Boilerplate Clauses, International Commercial Contracts and the Applicable Law

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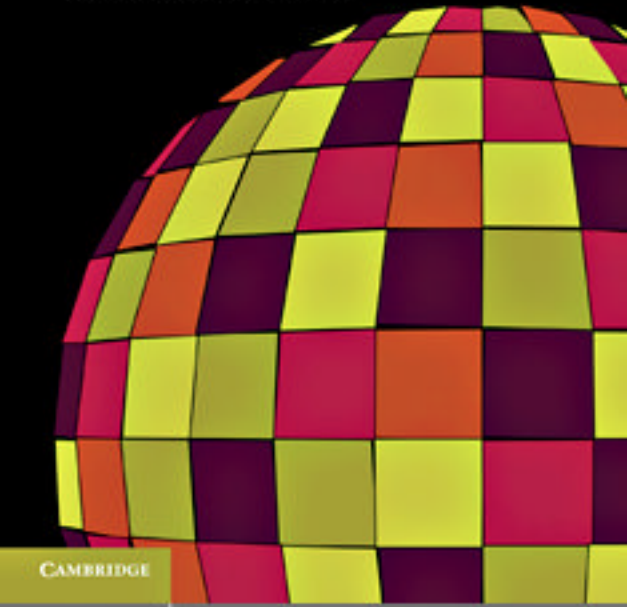

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will be applied equally irrespective of the governing law. If the same wording may have different legal effects within the same legal family, even larger discrepancies may be expected when the involved legal traditions belong to different families. Jean-Sylvestre Bergé observes in Chapter 6 that the circulation of legal models is a phenomenon occurring on different levels and shows that the system of the EU forces acceptance of legal concepts belonging to different legal traditions.

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Does the use of common law contract models give rise to a tacit choice of law or to a harmonised, transnational interpretation?

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Before turning to how the various national laws may affect the interpretation and application of an international contract (which will be the subject of Part 3 of this book), some methodological questions must be addressed. Should an international contract be governed by a national law different from the one that inspired its drafting? Should an international contract be governed by a national law at all? Rather, should not an international contract be subject to a harmonised, transnational law? The thesis of this chapter is that the applicable law should be chosen according to the general conflict rules, even though this would lead to a situation where the contract is governed by a law different from the law that inspired it. Furthermore, the contract is ultimately subject to a state law, even though the underlying transaction is international. These two aspects are dealt with separately in Sections 1 and 2 below.

1 Does the drafting style imply a choice of the applicable law?

The first question regards the choice of the applicable law. An international contract is potentially governed by the laws of at least two different countries, those with which the legal relationship has a connection: these could be the countries where the parties have their respective place of business, the country where the contract is to be performed or other countries with which the contract had other connections.

A judge who has to decide a question arising out of an international contract first of all has to find out which law governs. To do so, the judge will look at the private international law of his or her own country. As is known, private international law, also called conflict of laws or choice-of-law rules, is a branch of the national law of every single legal system, which means that

each private international law might contain its own peculiar rules to identify which country's substantive law governs the contract. This might lead to a considerable lack of harmony in the field of international contracts, because the identity of the law governing the contract might change according to which private international law is applied, i.e., according to which country the proceeding was started in. To avoid this undesirable result, many rules of private international law have been made uniform by international convention or supranational instruments.

The most relevant supranational instrument in the area that is of interest here is the EU Regulation 593 of 2008, known as 'Rome I', which is the successor of the Rome Convention of 1980 on the Law Applicable to Contractual Obligations, binding the members of the European Community. The Rome I Regulation is the private international law in the area of contracts that prevails across the whole EU, with the exception of Denmark, in respect of which the Rome Convention still applies.

In the field of commercial contracts, the most important connection that determines the governing law is the choice made by the parties, so-called party autonomy. In the Rome I Regulation, party autonomy is regulated in Article 3. If the contract contains a choice-of-law clause or if the parties have afterwards specified which law shall regulate their relationship, the contract will have to be interpreted in accordance with that law and will have to be subject to the rules of that law. If the parties have not chosen the governing law, this will be determined by other conflict rules, based on various connecting factors – in Article 4 of the Rome I Regulation, the connecting factor is the seat of the party making the characteristic performance.

The question that will be examined below is: how explicitly do the parties have to choose the governing law? If the contract contains a choice-of-law clause determining that the contract is to be governed by a civilian law, for example, Norwegian law, the choice is expressed clearly. However, if the contract is written on the basis of a common law model and contains some clauses that do not make any sense under Norwegian law but have a clear effect under the original law, could the parties be deemed to have made a tacit choice of the original law for that particular part of the contract? The Rome I Regulation permits different parts of the contract to be subject to the law of a different country, and this could theoretically be an example of this principle of severability.

