 NYS2d 892.

to maintain this pre-eminent position, it is important that the operators under New York law protect the justified expectations of the parties. The fact that payment had become illegal under Ugandan law does not affect the role that a New York bank should play. This is a situation where a recognised principle of transnational law (the diversity in responsibility between an advising bank and a confirming bank) conflicts not with some mandatory rules of the governing law, but with some policies, which in the eyes of the court must have been so important that they represented public policy and they had to override them.

(iii) Case 3 Case 3[197] presented the following scenario. DCA has entered into a contract for the supply of certain military equipment to the State of India and has issued a letter of credit as a performance guarantee. The main document to be presented to obtain payment under the letter of credit is a certificate by the State of India stating that DCA is in breach of contract. War breaks out between India and Pakistan, and the United States announces an embargo on India. The military equipment is delivered FOB at DCA's plant; DCA alleges that it has fulfilled its obligation to supply the equipment at its plant. The embargo prevents the shipment going abroad and the State of India presents to the banks a certificate of breach of contract, as provided for under the instructions of the letter of credit, and requests payment under the letter of credit. Is the beneficiary entitled to payment under the letter of credit?

The principles governing documentary credits, as we have seen, clearly state that payment has to be effected upon presentation of the listed documents, and that the bank shall not be concerned with the underlying transaction. If the State of India has presented a certificate of breach of contract, and this was the document that had to be presented according to the instructions, then payment should be made.

However, the District Court of Georgia resolved to grant a preliminary injunctive relief and a permanent injunction against the bank, protecting the debtor from claims relating to its obligation to effect payment.

The Court first confirmed the known principles governing letters of credit: that payment has to be made by the bank, irrespective of the circumstances of the underlying transactions, if the listed documents have been presented. However, the Court went on to consider the matter of fraud, and affirmed that, in the case of fraud, the bank should nevertheless have the obligation to effect payment to 'innocent third parties', whereas, in cases where the beneficiary is not 'innocent', the bank does not have the obligation, but the option to effect payment. The Court went on to affirm that, in this case, the beneficiary was not an innocent third party because there was a dispute as to the validity of the certificate of breach of contract presented to the bank for payment. The Court affirmed that the certificate of breach was unspecified (the wording being 'failed to carry out certain obligations of theirs'). The Court affirmed,

[197] *Dynamics Corp. of America* v. *Citizens and Southern National Bank* [1973] 356 F Supp 991.

further, and correctly, that the beneficiary did not have to prove that the breach actually had taken place, since this would be a question relating to the underlying contract, and the court had no jurisdiction on that matter (the contract had chosen arbitration in India for settlement of disputes arising out of the contract). The Court then justified its issuance of the injunction on the basis of its alleged duty to guarantee that the beneficiary does not take 'unconscientious advantage of the situation and run off with plaintiff's money on a pro forma declaration which has obviously no basis in fact'. In this case, therefore, the principles governing documentary credit have been superseded by the governing law's rules on fraud. Several comments are possible on this decision: we will concentrate on the quality of the listed documents and on the question of fact.

When it comes to the quality of the document, the court is concerned with the fact that the certificate was unspecified. This, however, should primarily have been a concern of the parties when they drafted the instructions to the bank. Allowing payment upon presentation of a certificate issued by the beneficiary is not advisable, as it can open up possible abuses. Allowing such a certificate without specifying its contents is even less advisable, since it means that there are no parameters that have to be met before the beneficiary issues such a certificate. What is surprising in this case is that the court found it appropriate to override the agreement between the parties because the list of documents had not been written with the appropriate diligence.

The next comment is a matter of fact, and, as such, does not belong to the dispute upon which the court had jurisdiction. However, the court invites this comment, by mentioning that the beneficiary should not run off with the money with no basis in fact. If the goods had to be delivered FOB, then the responsibility for clearing them for export was with the seller.[198] If the goods could not be exported, the seller had not complied with its obligations, even if the goods were made available at the place of delivery. The goods could not be exported because of an embargo and not because of a lack of diligence by the seller, and therefore it might be questioned as to whether this could amount to a default by the seller. However, the adoption of the term FOB indicates that the risk for not obtaining the export licence is held by the seller, and not the buyer.

(b) The UPICC: Irrevocable Offer and Consideration

The case of an offer that purports to be irrevocable for a certain period is an example of the relationship between the UPICC and the mandatory rules of the governing law. As long as the offer is not accepted, there is no contract between the parties. However, a written offer with a promise of irrevocability has legal consequences that are

[198] Another matter is that the term FOB assumes that the place of delivery is a port, and not the seller's plant, as had apparently been agreed in the contract.

regulated by the contract law of each state. What would the legal consequences be if the offeror decides to revoke the offer before the term indicated in the firm offer has elapsed?

Firm offers are regulated in Article 2.4 of the UPICC. The Article starts by setting forth a general rule, according to which offers can be revoked until they have been accepted. The second paragraph of the Article is devoted to irrevocable offers, and reads as follows:

(2) However, an offer cannot be revoked

(a) if it indicates, whether by stating a fixed time for acceptance or otherwise, that it is irrevocable; or

(b) . . .

The solution provided by the UPICC, therefore, coincides with the solution provided by civil law systems, as will be seen in Section 3.6.1.

But what if the relationship is subject to English law? As Section 3.6.1 will show, English law has a different outcome for this situation, due to the applicability of the doctrine of consideration. The doctrine of consideration is mandatory and cannot be derogated from by agreement of the parties, or by a non-binding source of transnational law with persuasive authority. If the relationship is subject to English law, therefore, the solution suggested by the UPICC will be overridden by the governing law.

As long as the UPICC are incorporated into the contract (as opposed to chosen as a governing law), then they are not able to provide a harmonised solution. As seen, generally, sources of transnational law are deemed to be incorporated into the contract when the dispute is brought before a court. When a dispute is submitted to arbitration, on the contrary, various arbitration laws and arbitration rules permit the parties to choose transnational sources as governing law, as Section 5.6.7 explains.

The particular situation analysed in this section would receive a harmonised solution if the parties or the arbitral tribunal were empowered to choose the UPICC or the PECL and had done so.

(c) ISDA Model Swap Agreement

The style in which the ISDA Master Agreement is written does not invite construing the agreement differently than it appears from its wording. The English Court of Appeal[199] has declined to imply a term into the contract that would limit to a reasonable time the non-defaulting party's right to withhold payment.

Article 2(a)(iii) permits the non-defaulting party to suspend payment to the defaulting party until the default is repaired. If the defaulting party is insolvent, this may give the other party the possibility to speculate, insolvency being defined as an event of default in the contract. Assume that there are more payments outstanding between the two parties, and that the net amount is in favour of the insolvent party.

[199] *Lomas* v. *JFB Firth Rixson Inc* [2012] EWCA Civ 419.