The question of tacit choice of law would become even clearer if the contract did not contain any choice of law at all, so that it would be quite

legitimate to scrutinise whether the parties meant to subject the whole contract (as opposed to only part of it) to the system of origin of the contract model. Could the parties be deemed to have made an implied choice of law in favour of the original law under which the model was developed, rather than being deemed not to have made any choice (the latter alternative would lead to the application of the law determined by the other applicable conflict rules, i.e., the seat of the party making the characteristic performance)?

As specified in Article 12 of the Rome I Regulation, the applicable law governs the interpretation and application of the contract. This extends to filling any gaps in the contract with rules of the applicable law, as well as correcting any clauses that might be contrary to mandatory rules of the governing law. Therefore, if the applicable law belongs to a civilian system, the common law-inspired contract will be fully governed by the chosen civilian law.

1.1 Tacit choice of law

The wording of Article 3 of the Rome I Regulation[1] makes it clear that, to be considered valid, a tacit choice of law has to appear as an actual choice made by the parties, even if not made expressly. Among other things, this means that the theory of the hypothetical choice of law, which was to be found prior to the Rome Convention in, for example, German private international law, is no longer applicable.[2] It is therefore not sufficient to argue that the parties (or reasonable persons under the same conditions as the parties) would have made a certain choice of law had they considered the question. A hypothetical choice of law may be a reasonable solution to the question of the governing law, but it is not allowed under the wording and the spirit of Article 3, which requires evidence that the parties have actually considered the question and have made a real choice in favour of a specific law. This actual choice of law does not need to be expressed in words and it is sufficient that it is clear from the terms of the contract or other circumstances. However, implying a choice

[1] 'The choice must be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case.'

[2] See M. Giuliano and P. Lagarde, *Report on the Convention on the Law Applicable to Contractual Obligations*, OJ C 282, 31.10.1980, comment to Article 3, para. 3 ('Giuliano-Lagarde Report'); and U. Magnus, *Staudingers Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebegesetzen*, Einleitung zu Art 27ff EGBGB, Article 27–33 EGBGB, etc. (Sellier, 2002), Article 27, notes 60ff. with further references.

of law actually made by the parties from the circumstances is quite different from determining what would be a reasonable choice under those circumstances.

Among the examples of tacit choice made in the Giuliano-Lagarde Report to the Rome Convention is the case of a specific contract form that is known for having been written under a specific governing law, such as the Lloyd's policy of marine insurance developed under English law.[3] By applying this contract form, the parties may be deemed to have tacitly chosen English law. The Rome I Regulation has not brought any modifications to the principles of the Rome Convention in regard of tacit choice of law. Therefore, the observations made by the Giuliano-Lagarde Report under the Rome Convention, are also relevant to the Rome I Regulation.

The case of an identifiable contract form knowingly written under a certain law is quite different from the case assumed here of a contract inspired by a more generalised way of drafting agreements. The practice of general commercial contracts such as agency, distribution, sale, commercial cooperation, etc., finds its inspiration in a plurality of sources such as international standards, international commercial publications, research databases, experience from previous transactions in a variety of countries, etc. The final contract may be based on a patchwork of all these sources. This means, first, that the model upon which the contract is based may be difficult or impossible to determine. Secondly, even the legal system(s) under which the model was developed cannot be identified clearly. While it is clear that these contracts are inspired by common law, it is not usually at all justified to automatically assume that the original legal system is the English system, rather than the US system, the Australian system or any other system of common law. Even if they belong to the same legal family, there may be considerable differences between the contract laws of, for example, England and the US.[4] If the state law under which the specific contract was developed is not identifiable or if there is no international usage to subject that specific model to a specific law, the interpreter is left without rules on the interpretation of contracts, on contractual remedies, on duties between the parties, etc., that can be applied to the contract. A generic reference to the common law tradition would not be of much help.

[3] Giuliano-Lagarde Report.

[4] On the different legal effects a contract may have under English law and under US law, see Chapter 5 of this book by Edward Canuel.

A specific state law as a system of origin is not usually identifiable in the commercial contracts drafted as described above, and this would be sufficient to exclude the possibility that an actual choice of law is demonstrated with reasonable certainty, as the Rome I Regulation requires. In addition, the identification of a system of origin for the contract is usually impossible when international contracts are negotiated by lawyers coming from different legal systems (none of which necessarily belongs to the common law family) and on the basis of their own respective international experience and documentation. Even if it is assumed that the first draft presented by one party was developed under a specific legal system (which is not always the usual practice), the origin of that draft is not necessarily known to the other party and is generally lost during the negotiations, after each of the parties has added to and modified the clauses of the first drafts in several rounds. The final text that comes out of this process can hardly be said to permit, with reasonable certainty, the implication that the parties actually wanted to choose for their contract the law under which the first draft was originally developed (if any).

Therefore, the simple fact that the contract is written in English and follows the common law drafting technique is not sufficient to identify, with any certainty, the law under which the contract was developed. It would be totally arbitrary to assume that the parties intended English law to govern the contract, as the most representative or well-known law within that legal family. In addition, trying to apply a minimum denominator common to a majority of common law systems would be not only very vague but against the rule of Article 3 of the Rome I Regulation, which assumes a clear choice of the law of a specific state.

1.2 Closest connection

If the parties have not chosen the applicable law, the connecting factor will be, according to the first and second paragraphs in Article 4 of the Rome I Regulation, the seat of the party making the characteristic performance. The third paragraph in Article 4 provides for an exception: 'Where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that indicated in paragraphs 1 or 2, the law of that other country shall apply.' Does the circumstance whereby the contract was inspired by the common law create a connection with another country that is manifestly closer than the one based on the general conflict rule?

First of all, reference must be made to the reasoning made above in respect of the possibility of a tacit choice of law: as long as no specific state law can be identified as the system of origin of the contract, no connection with a specific country may be assumed.

Furthermore, such a connection would be irrelevant in identifying the closest connection. The wording of Article 3, specifying that the closer connection must be 'manifest', is meant to show that the exception should be applied restrictively, as recitals 20 and 21 in the preamble of the Rome I Regulation also underline. Neither the language of a contract nor the style of drafting is mentioned among the elements that would create such a connection to override the connecting factor based on the general conflict rule. That the escape clause of the closest connection shall be used restrictively is confirmed by the history of the provision. Its predecessor, Article 4 of the Rome Convention, had a different structure that gave a prominent role to the formula of the closest connection. The first paragraph of Article 4 contained a wording that provided for a flexible approach as to which circumstances may be considered in order to determine the applicable law, and the second paragraph provided a presumption that gave more objectivity: the closest connection was presumed to be with the country of residence or main place of business of the party making the characteristic performance. The interpretation of this second paragraph has not been uniform: some courts have considered it a weak presumption and have applied the fifth paragraph of Article 4[5] to rebut it whenever the circumstances of the case showed a closer connection with another country. On the contrary, other courts have considered the presumption of Article 4(2) to be strong and have disregarded other circumstances of the case unless there are exceptional situations. This latter interpretation corresponds better to the spirit of Article 4, which inserted the presumption to ensure predictability in the application of the criterion of the closest connection.[6] If, as a

[5] '[. . .] the presumptions in paragraphs 2, 3 and 4 shall be disregarded if it appears from the circumstances as a whole that the contract is more closely connected with another country.'

[6] Giuliano-Lagarde Report, comment to Article 4, para. 3. For further references to problems of interpretation that arose out of the relationship between the second and the fifth paragraphs of Article 4, see the Green Paper on the Rome Convention, *Green Paper on the conversion of the Rome Convention of 1980 on the law applicable to contractual obligations into a Community instrument and its modernisation,* 14.1.2003, COM (2002) 654 final. For a more extensive development of the reasoning made in the text here, see also G. Cordero-Moss, *International Commercial Law*, 2nd edn, Publications Series of the Institute of Private Law No. 185 (University of Oslo, 2010), pp. 323ff.

general rule, any other factors were allowed to be evaluated (such as the language of the contract or its legal style), the choice of law would be deprived of this predictability. The strength of the presumption became even clearer when the Rome Convention was transformed into the Rome I Regulation. The previous approach of a flexible connecting factor (closest connection, in Article 4(1)) which is clarified by a presumption (of the habitual residence or main place of business of the party making the characteristic performance, in Article 4(2)) has been changed into a series of fixed rules (all based on the connecting factor of the characteristic debtor's habitual residence or main place of business) with a residual flexible connecting factor (closest connection) to be used in the event that the party making the characteristic performance cannot be identified or as an escape.

In conclusion, the legal style in which the contract is written does not seem to be a relevant criterion in assessing with which country the contract has its closest connection.

1.3 Conclusion

From the foregoing, it seems possible to conclude that the drafting style, legal technique and language of a contract as such are not sufficient bases for a tacit choice of law or as a circumstance showing close connection capable of prevailing over other connecting factors. The governing law will be chosen on the basis of the connecting factor generally applicable to contracts, without regard to the drafting style of the contract.

2 Is a uniform interpretation of international contracts that is independent from the applicable law possible?

Since international contracts are written in a style that does not depend on the applicable law, it is legitimate to enquire whether they may be interpreted according to principles that are also not affected by the applicable law, i.e., transnational principles. In this respect, it is necessary to distinguish between contract clauses that regulate specific matters without any impact on aspects of general contract law and contract clauses that have an impact on principles and general contract law rules. The former may easily be subject to uniform interpretation, as long as this may be founded on applicable transnational sources. The latter will be affected by the principles, rules and legal traditions of the applicable law.