Insolvency is defined in the Master Agreement as an Event of Default. The party owing the net amount, as the non-defaulting party, may elect to terminate the contract. If it does so, it will have to pay the net amount to the insolvency estate. However, under Article 2(a)(iii), the non-defaulting party may elect not to exercise its right to terminate the contract early, and instead withhold payment of what it owes to the defaulting party. Since the insolvent party will never be in a position to remedy its default, the non-defaulting party seeks to indefinitely avoid paying the net amount that it owes to the insolvent party.

The English Court of Appeal accepted this result.

A civil law court, however, might be inclined to imply a requirement of reasonable time to limit the non-defaulting party's possibility to speculate on the wording of the contract.

Furthermore, the effects of this clause may be restricted by other principles of the applicable law, such as the principle of equality of creditors and integrity of the estate in case the defaulting party is insolvent.[200]

(d) IBA Guidelines on Conflict of Interests

While there is a consensus on the more obvious situations that may create a conflict of interests, such as when the arbitrator is an officer of one of the parties to the dispute, opinions vary when the relationship between the adjudicator and the party is not direct. How close the indirect connection must be to have an impact on the appearance of independence and impartiality is not clear. In this context, courts and tribunals have applied criteria diverging from those of the IBA Guidelines.[201]

While the Guidelines are widely referred to whenever the independence or impartiality of an arbitrator is evaluated, they are not necessarily always applied faithfully by the courts. For example, the circumstance that a sole arbitrator is a partner in a law firm which provides services to an affiliate of a party, and derives substantial income therefrom, was deemed not to raise any appearance of bias by an English High Court,[202] but is listed in the non-waivable red list of the IBA Guidelines.[203]

To the contrary, repeat appointments are on the orange list of the IBA Guidelines of circumstances that need to be disclosed, and are often deemed to create a potential conflict of interests.[204] However, they are sometimes considered to be neutral.[205]

[200] In *Re Lehman Brothers Holdings, Inc.*, US Bankruptcy Court Case No 08-13555 et seq. (JMP).

[201] See the Note by the UNCITRAL Secretariat, *Working Paper on Possible reform of investor-State dispute settlement (ISDS), Ensuring independence and impartiality on the part of arbitrators and decision makers in ISDS*, A/CN.9/WG.III/WP.151, para 65.

[202] *W Limited* v. *M SDN BHD* [2016] EWHC 422 (Comm), para 42.

[203] Article 1.4: 'The arbitrator or his or her firm regularly advises the party, or an affiliate of the party, and the arbitrator or his or her firm derives significant financial income therefrom.'

[204] See, for references, Cordero-Moss 'Independence and Impartiality' (forthcoming).

[205] See the decisions on challenges in the ICSID cases *Tidewater* v. *Venezuela*, ICSID Case No ARB/10/5, Decision of 23 December 2010, and *Universal Compression* v. *Venezuela*, ICSID Case No ARB/10/9, Decision of 20 May 2011.

Also circumstances that are not expressly listed in the IBA Guidelines have been deemed to create a conflict of interests, such as when an arbitrator in another matter also acts as counsel for a client seeking annulment of an award which was rendered in an unrelated case, but on which one of the parties relies in its pleadings before the arbitral tribunal.[206]

2.3.3 When the Transnational Law Competes with the Contract Terms

As explained in Chapter 1, contracts are very detailed. If a contract subject to the UPICC regulates a certain issue, and the same issue is also regulated in the UPICC, what will be the relationship between the two regulations?

Will the UPICC superimpose their own regulation if the subject matter is already regulated in the contract? Or will they be deemed replaced by the terms of the contract? Will they supplement the contract if the contract is silent on a certain point? Or will the parties' silence be deemed to mean that they did not wish to regulate a certain effect?

Considering that the UPICC are based on an overarching principle of good faith pervading many of the provisions that regulate the issues usually regulated in detail in the contract, it seems reasonable to inquire whether the UPICC should be deemed to override and supplement contract terms, or whether they should be applied according to the *lex specialis* principle.[207]

Under the *lex specialis* principle, it can be assumed that the parties intended to derogate from the general regime of law by making their own rules in the contract. Hence, the specific regulation of the contract would override the general regulation of the law, as long as the latter were not mandatory.

On the other hand, the central role played by the principle of good faith in the UPICC, that pursuant to Article 1.7 cannot be derogated from by the parties, casts doubts about the extent to which agreed contract terms can prevail over the rules of the UPICC, which to a large extent rely precisely, explicitly or tacitly, on the principle of good faith.

As long as the relationship between the UPICC and the contract terms is not clarified, there is a risk that the UPICC will not be able to achieve the aim of predictability, which is so important for commercial contracts. If the UPICC are to be considered a commercially oriented set of rules, they should clarify this relationship so as to establish that the regulation contained in the contract takes precedence.

The attractiveness of the UPICC, therefore, would be considerably enhanced if there were no uncertainties under their regime about the ability to use negotiated

[206] *Telkom Malaysia* v. *Ghana*, Hague District Court, HA/RK 2004, 667, Decision of 18 October 2004.

[207] William W. Park, 'The Predictability Paradox: Arbitrators and Applicable Law'. In Fabio Bortolotti and Pierre Mayer (eds.), *The Application of Substantive Law by International Arbitration* (ICC Dossiers, 2014b), p. 62.

contract terms as the exhaustive, or at least primary, regulation of the parties' conduct under the contract.

Since the UPICC regulate commercial contracts, objective interpretation and the primacy of contract terms seem to be the correct starting point. There may be a need for less objectivity if the parties, though commercial, have different bargaining power or insight; for detailed contracts between equally professional parties, however, there seem to be good reasons for giving primacy to the contract terms, interpreted objectively. However, the many provisions in the UPICC that restrict the exercise of contract rights or impose ancillary obligations where the contract is silent seem to suggest the opposite approach, that is, that the UPICC be superimposed over the contract terms and lead to a situation where the detailed contract regulation is either disregarded or supplemented. This may render the choice of the UPICC less attractive for governing commercial contracts: if the parties have spent considerable resources in drafting and negotiating certain terms, developing contract management systems on the basis of those terms and assessing their legal position on the basis of those terms, why should they choose, as a governing law, a set of rules that may deprive some of those terms of their effect or supplement the terms with other, not negotiated terms?

Of course, commercial contracts need a governing law. Gaps must be filled, inconsistencies must be solved, unclear provisions must be interpreted. It cannot be excluded that even commercial contracts will, from time to time, need a corrective, and that it is necessary to strike a balance between the need for predictability proper to commercial relationships, on the one hand, and the need to provide a framework ensuring the respect of principles of loyalty and good faith, on the other hand. However, it seems that the attractiveness of the UPICC to commercial parties resides in their ability to respect the primacy of contract terms, rather than in their ability to override contract terms.