2.1 *Transnational sources*

A variety of instruments seeks to achieve harmonisation in the area of international commercial contracts:

(i) binding instruments – such as the 1980 United Nations (Vienna) Convention on Contracts for the International Sale of Goods ('CISG') creating a uniform law for the aspects of sale contracts that it regulates;
(ii) instruments issued by international bodies but without binding effect, either as models to be adopted by the legislature, such as the 1985 UNCITRAL Model Law on International Commercial Arbitration as revised in 2006, or as instruments to be adopted by the parties, such as the UNCITRAL Arbitration Rules, issued in 1976 and revised in 2010;
(iii) instruments issued by private organisations such as the International Chamber of Commerce 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'); and
(iv) restatements of principles of general contract law issued by international organisations, branch associations or academic groups – such as the UNIDROIT Principles of International Commercial Contracts ('UPICC')[7] and the Principles of European Contract Law ('PECL')[8] – or endorsed by competent authorities, such as the Common Frame of Reference ('CFR') currently planned in the EU, and for the moment only at the stage of a draft proposed by a group of scholars, known as the Draft Common Frame of Reference ('DCFR').[9]

Sources without a binding effect but with an authority based on their persuasiveness and their representativeness are generally referred to as soft law. As opposed to the other above-mentioned types of instruments

[7] *UNIDROIT Principles of International Commercial Contracts* (International Institute for the Unification of Private Law, 2004).
[8] O. Lando and H. Beale (eds.), *Principles of European Contract Law*, Parts 1 and 2 (Kluwer Law International, 2002); and O. Lando and H. Beale (eds.), *Principles of European Contract Law*, Part 3 (Kluwer Law International, 2003).
[9] Study Group on a European Civil Code/Research Group on EC Private Law (eds.), *Principles, Definitions and Model Rules of European Private Law – Draft Common Frame of Reference (DCFR)* (Sellier, 2009).

that may be defined as soft law, the CISG is a binding convention; nevertheless, in addition to its direct binding effect, it is sometimes referred to as having an authoritative effect that goes beyond its territorial and substantive scope of application and makes it one of the most important sources of soft law for general contract law. Together with two other illustrious instruments, the already-mentioned UPICC and PECL, it is sometimes referred to as the 'Troika', a body of transnational law particularly apt to govern commercial contracts.[10]

Both the CISG in its original binding function and some instruments of soft law, such as those mentioned above and issued by the UNCITRAL and ICC, have a specific scope of application. The CISG applies to certain aspects of the contract of sale; the model law and the Arbitration Rules apply to the procedural aspects of arbitration; INCOTERMS apply to the passage of risk from seller to buyer and other specific obligations between the parties; and the UCP 600 apply to the mechanism of documentary credits. None of these instruments have the goal of regulating all contract law aspects of the relationship between the parties, such as the validity of the contracts, their interpretation or all remedies for breach of contract. None of these sources create structural problems and all of them may successfully achieve harmonisation within their respective scope of application. They usually integrate the governing law by specifying details that lie within an area that may freely be regulated by the parties. If any of these sources reflects a trade usage, it will be applicable even without the need of reference by the parties. If any of these sources has been ratified or adopted by the legislature, it will govern that particular area of the law.

Characteristic of the restatements of general contract law is, conversely, the goal to act as the law that governs all aspects of the legal relationship between the parties and thus replaces the state governing law in its totality.

2.2 Does transnational law have the force of law?

The goal of replacing the governing law creates, first of all, a challenge in terms of private international law. If the restatements of general contract law or other sources of soft law are to replace the governing law, they will

[10] See, for example, O. Lando, 'CISG and its Followers: A Proposal to Adopt Some International Principles of Contract Law', *American Journal of Comparative Law*, 53 (2005), 379–401, 379ff.

not be subject to any mandatory rules of the otherwise applicable law, with the exception of overriding mandatory rules. On the contrary, if these instruments are incorporated into the contract and become contract terms, they remain subject to any mandatory rules of the applicable law, are interpreted according to the governing law's underlying principles and are 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.' Also, the Rome I Regulation excludes the possibility that the parties may select sets of rules that are not state laws (with an exception for possible future European instruments of contract law).[11] This was the conclusion of a long process started with the Commission's Green Paper on the conversion of the Rome Convention.[12] A draft issued during the process gave the parties a certain room for choosing a non-state body of law to govern the contract.[13] The opposition to this opening was such that the final text of the Regulation excluded this possibility and specified in the preamble (recital 13) that nothing prevents the parties from *incorporating* transnational instruments of soft law into the contract. However, as a consequence of such incorporation, transnational instruments are given the status of a term of contract, not of governing law.

While private international law prevents the parties from choosing transnational law to govern their contract when disputes are decided by courts of law, there is often greater flexibility in disputes that are submitted to arbitration. The UNCITRAL Model Law on International Commercial Arbitration, for example, which has been adopted more or less literally in over fifty countries, provides in Article 28(1) that the arbitral tribunal shall apply the 'rules of law' chosen by the parties. This terminology, as opposed to the word 'law' used in Article 28(2) to cover the eventuality that the parties have not made a choice, is often interpreted to be an opening to transnational law.

Yet, the fact that the parties, in the frame of arbitration, may choose to replace the governing law with transnational sources is not sufficient to ensure a harmonisation of the general contract law. First of all, there may

[11] Council Regulation No. 593/2008, Article 3.
[12] *Green Paper on the conversion of the Rome Convention of 1980.*
[13] *Proposal for a Regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I)*, COM (2005) 650 final.

be gaps in the transnational sources, so that ultimately the application of a state law may be necessary.[14] Furthermore, as will be seen below, certain principles of general contract law are deeply rooted in the legal tradition of the interpreter and harmonisation will not be achieved in full until there is a centralised court that establishes a uniform legal tradition. An instrument with the task of harmonising different legal traditions must be precise and leave little to the judge's discretion, otherwise the harmonised rules are applied differently by the different countries' courts.[15]

2.3 Does transnational law exclude the applicable law?

Transnational sources of soft law may complement the applicable law, but are not able to replace it. The interaction between these sources and the governing law may prejudice the desired harmonising effect.

2.3.1 Specific contract regulations

One example of specific contract regulations may be INCOTERMS. The interpretation of the terms of delivery contained therein is undoubtedly harmonised, and everybody who reads a contract saying, for example, that delivery shall be made 'FOB Rotterdam according to INCOTERMS 2000' knows that the goods have to be loaded and cleared for export by the seller on the ship nominated by the buyer at the named port, that the buyer must take delivery on board of the ship, that the risk of damage to the goods passes from the seller to the buyer when the goods are loaded, etc. If INCOTERMS were the only source applicable to the contract, there would be no rules on the validity of the contract, on the effects that

[14] Both the UPICC and the PECL shall be interpreted autonomously; see, respectively, Articles 1.5 and 1:106. However, should it still be impossible to fill a gap, the governing law shall be applied. It is expressly provided for in the second paragraph of Article 1:106 of the PECL, and implied by the UPICC, whose model clause recommends the use of state law as a supplement; see the official commentary to the UPICC, published by UNIDROIT in 2004 at www.unidroit.org/english/principles/contracts/principles2004/integralversionprinciples2004-e.pdf, comment No. 4 to Article 1.6, last accessed 15 March 2010.

[15] H. Eidenmüller *et al.*, 'The Common Frame of Reference for European Private Law – Policy Choices and Codification Problems', *Oxford Journal of Legal Studies*, 28 (2008), 659–708, criticising the DCFR for not being sufficiently precise. The DCFR was presented by two academic groups in the framework of the Joint Network on European Private Law with the aim of contributing to the development of a European law of contracts, and was largely based on the PECL. See also R. Schulze (ed.), *CFR and Existing EC Contract Law*, 2nd revised edn (Sellier, 2009).

the sale has for third parties who are creditors, etc. Obviously, INCOTERMS do not have the goal of being the only applicable source of law, because they do not regulate these aspects of the contract. Therefore, they need to be integrated with an applicable law. This may have an impact not only on the areas that are not regulated by INCOTERMS, but even within their scope of application. Suppose that goods were destroyed after the risk passed to the buyer. According to INCOTERMS, the buyer is obliged to pay the price. Suppose that the applicable law is of a state that has ratified the CISG and that therefore the sales agreement is also regulated by the CISG. Article 66 of the CISG provides that the buyer is not obliged to pay the price even if the damage occurred after the risk passed, as long as the damage was due to the seller's act or omission. Thus, the CISG interacts with INCOTERMS in such a way that it modifies their application. Hence, INCOTERMS ensure harmonisation of the rules within their scope of application to a large extent, but not completely.

2.3.2 General contract regulations

Other clauses that often appear in international contracts are even more difficult to interpret uniformly, because they may require the involvement of general principles that are deeply rooted in the interpreter's legal tradition. Many contracts attempt to achieve harmonisation by inserting clauses aimed at rendering the contract self-sufficient, with the precise purpose of excluding interference by external elements, including the applicable law. According to the logic underlying this drafting style, if the contract is to be interpreted and applied exclusively on the basis of its words, it will be interpreted and applied equally, irrespective of any legal tradition. In many situations, the intent of the parties is successful: contracts are written in a detailed and comprehensive manner, and they mainly regulate matters that are within the scope of the parties' contract freedom. By this combination, and if the contract is sufficiently clear, there is often no room for interference by the applicable law. Therefore, the interpretation and application of the clauses will not be affected by the differing legal traditions or by the application of transnational sources.