The following sections will give some illustrations of the need for clarifying the relationship between the UPICC and contract terms. These examples are chosen because they correspond to a series of decisions rendered by Norwegian courts and directly or indirectly inspired by the UPICC.[208]

(a) Ancillary Obligations Not Regulated in the Contract

Article 5.1.2 of the UPICC regulates implied obligations, that is, obligations that may bind one party even though they have not been spelled out in the contract. A party may be expected, to a certain extent, to be under an obligation to cooperate with the other party in order to permit or facilitate performance of the contract. Among the

[208] Giuditta Cordero-Moss, 'Detailed Contract Regulations and the UPICC: Parallels with National Law and Potential for Improvements: The Example of Norwegian Law'. In *Transnational Commercial and Consumer Law* (Springer, 2018a), pp. 91–110; UNIDROIT (ed.), *Eppur si muove: The Age of Uniform Law. Essays in Honour of Michael Joachim Bonell* (UNIDROIT, 2016b), pp. 1302–17.

sources that may be used to read implied obligations into a contract, subparagraph (c) mentions the principle of good faith.

Examples of such implied obligations are given in the Comment to Article 5.1.2. Illustration 3, regarding implied obligations stemming from good faith, relates to the implied obligation on a party to inform the other party if the first party does not intend to pursue a joint project. However, what the Comments do not make clear is how far implied obligations go.

(i) No Assignment Imagine a dispute regarding a contract obliging a fishing company to deliver all its fish for slaughter to the other party, a slaughterhouse.[209] During the term of the contract, the fishing company transferred some of its fishing concessions to a third party, thus considerably reducing its fishing activity and consequently, the volume of fish that was delivered under the contract. The slaughterhouse claimed that the fishing company was in breach of its contractual obligations, notwithstanding that the contract did not mention any restrictions on the company's entitlement to transfer its concessions to third parties.

It could be useful to clarify whether the UPICC permits reading into a contract for the slaughtering of fish an obligation not to transfer the fishing concessions to third parties, like the Norwegian Supreme Court did in spite of the circumstance that the contract does not contain such an obligation nor a commitment to deliver a particular volume. In an earlier case, the Norwegian Supreme Court had found that the price for the purchase of shares which, according to the contract, would be triggered if the buyer had purchased more than a certain percentage of those shares, could not be applied when the buyer indirectly obtained the same percentage of shares because it was acquired by a third company which already owned some of those shares. In this earlier decision, the Court reasoned that it was not possible to read into the contract an obligation to pay the agreed price also in case of indirect ownership, as the contract provided that price for direct ownership.[210] If the parties had desired to extend that price to indirect ownership, they could have expressly regulated that.

Commercial parties would appreciate the latter approach, whereas they might find that the former created significant uncertainty. In contracts that have been carefully negotiated, significant terms such as the restriction on transferring a concession to third parties should be expected to be expressly regulated – among other things, because they would have an impact on other parts of the contract, such as the price. If the contract is silent on those issues, the reason is probably either that the parties did not want to regulate that matter, or that they could not reach an agreement on how to regulate it. In either case, it does not seem appropriate to read a term into the contract.

[209] This dispute was decided by the Norwegian Supreme Court in Rt. 2005 s. 268. [210] Rt. 1994 s. 581.

The Comments to Article 5.1.2(c) could contribute to the attractiveness of the UPICC if they clarified that the purpose of the provision is to permit performance of the contract, and not to introduce new terms that would extend the obligations of the parties.

(b) Competing Contract Regulation

As explained in Chapter 1, contracts often contain detailed regulation of the manner in which the contract is to be interpreted and applied. Many of these contract terms may overlap with or contradict the provisions of the UPICC. In these situations, it is important to clarify whether the contract terms will be deemed to replace the competing rules of the UPICC, or whether they will be supplemented or overridden by the UPICC. Needless to say, commercial parties would prefer the former approach.

(i) Notice of Defect Imagine a dispute arising out of a sales contract between two professional parties. The contract contains a regulation of the procedure that the buyer needs to follow to notify the seller in case the goods do not conform with the specifications. The contractually agreed notification procedure does not correspond in full with the notification procedure in the governing law – the rules of the governing law, however, are not mandatory. The seller argues that the notification was not made in accordance with the law. The Norwegian Supreme Court assumed that the contract regulation did not replace the rules of the governing law on notice of defect.[211]

What would the result be under the UPICC?

Articles 7.2.2(e) and 7.3.2(2) of the UPICC regulate the notice that has to be given to the defaulting party in case of non-conformity of the performance with the contract requirements. Contracts often contain their own procedure on this matter and, as explained in Chapter 1, parties may on this basis develop guidelines on the performance of the contract. What if the procedure agreed in the contract is contested as violating the UPICC requirements, for example, the requirement that the notice be given within a reasonable time? If the UPICC are applied in addition to the contractual procedure, this may lead to uncertainty in the performance of the contract and should be avoided. To enhance the attractiveness of the UPICC, the Comments could clarify that the UPICC regulation is to be considered replaced by corresponding rules contained in the contract.

(ii) Hardship A further example is found in Articles 6.2.2 and 6.2.3 providing for a duty to renegotiate the contract in case of hardship, and for the power of the courts to modify the contract in case the parties do not reach an agreement. Contracts often

[211] Rt. 2012 s. 1779, paras 55–65.

contain very detailed hardship clauses that may define the events triggering the duty of renegotiation more narrowly than Article 6.2.2. Also, the contract clause may regulate the consequences of hardship in a way that is narrower than Article 6.2.3 – for example, it may exclude the intervention of the courts to modify the contract. Would the broader regulation of hardship contained in the UPICC supplement the contract clause? Comment No 7 to Article 6.2.2 recognises that the parties may adapt the content of the Article to the specific situation, but it does not specifically address the question as to whether the provisions of the Article remain applicable as an underlying general basis, or whether they are replaced by the contract clause.

(iii) No Oral Amendments Further examples may be mentioned where contract terms may risk being overridden by the UPICC. One such is the clause specifying that amendments to the contract may be made only in writing, see Section 1.5.1(c). This clause runs the risk of being overridden by Article 2.1.18 of the UPICC, which recognises so-called No oral amendments clauses but restricts their application by stating that a 'party may be precluded by its conduct from asserting such a clause to the extent that the other party has reasonably acted in reliance on that conduct'. The No oral amendments clause has an important function in complex relationships, where a plurality of persons may be involved on behalf of both parties – technicians may be cooperating on the technical implementation, designers may be cooperating on the development of the product, marketing experts may be cooperating on the distribution of the product and so on. If every technical discussion between these teams of specialists were capable of amending the contract, it would be very difficult to have a complete overview of the contract terms at any time. For the purpose of ensuring predictability in the performance of the contract, it is important that amendments be discussed and decided at the appropriate level of the organisation and formalised in written amendments. To what extent would this be permitted under Article 2.1.18 of the UPICC? Illustration 2 in the Comment to Article 2.1.18 seems to suggest that the application of the clause may be restricted when one party has maliciously failed to draw the other party's attention to the necessity of complying with the original terms of contract. In the complicated setting described, it may be difficult to determine the spirit in which the various teams of specialists carried out discussions within their areas of competence, how these discussions were understood by either party, how the teams understood their respective competences in respect of the overall contract and so on. Therefore, it could be helpful if the Comments clarified the relationship between the clause and Article 2.1.18 in situations such as that described here.