Under some circumstances, however, a literal application of the clauses may challenge some fundamental principles of the applicable law, including, first of all, the principle of good faith (some examples will be made below). How are the clauses to be interpreted in these situations? On the basis of their wording, which may possibly conflict with the

principle of good faith in the governing law? Or on the basis of the principle of good faith, thus disregarding the words of the contract? And how exactly is the content of the principle of good faith to be determined?[16] As the chapters in Part 3 of this book will show, different legal systems have different approaches.[17] This chapter will deal with transnational law's ability to achieve harmonisation in these situations.

The clauses discussed here are frequently part of international commercial contracts, irrespective of the type of contract. Not only are they generally expected to be an integral part of contract drafting, they are also immediately recognised and thus very seldom discussed during the negotiations. The drafting of these clauses is often considered to be a mere 'copy and paste' exercise. They are often referred to as 'boilerplate', standard language with a general applicability that follows automatically and does not require particular attention. The following are examples of the most typical clauses:

Entire agreement The Contract contains the entire contract and understanding between the parties hereto and supersedes all prior negotiations, representations, undertakings and agreements on any subject matter of the Contract.

No waiver Failure by a party to exercise a right or remedy that it has under this contract does not constitute a waiver thereof.

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

Severability If a provision of this Agreement is or becomes illegal, invalid or unenforceable, that shall not affect the validity or enforceability of any other provision of this Agreement.

Conditions/fundamental terms The obligations regulated in Section [xx] are fundamental and any breach thereof shall amount to a

[16] On the various roles that the principle of good faith may have in contract law, see H. Beale, 'General Clauses and Specific Rules in the Principles of European Contract Law: The "Good Faith" Clause', in S. Grundmann and D. Mazeaud (eds.), *General Clauses and Standards in European Contract Law* (Kluwer Law International, 2006), pp. 205–218, 207ff.

[17] For a thorough analysis of the different approaches to good faith in the various legal systems of Europe, see R. Zimmermann and S. Whittaker, *Good Faith in European Contract Law* (Cambridge University Press, 2000). See also G. Cordero-Moss, 'International Contracts between Common Law and Civil Law: Is Non-State Law to be Preferred? The Difficulty of Interpreting Legal Standards such as Good Faith', *Global Jurist (Advances)*, 7 (2007), Article 3, 1–38.

fundamental breach of this contract [*Alternative:* [Time] is of the essence].

Sole remedy [Liquidated damages paid in accordance with the foregoing provision] shall be the Buyer's sole remedy for any delay in delivery for which the Seller is responsible under this Agreement.

Subject to contract This document does not represent a binding agreement between the parties and neither party shall be under any liability to the other party in case of failure to enter into the final agreement.

Through these clauses, the parties attempt to exhaustively regulate the contract's interpretation (entire agreement) and validity (severability), the exercise of remedies for breach of contract (no waiver, conditions, sole remedy), and the legal effects of future conduct (no oral amendments, subject to contract). At the same time, these clauses attempt to exclude any rules that the applicable law may impose on these aspects.

This drafting style has the same approach that inspired the original common law models: *caveat emptor*.[18] A commercial contract between professionals, often written by expert lawyers, is expected to reflect careful evaluations made by each of the parties of its respective interests. The parties are assumed to be able to assess the relevant risks and to make provisions for them. The negotiations are expected to be carried out in a way that adequately takes care of each of the parties' positions, and the final text of the contract is deemed to reflect this. The contract is deemed to have been written accurately, so that each party may use the contractual regulation to objectively quantify its risk and, for example, insure against it. Contracts may also be assigned to third parties, for example, as collateral for other obligations or in the frame of other transactions. Contracts must therefore contain all elements according to which they will be interpreted, and interpretation must be made objectively and on the basis of the contract's wording. Under these circumstances, a literal and thus predictable application of the contract is perceived as the only fair application of contracts. It would be unfair to draw on external elements in addition to the wording of the contract, such as the conduct or silence of one of the parties that may have created expectations in the other party at some stage during the negotiations or even after the contract was signed. How can a contract circulate and be used as a

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

basis for calculating an insurance premium, granting a financing or be assigned to a third party if its implementation depends on elements that are not visible from the contract itself?

Sometimes, however, a literal application of the clauses may lead to results that may seem unjustified or not proportional to the interests of the other party. The following cases may serve as illustrations:

Entire agreement What happens if the parties have, on a previous occasion, agreed on certain specifications for certain products, but have not incorporated those specifications into the present contract? Can the contract be interpreted in light of the previously agreed specifications, in spite of the Entire Agreement clause?

No waiver Assume that the contract gives one party the right to terminate in case of delay in the delivery. What happens if the delivery is late, but the party does not terminate until, after a considerable time, the market changes and the contract is no longer profitable? The real reason for the termination is not the delay, but the change in the market. May the old delay be invoked as a ground for termination or is there a principle preventing it, in spite of the no waiver clause?

No oral amendments What happens if the parties agree on an oral amendment and afterwards one party invokes the NOA clause to refuse performance (for example, because it is no longer interested in the contract after the market has changed)?

Severability Some contract laws provide that the invalidity of certain contract terms renders the whole contract invalid. This conflicts with the clause. Moreover, a literal interpretation of the clause may lead to an unbalanced contract, if the provision that becomes invalid or unenforceable has significance for the interests of only one of the parties.

Conditions, essential terms Assume that the contract defines delay in delivery as a fundamental breach; there is a delay, but it does not have any consequences for the other (innocent) party. What happens if the innocent party terminates the contract because the market has changed and the contract is no longer profitable? Can the clause on fundamental breach be invoked, even if the real reason for the termination is not the delay, but the change in the market?

Sole remedy Assume that the contract defined the payment of a certain amount as the sole remedy in case of breach. What happens if the non-defaulting party is able to prove that the breach has caused a considerably larger damage than the agreed amount?

Subject to contract Assume that the parties entered into a Letter of Intent specifying that failure to reach a final agreement will not expose any of the parties to liability. What happens if one party never really intended to enter into a final agreement and used the negotiations only to prevent the other party from entering into a contract with a third party?

The drafting style of commercial contracts attempts to exclude any interference from external elements and to create a self-sufficient system detached from the governing law. The assumption is that if the parties had wanted to restrict or qualify the application of the contract provisions, they would have written the restrictions or the qualifications in the contract. Rules of interpretation of the governing law, principles of good faith and other mandatory rules would interfere with the contract and create uncertainty. Part 3 of this book will show that often contracts do not succeed in creating a self-sufficient system detached from the governing law. This means that two contracts with exactly the same wording might have different legal effects, depending upon the governing law. This is sometimes considered to be confusing and undesirable. Would transnational law be a suitable alternative to the various state laws and reinstate uniformity for international contracts?

2.4 Does transnational law provide a uniform standard?

The UPICC and the PECL are the most systematic restatements of transnational principles of contract law, and therefore they will be used as a basis for the analysis in this chapter. Both restatements contain a general clause on good faith in, respectively, Articles 1.7 and 1.201, requiring each party to act in accordance with good faith and fair dealing in international trade. They also contain numerous provisions[19] that apply the general principle of good faith to specific situations.

In other words, the general principle of good faith is, in these restatements, an overriding principle that functions as a corrective action to the

[19] Comment No. 1 to Article 1.7 (last accessed 15 March 2010) 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; 3.5, 3.8 and 3.10; 4.1(2), 4.2(2), 4.6 and 4.8; 5.1.2 and 5.1.3; 5.2.5; 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 also 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 and 2:301; 4:103, 4:106, 4:109 and 4:110; 5:102; 6:102; 8: 109; 9:101, 9:102 and 9:509.

mechanisms regulated in the contract whenever a literal application leads to results that seem too harsh on 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 may be considered to be against the principle of good faith if it amounts to an abuse of right. An abuse of right is defined by the official commentary to 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.'[20] Under the drafting style described above, if the parties had granted a certain contractual remedy for a certain purpose and not for another, they should have spelled it out in the contract. If they had intended to exclude some results from the possible consequences of exercising a certain right, they should have regulated that expressly. How can this be reconciled with the discretion that the UPICC give to the interpreter?

An example is Article 2.1.15(3) of the UPICC,[21] providing liability for the party that has started negotiations without serious intentions to eventually enter into the contract. The official comment to this provision reads: 'One particular instance of negotiating in bad faith which is expressly indicated in paragraph (3) of this Article is that where a party enters into negotiations or continues to negotiate without any intention of concluding an agreement with the other party.' Would this prevail over the subject to contract clause mentioned above, which has the purpose of exempting the parties from any liability in the event that they do not reach the final agreement?[22] According to the language of the clause, the exemption is absolute and is not affected by the reasons for starting or breaking off the negotiations. However, according to Article 1.7(2) of the UPICC, the parties may not derogate from the general principle of good faith.

In short, it is evident that the clauses described above are affected by the principle of good faith contained in the restatements. The principle of good faith in the UPICC and in the PECL overrides the language of the

[20] Comment No. 2 to Article 1.7 (last accessed 15 March 2010).

[21] The corresponding provision in the PECL is Article 2.301.

[22] For a more extensive analysis of the function and effects of Letters of Intent, particularly from the point of view of the common law–civil law tension, see G. Cordero-Moss, 'The Function of Letters of Intent and their Recognition in Modern Legal Systems', in R. Schulze (ed.), *New Features in Contract Law* (Sellier, 2007), pp. 139–159.

contract. The next question is then: are the restatements so precise that they can provide a basis for uniform interpretation?

In the commentary to 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 should be made to any standard that has been developed under any state law.[23] This approach is in line with the requirement of autonomous interpretation of the UPICC contained in Article 1.6 thereof: 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. However, 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 towards creating clarity in respect of the content of good faith as a standard, as will be seen below.