A similar reasoning may be made in respect of Article 4.3(c) of the UPICC and the often very detailed contract terms regulating so-called variation orders. Article 4.3(c) provides that the conduct of the parties subsequent to the conclusion of the contract is a relevant circumstance in the interpretation of the contract, while the contract

terms usually restrict the relevance of subsequent conduct and require that formalised procedures be followed. The 2016 edition has actually introduced a Comment to Article 4.3 going in this direction. The Comment seems to clarify that the interpreter may not override the wording of the contract, although the effect of this important statement is restricted by the quite careful style in which it is written: 'As a rule the subsequent conduct of the parties can only be an interpretative tool, i.e. be used to explain or amplify, but not to contradict, the terms of the contract as originally agreed between the parties.'[212]

Article 4.3 regulates the interpretation of contracts – in particular, the circumstances that may be taken into consideration when interpreting contracts. Among these circumstances is, in letter (c), the conduct of the parties subsequent the conclusion of the contract. As I noticed elsewhere,[213] it is advisable to clarify the relationship between this provision and the practice of issuing variation orders in construction contracts. Variation orders are a contractually regulated procedure aimed at ensuring that amendments to construction contracts are binding only if they were formalised according to the procedure described in the contract. This is meant to prevent the contract being amended in an informal way, and particularly to exclude that the conduct of party representatives who are involved in only part of the contract performance may be interpreted as a formal change of designs, plans or specifications. In complex contracts, where each party engages teams representing different skills and technologies, there is the need to coordinate inputs from the various teams. Contract management would be very difficult, if the contract could be changed on the basis of the conduct of someone who is involved in only part of the performance. There is a need to coordinate all the inputs before the contract can be changed. Hence the necessity to centralise and formalise the procedure for amendments. The 2016 edition has introduced a Section 3 in the Comment, specifying that, 'Obviously, the more precisely the parties regulate the procedure for adjustments to the contract, the less relevant any informal conduct of the parties would be to the interpretation of the contract'. This is an important clarification of the relationship between Article 4.3(c) and the contract terms on variation orders, albeit a relatively careful clarification. This seems to take into consideration the needs of commercial practice.

However, the new version of Section 4 in the Comment to the same provision seems to indicate that the UPICC prevail on the terms of the contract. The Comment refers to the practice to insert 'No-oral modifications-clauses'. These clauses have a function similar to that of the previously described regulation of variation orders. The intention is to avoid unauthorised amendments in contract relationships where the contract is implemented by a plurality of representatives, as described. However, in respect of these clauses the Comment does not suggest that detailed contract wording may make the UPICC provisions redundant. To the contrary, the

[212] Comment to Article 4.3, Section 3. [213] Cordero-Moss (2016b), pp. 1315f.

Comment makes reference to the good faith-based rules of Articles 2.1.18 and 1.8. Hence, the Comment seems to promote the prevalence of the UPICC provisions over the contract terms.

The mentioned advisability to clarify the relationship between the UPICC and contract terms is, therefore, still valid.

(c) Discretionary Contract Rights

The UPICC require that contractual rights giving one party unfettered discretion must be exercised in good faith.

The aim of preventing abusive situations may be supported – however, contract terms permitting one party to exercise a right on the basis of its own discretion are not necessarily meant to create an abusive situation, even where that party exercises its discretion exclusively to further its own interest, as will be explained.

(i) Subject to Contract In commercial negotiations the parties often execute a series of documents (letters of intent, memoranda of understanding, heads of agreement or the like) that may be so detailed that they could be deemed to be final contracts, were it not for the clause stating that the document does not represent a binding document. The purpose of this clause is to permit full and detailed negotiation of all aspects of the prospective deal, without being legally bound before the final contract is executed. Also, the text of the final contract often contains a clause specifying that the entry into force of the contract is subject to approval by the board of directors of one or both of the parties. The Comments to, respectively, Articles 2.1.13 and 5.3.1 of the UPICC reflect this practice and explain that these clauses are sufficient to prevent the parties being deemed to be bound by the contract. This is a welcome clarification. However, it seems that these clauses are not sufficient to avert application of the provision on negotiations in good faith contained in Article 2.1.15 of the UPICC. One of the areas of application of Article 2.1.15 is where negotiations are carried out without the intent of entering into a final contract. In commercial practice, clauses such as the abovementioned Subject to contract or Subject to board approval are meant to leave the parties discretion to walk out of the deal without exposing themselves to liability of the kind regulated in Article 2.1.15. A party may negotiate a plurality of deals and submit them to the management or the board in competition with each other; only one will be chosen; the other contracts will not be entered into. The party inserts the clauses discussed here for the purpose of making it clear that the final decision of entering into the contract will be taken after the negotiations have been concluded on the basis of that party's own business interests, its financial position at that time, any available alternative options, its own strategy that may have been modified and might consequently deprive the deal of relevance and so on. By inserting these clauses, the party assumes that it has advised the other party and that therefore it will not incur any liability if it does not enter into the

contract. Would these clauses achieve their goal, or would they be overridden by the UPICC? Comment 5 to Article 5.3.1, Illustration 7, seems to indicate that the party which has not obtained board approval is liable for having carried out negotiations in bad faith.

It would contribute to the attractiveness of the UPICC if the Comments to Articles 2.1.13 and 5.3.1 clarified this aspect and confirmed that these clauses exclude liability under Article 2.1.15.

(d) Conclusion

The 2016 edition of the UPICC had the purpose of highlighting that the UPICC are suitable to govern not only discrete contracts, but also more complex, long-term relationships. In order to underline this suitability, the 2016 UPICC have emphasised that they embrace the approach underlying the relational theory of contract, see Section 1.7. As a governing law, the UPICC supply the means to operate a contract with terms left open or subject to evolution, to take into consideration the requirements of good faith and cooperation between the parties, and to have regard to the necessity of considering the balance between the parties' interests.

This corresponds to the ideal of the relational contract theory: contract terms are simply a framework, and the legal relationship between the parties is based on mutual trust and on the shared interest of achieving common goals.

However, not all contracts have these characteristics. In some relationships, the parties' interests are antagonistic. If there are no common interests, it cannot be left to mutual trust alone to form the respective rights and obligations. In these contracts, the parties negotiate detailed regulation to protect their respective interests, they draft mechanisms to ensure their respective positions are safeguarded in case of supervening events, they rely on objective criteria that are carefully regulated, and they try to avoid discretionary adjustments. In these contracts, the instruments inspired by the relational theory of contract are not adequate.

The UPICC recognise, in the Comments, that not all of their provisions are equally applicable to all contracts in all situations. Therefore, they open for the interpreter to evaluate whether and to what extent the UPICC provisions shall be applied. This is a particularly important question when the provisions open for interpreting the contract terms restrictively or expansively, or for adding implied obligations to the contract terms. If the contract terms have been carefully negotiated, it may be assumed that the parties have chosen to regulate their relationship in accordance with the agreed terms on the basis of a calculation of risks and benefits. Adding to or restricting the agreed terms may be an undesired surprise. It is, therefore, positive that the UPICC accept that their provisions are not necessarily adequate in all situations. However, the UPICC do not give precise guidelines regarding the relationship between their provisions and detailed contract regulation. It is, therefore, up to the interpreter to evaluate whether the UPICC provisions shall override the

contract terms or be derogated from by them. The interpreter's evaluation is rendered more demanding by the circumstance that the provisions that may override contract terms are mainly a manifestation of the principle of good faith, and that the UPICC state that the principle of good faith cannot be derogated from by contract terms. This creates a significant uncertainty about the application of the UPICC.

2.3.4 When the Transnational Law Has Gaps: Autonomous Interpretation

In some situations, transnational sources do not provide a regulation.

The doctrine of autonomous interpretation, meant to prevent different interpretations of transnational provisions, was developed under the CISG, see Section 2.2.5(c). Thus, the CISG aspires to being interpreted in a way that is not affected by the rules and principles of the system within which it is being applied – which would undermine its goal of representing a uniform regulation.

The same principle is laid down in the UPICC (see Section 2.2.5(f)) and in many instruments of soft law, such as the UNCITRAL Model Law on Arbitration.

The idea behind the principle of autonomous interpretation is commendable: if construction of the convention was affected by the legal tradition of each interpreter, the uniformity would be reduced to the wording of the convention – whereas the legal effects of the wording would reflect the differences in legal traditions. Research shows, however, that neither courts nor arbitral tribunals truly commit to the goal of contributing to an autonomous interpretation of the CISG.[214]

Similarly, the UPICC (Article 1.6) and the PECL (Article 1:106) contain guidelines for interpretation and application. In their first paragraphs, both Articles establish the principle of autonomous interpretation: the restatements of principles shall be interpreted having regard to their international character and bearing in mind their purpose to promote uniformity in their application. In other words, this paragraph aims to avoid the restatements being interpreted in the light of state laws. The second paragraph of both Articles provides that, in the case of lacunae, the interpreter will have to apply, to the extent that is possible, the general principles underlying the restatements. The autonomous interpretation is enhanced by this provision: lacking an express regulation of a certain aspect, the interpreter will first have to look at the principles that inspire this codification and construe them so as to elaborate a regulation in line with the fundamental ideas upon which the principles are based. It cannot be excluded, however, that even the underlying principles are not sufficient to provide the regulation for a certain aspect. In these cases, lacunae will

[214] Petra Butler, 'CISG and International Arbitration: A Fruitful Marriage?' *International Trade & Business Law Review* 17 (2014), analysing three recurring issues: the applicability of the CISG, interests and contractual penalties. See also Judit Glavanits. 'How Do You Mean It, CISG? Applying the CISG More "21st Century"-Way'. In UNCITRAL, *Modernizing International Trade Law to Support Innovation and Sustainable Development*, Volume 4 (Proceedings of the Congress of the United Nations Commission on International Trade Law, 2017), p. 333.

have to be filled by applying the governing law, as is expressly stated in the PECL, Article 1:106(2).

The ideal of uniformity that inspires the restatements, consequently, might fail if the solutions provided by state laws differ from state to state.

The UNIDROIT document on model clauses identifies some examples of what Article 1.6 of the UPICC defines as gaps:[215]

> Indeed, comprehensive as the UNIDROIT Principles are, there are still issues which fall within their scope but are not expressly settled by them (e.g. specific cases of negotiations in bad faith (see Comment 2 to Article 2.1.15 UNIDROIT Principles 2010); the extent of the duty of co-operation (see Comment to Article 5.1.4 UNIDROIT Principles 2010); specific duties to preserve the other party's rights pending fulfillment of a condition (see Article 5.3.4 UNIDROIT Principles 2010); etc.).

A further example follows in the next section of failure by the UPICC to provide a uniform regulation where the national laws diverge – the gap is in the field of *force majeure* (see Section 3.5.3). As Section 2.3.4(a) will show, the CISG regulation of *force majeure* is also not free for challenges.

(a) The UPICC: *Force Majeure* and Choice Between Contracts

Assume that a seller has entered into a plurality of contracts with several buyers for the sale of its products. If a *force majeure* event prevents the production of part of the volume that the seller has committed to its buyers, the position of the seller will vary according to the governing law. As will be seen in more detail in Section 3.5.3(a), if the governing law is Norwegian, the seller will be under the obligation to supply in time, to the fullest possible extent, the first commitment, and will not be responsible for non-performance of the other contracts. If the governing law is Italian or German, the seller will be entitled to reduce the supplies to each buyer pro rata. If the governing law is English, the seller will remain under its full obligations and will not be excused by frustration of the contract, assuming the contract does not provide for this eventuality.

One of the most important functions attributed to transnational law is to eliminate discrepancies such as these, and to provide a uniform and reasonable treatment that can be used to govern international contracts in respect of the expectations of the parties.

Would the UPICC succeed in giving a harmonised solution? As opposed to the example of the irrevocable offer made in Section 2.3.2(b), the matter of allocation of risk is within the freedom of contract, and therefore is capable of being harmonised by transnational sources. However, the UPICC do not contain an answer to the

[215] Model clauses www.unidroit.org/english/principles/modelclauses2013/modelclauses-2013.pdf, Comment 1.1(3).

situation arising in the case of partial impediment and the plurality of creditors. Article 7.1.7 of the UPICC regulates *force majeure* circumstances preventing in total and in part the contractual performance, but it does not regulate the allocation of risk in cases of the plurality of creditors. Article 8:108 of the PECL has similar content.