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.[24] How would the interpreter evaluate the wording of the contract, which seems to provide for and permit the very conduct sanctioned 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, taken 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 may consider that the 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

[23] Comment No. 3 to Article 1.7 (last accessed 15 March 2010).

[24] For an analysis of the application of general clauses, with particular but not exclusive reference to the German system, see P. Schlechtriem, 'The Functions of General Clauses, Exemplified by Regarding Germanic Laws and Dutch Law', in Grundmann and Mazeaud (eds.), *General Clauses and Standards in European Contract Law*, pp. 41–55, 49ff.

interpretation consists in an accurate interpretation of the contract. To the latter, it consists in intervening and reinstating a balance between the parties.

Where does the interpreter of transnational sources look for guidance?

In an international setting, it is natural to look for inspiration and guidance to the body of rules regulating international contracts and emanating from non-authoritative and non-state sources, the so-called *lex mercatoria*.

The most important of the sources that are usually considered to constitute the *lex mercatoria* (generally recognised principles, trade usages, contract practice and, according to some authors, international conventions) seem to give no specific criteria upon which a notion of good faith and fair dealing may be shaped, as will be seen immediately below.

There is no generally recognised uniform notion of good faith and fair dealing that might be valid for all types of contracts on an international level, and there is hardly a notion that is generally recognised for one single type of contract either.[25] There is no evidence of trade usages in respect of how the standard of good faith (if any) is applied in practice.[26] Among the most authoritative sources mentioned for the principle of good faith in international trade[27] are the UPICC and the PECL; however, these rely on the existence of this principle in international trade in order to determine its precise scope. In a rather circular logic, the principle of good faith is based on the restatements, and the restatements are based on the principle of good faith. There are few principles in respect of good faith and fair dealing that may be considered common to civil law and common law systems, and, even among civil law systems, there are considerable differences.[28]

[25] For a detailed analysis, see G. Cordero-Moss, 'Consumer Protection Except for Good Commercial Practice: A Satisfactory Regime for Commercial Contracts?', in Schulze (ed.), *CFR and Existing EC Contract Law*, pp. 78–84.

[26] On the establishment of uncodified usage and the *lex mercatoria*, see R. Goode, 'Usage and its Reception in Transnational Commercial Law', *International and Comparative Law Quarterly*, 46 (1997), 1–36.

[27] See, for example, the recognised digest of principles of the transnational law published by K. P. Berger, Trans-lex.org, commenting on Article 1.1, at www.trans-lex.org/output.php?docid=901000&legis_principle_ref=1, last accessed 13 March 2010. For a detailed analysis of the various sources mentioned in this digest, see Cordero-Moss, 'Consumer Protection Except for Good Commercial Practice', pp. 80–84.

[28] See Zimmermann and Whittaker, *Good Faith in European Contract Law*. See also Cordero-Moss, 'International Contracts between Common Law and Civil Law'.

Even focusing on the common core that underlies the different legal techniques of the various systems[29] may be of little help. Piecemeal solutions in English law[30] in certain areas make it possible to reach results comparable to the general principle of good faith in other systems. To what extent this may be useful in substantiating a general clause on good faith in international trade is uncertain. Although English law may, by applying its own remedies or techniques, achieve results in part similar to those that the principle of good faith may make it possible to achieve in some of the other systems, it also makes it possible to avoid these results by clear language in the contract. Many clauses used in commercial contracts were developed precisely with the aim of avoiding those results.

Contract practice is generally 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 good faith and fair dealing standard, even in countries where the legal system does recognise an important role to good faith.

The instrument that is generally considered as a high expression of the *lex mercatoria*, the CISG, has willingly omitted including good faith as a duty between the parties, which renders the very existence of this criterion in the transnational context dubious. The CISG is silent on the question of good faith as a duty between the parties, in spite of repeated requests during the drafting phase to expressly mention that the parties have to perform the contract according to good faith. During the drafting of the convention, specific proposals on good faith were presented in the precontractual phase, as well as general proposals dealing with the requirement of good faith. The specific proposals relating to precontractual liability were rejected and the generic proposals on good faith were incorporated in Article 7 in such a way that the principle of good faith is

[29] Modern comparative studies showed that the common law/civil law divide is much more complex than is traditionally believed. Thus, under certain circumstances common law reaches the same results that would be reached under civil law on the basis of the good faith principle. On the other hand, civilian law has a much less unitary approach to good faith than is traditionally assumed. See Zimmermann and Whittaker, *Good Faith in European Contract Law*, p. 678: despite the observation that the principle of good faith is relevant to all or most of the doctrines of modern laws of contract, the authors conclude that each system draws a different line between certainty and justice.

[30] The expression is taken from a famous observation made by Judge Brimham LJ in *Interfoto Picture Library Ltd* v. *Stiletto Visual Programmes Ltd* [1988] 2 WLR 615.