How can this lacuna be filled? In the case of partial impediment and the plurality of creditors, it does not seem that the interpretation rules contained in Article 1.6, or even the reference to usages of Article 1.9 of the UPICC can offer any specific help. Principles underlying the codification, referred to in Article 1.6, do not seem to be relevant to this particular situation. In 2010, a Chapter 11 was added to the UPICC dealing with the plurality of obligors and of obligees. Article 11.1.9 allocates obligations pro rata among the obligors, when these are jointly and severally liable towards another party. This, however, regulates the situation when a plurality of parties has assumed the same obligation towards another party, or when a plurality of parties is entitled to the performance of the same obligation by another party. This is quite a different situation from the one envisaged here. In our scenario, there is a plurality of discrete bilateral contracts, and none of the buyers has any rights or obligations towards each other. A rule that assumes joint and several liability, as with the provision of Article 11.1.9, therefore, cannot be considered relevant and the underlying principle is of no help. It could be possible to interpret Article 7 on the basis of an analogy with the solution presented by civil law systems. As mentioned, the civilian solution provides for a corresponding reduction of the performance in case of partial impediment and is construed to permit a pro rata reduction among the various creditors. However, how could such an interpretation by analogy with the state laws of the civil law system be compatible with the abovementioned Article 1.6, which wishes to avoid that the UPICC are interpreted in light of state laws? As far as Article 1.9 is concerned, referring to usages and practices, it does not seem easy to determine what generally recognised usages might say in this situation. The principle of *rebus sic stantibus*, which is the expression of the *force majeure* rule in the transnational law, does not seem to have generally recognised rules on partial impediments and the plurality of creditors. Therefore, the consequences of the situation arising in our scenario have to be solved by applying the governing law.

In this situation, in conclusion, transnational law has not achieved its aim of providing a uniform regulation of international contracts.

2.3.5 When the Transnational Law Needs Interpretation: Autonomous Interpretation

The principle of autonomous interpretation applies not only when soft law sources have gaps, but also when the meaning of the provisions is to be ascertained.

An autonomous interpretation aims at construing and applying a rule in a uniform way that is common to all countries that have adopted or ratified the instrument. It assumes that a court avoids special interpretations due to peculiarities of its specific national system, and it requires that a court take into consideration the construction

and application of the instrument in other countries as a parameter for its own interpretation.

The concept of autonomous interpretation was introduced in the CISG, see Section 2.2.5(c).

For the purpose of facilitating an autonomous interpretation, numerous databases and digests collect and comment on court decisions and literature on these sources.

The already mentioned Unilex[216] collects materials on the UPICC and on the CISG.

Material on the CISG can also be found in the CLOUT database.[217] In this publicly available database, the UNCITRAL collects court decisions on the CISG.

Perhaps the most comprehensive database on the CISG is that administrated by Pace Law.[218] This database requires a login, whereas the other mentioned databases are publicly accessible.

Material on the application of the UNCITRAL Model Law and of the New York Convention may be found in CLOUT.

Furthermore, the UNCITRAL Secretariat has compiled a guide on the New York Convention[219] and, in addition, it has a webpage on the New York Convention, containing among other things a guide to the application of the Convention and collecting court decisions.[220] The guide and the webpage are publicly available.

A digest of court cases on the Model Law was published by the UNCITRAL in 2012.[221]

Moreover, court decisions relevant to arbitration, including court decisions applying the public policy defence, are reported in the ICCA *Yearbook Commercial Arbitration*.[222] Comparative collections have been published, for example, by the International Bar Association on public policy.[223]

As will be seen, however, the dissemination of case law and doctrine is not always sufficient to ensure a consistent interpretation of the sources of soft law.[224] The aim of

[216] www.unilex.info. [217] www.uncitral.org/clout/showSearchDocument.do?lf=898&lng=en.

[218] https://iicl.law.pace.edu/cisg/cisg.

[219] UNCITRAL Secretariat, Guide on the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (2016), https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/2016_guide_on_the_convention.pdf.

[220] http://newyorkconvention1958.org/.

[221] www.uncitral.org/uncitral/en/case_law/digests/mal2012.html.

[222] Also available at www.kluwerarbitration.com.

[223] International Bar Association, Subcommittee on Recognition and Enforcement of Arbitral Awards, Report on the Public Policy Exception in the New York Convention (2015), https://uk.practicallaw.thomsonreuters.com/Link/Document/Blob/Icc585ac3773d11e598dc8b09b4f043e0.pdf?targetType=PLC-multimedia&originationContext=document&transitionType=DocumentImage&uniqueId=b783c322 c20e-4d78-8cd6-80bce5136e85&ppcid=d99f1dae999247d49fb.

[224] For an analysis of autonomous interpretation of the CISG, see Franco Ferrari, 'Autonomous Interpretation Versus Homeward Trend Versus Outward Trend in CISG Case Law'. *Uniform Law Review* 22.1 (2017), pp. 244–57. For a study of autonomous interpretation of Article 17A of the UNCITRAL Model Law on arbitration, regarding interim measures, see Jose F. Sanchez, 'Applying the Model Law's Standard for Interim Measures in International Arbitration'. *Journal of International Arbitration* 37.1 (2020), pp. 56ff.

autonomous interpretation is not necessarily always in the mind of the courts,[225] even when they apply uniform rules.

(a) The CISG: *Force Majeure* and the Requirement of Beyond the Control

Imagine a sales contract, under which the seller fails to deliver the goods according to the agreed timing. The seller could not fulfil its obligations towards the buyer because it could not produce the goods according to its plan. The production plan could not be respected because the seller did not receive its raw materials. The seller had entered into a procurement contract with a supplier of raw materials. Had the procurement contract been fulfilled by the supplier, the production plan would have been respected and the seller could have fulfilled its obligations towards the buyer. However, due to a *force majeure* event (see Section 3.5.3), the supplier is prevented from delivering the raw materials: an unforeseen accident blocks for days the only existing transportation route from the supplier to the seller (for example, the Suez Canal). None of the parties is to be blamed in this situation: the seller had diligently entered into a procurement agreement with a reliable supplier; the supplier had started transportation in time and was not involved in the accident that blocked the Suez Canal. Nevertheless, the goods are not delivered on time to the buyer. Who, between the seller and the buyer, is to bear the consequences of the accident in the Suez Canal?

According to Article 79 of the CISG, a party is not liable for failure to perform its obligations if it proves that the failure was due to an impediment beyond its control, which was unforeseeable and that could not reasonably have been overcome.

The seller has not been negligent in any way and cannot be blamed for not having received the raw materials. But is it excused under Article 79?

Under a certain interpretation, particularly represented in the Scandinavian legal tradition, the sphere of control under Article 79 is the sphere of the control that can actually be exercised. After the supplier was chosen and the procurement contract is formed, the seller's possibility to influence deliveries ceases. Therefore, what happens in the phase of delivery of raw materials is not within the control of the seller. According to this interpretation, the seller would be excused under Article 79.

However, the CISG does not contain any reference to the diligence of the affected party as a criterion for exempting it from liability; in another context, the Convention confirms that diligence is not a criterion for excuse, and Articles 45(1)(b) and 61(1)(b) regulate that each party may exercise contractual remedies for non-performance against the other party without having to prove any fault or negligence or lack of

[225] See, for example, Giuditta Cordero-Moss, 'National Report, Norway: Due Process'. In Franco Ferrari, Friedrich Rosenfeld and Dietmar Czernich (eds.), *Due Process as a Limit to Discretion in International Commercial Arbitration* (Kluwer Law International, 2020c), pp. 313–32, on Norwegian courts' application of the Norwegian Arbitration Act 2004, which is based on the Model Law.

good faith of that party, nor do they mention that any evidence of diligence would relieve the other party from its liability. Additionally, as seen in Sections 2.2.5(c) and 2.2.5(g) , the CISG does not contain any requirement that the parties act in good faith. The lack of any reference to good faith or diligence in Article 79 also makes it difficult to imply in its rule that the affected party may be exempted on the basis of the criterion of diligence (which prevails in civil laws, see Section 3.5.3).

The Secretariat Commentary[226] (the closest counterpart to an Official Commentary on the CISG) does not address the question of how the criterion of the sphere of control shall be interpreted – whether literally, or as a reference to the actual control and the criterion of responsibility.

Bearing in mind that the CISG requires being interpreted autonomously, without reference to domestic legal systems, it seems appropriate to apply the literal interpretation and to see Article 79 as a reference to an objective division of the landscape into two spheres, that of the seller and that of the buyer, without reference to specific actual possibilities for exercising control.

This is confirmed by case law, as summarised in the Digest edited by the UNCITRAL:[227]

> Several decisions have suggested that the seller normally bears the risk that its supplier will breach, and that the seller will not generally receive an exemption when its failure to perform was caused by its supplier's default.

This is confirmed by doctrine, which affirms that procurement risk falls within the sphere of the risk of the seller, and that, therefore, failure by the seller's supplier is not deemed to fall outside of the seller's sphere of responsibility (unless the relevant good has disappeared completely from the international market).[228]

This is confirmed by the Secretariat Commentary to the second paragraph of Article 79. The provision of the second paragraph applies to failure by subcontractors and says that the seller may be excused in case of failure by subcontractors, only on the condition that the impediment affects both the seller and the subcontractor. The Secretariat Commentary specifies that this provision does not include suppliers of raw material or of goods to the seller.[229] Failure by the supplier is, therefore, to be

[226] Text of draft Convention on Contracts for the International Sale of Goods approved by the United Nations Commission on International Trade Law together with a commentary prepared by the Secretariat (A/CONF./97/5).

[227] UNCITRAL, *Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods* (2016), https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/cisg_digest_2016.pdf, Article 79, para 11.

[228] See Schwenzer and Schroeter (2022), Article 79, paras 3, 12, 27 and 38; Brunner and Gottlieb (2019), Article 79, paras 12f. See also Dionysios P. Flambouras, 'The Doctrines of Impossibility of Performance and Clausula Rebus Sic Stantibus in the 1980 Convention on Contracts for the International Sale of Goods and the Principles of European Contract Law: A Comparative Analysis'. *Pace International Law Review* 13 (2001), pp. 261–93, with references to the literature and case law in footnote 20.

[229] UNCITRAL Secretariat Commentary (see n. 226), p. 172.

distinguished from failure by a subcontractor, and is subject to the general rule of the first paragraph, which shall be interpreted strictly and without reference to the seller's diligence.

However, this is not the only way of understanding the criterion of 'beyond the control'. Article 79 of the CISG may be interpreted differently, depending on the interpreter's legal tradition – something that has been defined as 'troubling'.[230]

Because of the plurality of interpretations of Article 79, an opinion was rendered by the CISG Advisory Council. The Council was established in 2001 by the Pace Institute of International Commercial Law and by the Centre for Commercial Law Studies of Queen Mary University of London.[231] It is composed of international experts who render opinions on controversial issues in the interpretation of the CISG, with the purpose of facilitating an autonomous interpretation.

In its Opinion No 7 the Advisory Council affirmed that:

> Several courts and arbitral tribunals have addressed the question whether the seller may be excused due to an impediment allegedly beyond the control of a supplier to whom the seller looks to procure or produce the goods. In a handful of cases, the seller's plea to be excused has been granted, but in the majority of cases it has been held that the requirements of Article 79 have not been satisfied, even when the supplier's failure to deliver conforming goods was totally unforeseeable to the seller.[232]
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> There is a consistent line of decisions suggesting that the seller normally bears the risk that third-party suppliers or subcontractors may breach their own contract with the seller, so that at least in principle the seller will not be excused when the failure to perform was caused by its supplier's default.[233]
>
> . . .
>
> Although a seller who depends on ancillary suppliers cannot always control the conformity of the goods, it seems fair to assign to the seller the risk of non-conformity and resulting damages for non-conformity as part of the overall procurement risk borne by sellers.[234]
>
> . . .
>
> Attributing to the seller the responsibility for the supplier's actions under Article 79(1) appears consistent with a sound policy of placing the risks

[230] Peter Schlechtriem, *Commentary on the UN Convention on the International Sale of Goods (CISG)*, 3rd ed. (Oxford University Press, 2010), Article 79, para 11, footnote 28 of the third edition. In the fifth edition of Schwenzer and Schroeter (2022), the qualification as 'troubling' has been deleted, but reference to the different interpretations as influenced by the legal tradition has been maintained: see Article 79, para 12, footnote 32.

[231] www.cisgac.com/.

[232] See the CISG Advisory Council Opinion No 7 in Alejandro M. Garro, 'Exemption of Liability for Damages under Article 79 of the CISG'. CISG Advisory Council Opinion No. 7 (2007), https://cisgac.com/opinions/cisgac-opinion-no1-copy/, para 15.

[233] Garro (2007), para 18. [234] Garro (2007), para 23.

> involved in non-conformity on the party who is in the best position to avoid or minimize those risks.[235]

The degree to which the CISG influences domestic law is said to be one of the elements favouring an autonomous interpretation of the CISG.[236] An interesting demonstration of the impact of legal tradition on the interpretation of what constitutes an event beyond a party's control is given by Norwegian law. Norwegian law (like the law of the other Nordic countries) is particularly interesting in respect of the CISG, because it has adopted the Convention as a basis for its own domestic law.

Norwegian law transformed the CISG into a domestic statute applicable to all sales governed by Norwegian law, both domestic and international. The statute originally contained a few adjustments for international sales that were later replaced by a reference to the CISG.

The provision on 'beyond the control' was implemented in § 27 of the Act on Sale of Goods, applicable to all sales, both domestic and international – the latter because this provision is the direct translation into Norwegian of Article 79 of the CISG.[237] The provision introduced the concept of an impediment beyond the control of the prevented party.[238] By introducing this concept, the legislator intended to mitigate the then existing regime, which was based on strict liability.[239]

As seen, in the CISG, the criterion of the sphere of control seems to serve to determine the allocation of risk between the parties, and therefore to represent a border between what abstractly falls within the sphere of the seller and what falls within the sphere of the buyer, irrespective of the factual circumstances of the specific case, the diligence of the parties and so on. Interpreting the criterion in the same way would have led to a very strict regulation under Norwegian law; this, however, would have contradicted the legislator's intention, as seen.

Therefore, the criterion of the sphere of control is interpreted by part of Norwegian legal doctrine[240] not, as in the prevailing interpretation of the CISG, as having an *abstract* understanding of each party's sphere of control, since this would have probably rendered the Norwegian regulation even stricter than prior to the enactment of the Sale of Goods Act. The criterion is interpreted on the basis of the *actual* sphere of control of each party. If one party actually has the possibility of influencing a certain process, then events caused by that process are to be deemed within the sphere of control of that party. Norwegian doctrine also emphasises that, even if a party

[235] Garro (2007), para 25. [236] Glavanits (2017).

[237] There is a discrepancy that, however, is not relevant here. For an analysis, see Giuditta Cordero-Moss, 'Forstyrrelser i leveransekjeden, force majeure og kontrollansvaret'. *Festskrift for Lasse Simonsen* (forthcoming).

[238] Sale of Goods Act of 13 May 1988 No 27, § 27.

[239] Ministry of Justice's Report on the Sales of Goods Act and on ratification of the CISG, Ot.prp.nr. 80 (1986–87), pp. 38 ff. and, extensively on the preparatory works in this context, Viggo Hagstrøm, *Obligasjonsrett*, 3rd ed. (Universitetsforlaget, 2021), pp. 530f.

[240] Hagstrøm (2021); Lasse Simonsen, *Avtaler om bygging og kjøp av bolig* (Gyldendal, 2022), pp. 388f., 393f.; Anders B. Mikelsen, *Hindringsfritak. Det såkalte kontrollansvaret i kjøpsloven § 27* (Gyldendal, 2011), p. 166f.

has started a process, this in itself does not mean that any events occurring in the course of that process are in the sphere of control of that party. The test must be if that party actually had the possibility of being able to influence the part of the process in connection with which those events occurred. Hence, the decision in this case would be opposite to the outcome under the CISG: the seller chose the supplier, and this choice is certainly within the seller's sphere of control (the seller could have chosen another supplier and then the default would not have happened). However, the seller has no actual possibility of influencing the performance of the supplier, therefore any impediment in connection therewith is to be deemed outside of the seller's sphere of control.[241]

The criterion of the sphere of control, although it is a word-by-word implementation of the CISG, is applied in a significantly different way from the criterion contained in the CISG: not as a way of allocating the risk between the two parties, but as a way of determining whether the affected party had the possibility of being able to control the impediment. The interpretation of this criterion resembles, therefore, the regime that prevails in Germany, where the criterion for exemption from liability is not the sphere of control, but the responsibility of the affected party.

It is not unlikely that similar discrepancies may occur when the *force majeure* provision of the CISG is applied, which served as a model for § 27. It must be mentioned, for the sake of completeness, that this doctrinal interpretation is not unanimous and is not shared by Norwegian courts.[242]

2.4 Conclusion

The foregoing shows that transnational instruments are a useful supplement to the governing law for specific and technical aspects of commercial relationships. If they are enacted as binding instruments, they will apply directly; if they are soft law, they will need to be incorporated by the parties unless they reflect trade usages. Otherwise, they can be used as a means to interpret the governing law, or to corroborate an outcome based on the governing law.

The legal effects of a contract do not flow simply from the contract itself but are a result of the combination between the contract and the governing law. In particular, the governing law influences the interpretation and construction of the contract. In addition, the governing law plays an important role in filling any gaps that the contract might have; moreover, mandatory rules of the governing law will override

[241] Hagstrøm (2011), Section 5.3. Hagstrøm's interpretation is based on a Supreme Court decision rendered in 1970, long before the implementation of the CISG in the Norwegian system. However, he refers to this decision as correctly incorporating Norwegian law after the enactment of the Sale of Goods Act. See also Mikelsen (2011), p. 33.

[242] In Rt. 2004 p. 675 (confirmed in HR-2022-192-A in the field of consumer protection) the Supreme Court affirmed that, in the context of defects of generic goods, the liability is strict, and the test will be whether the defects objectively are within the sphere of control of the seller. In this context, therefore, the Supreme Court has rejected the test of actual control and is more in line with the regulation contained in the CISG.

any regulation to the contrary that the contract might contain. As will be seen in Chapter 3, this means that the wording of one and the same contract may have different legal effects depending on the governing law, and that the transnational law does not manage to overcome these differences and create a harmonised regime.

This does not mean that the transnational law may not regulate international contracts. Contract laws usually do not contain many mandatory rules; therefore, the parties might not even notice that the contract is regulated by a certain governing law. In the absence of mandatory rules (i.e., within the scope of the freedom of contract granted by the governing law), the parties are free to use their contract to develop practical mechanisms to respond to the needs of the specific case. Within this scope, and as long as there are no interpretative challenges, transnational sources thrive: commercial practice and transnational sources provide useful regulations and models, and the parties develop mechanisms for the regulation of their respective interests that do not depend on the governing law and may be used across the borders.

What the contract and the incorporated transnational law might not achieve, however, is to harmonise the general interpretation, construction and application of contracts. These depend on the general contract law, which, in turn, is a result of each system's legal tradition. Unless transnational law is interpreted and applied by a centralised court that, over time, may create a coherent body of jurisprudence, its application will be tainted by the interpreter's own legal tradition, thus impairing the desired harmonisation.[243] Absent a unitary legal tradition, aspirations to create a coherent jurisprudence will probably be made difficult by the fragmentation of arbitration, as will be seen in Section 3.7.[244] Commercial arbitration is carried out in a large variety of institutions in all regions of the world, and many proceedings are ad hoc and therefore outside of the framework of any institution; the more or less systematic publication of commercial awards organised by some institutions is not capable of giving any significant harmonisation to such a fragmented picture. A significant number of commercial disputes are decided by arbitrators appointed by private parties according to the most disparate criteria, and awards are written with the sole purpose of solving the particular dispute and with the awareness that they will not be read by anyone else besides the parties involved. Sometimes awards do not even need to state reasons for the decisions. Not only is coherence of arbitration practice not a goal that the commercial tribunals wish to pursue to a particularly high degree; even if it were a goal, it would be impossible to achieve in such a multifaceted system.

[243] I am launching a multidisciplinary research project aimed at verifying to what extent the use of standardised English language contracts may lead to a uniform legal frame for international contracts. A description of the research idea may be found in Giuditta Cordero-Moss, 'Non-National Sources in International Commercial Arbitration and the Hidden Influence by National Traditions'. *Scandinavian Studies in Law* 63 (2016a), pp. 23–44, see particularly Section 4.1.

[244] As well as by the ultimate control of judicial courts over arbitral awards. Courts may not review the awards, either in terms of the merits or in regard of the application of the law. However, if the award disregards particularly important principles of the legal system, it may be deemed, *inter alia*, to violate public policy and thus be ineffective. For an analysis of the matter, see Chapter 5.