Boilerplate Clauses, International Commercial Contracts and the Applicable Law

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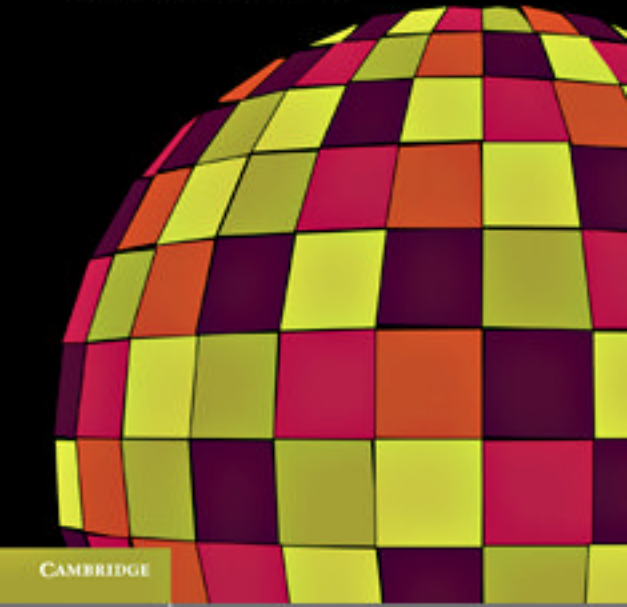

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Even focusing on the common core that underlies the different legal techniques of the various systems[29] may be of little help. Piecemeal solutions in English law[30] in certain areas make it possible to reach results comparable to the general principle 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.

not directed at regulating the parties' conduct in the contract, but at the contracting state's interpretation of the convention.[31] The main arguments against the inclusion of good faith as a duty of the parties were that the concept was too vague to have specific legal effects, and that it would be redundant if mention thereof had only the character of a moral exhortation. Therefore, the CISG does not contribute to the determination of a standard of good faith for international contracts.

The theory of transnational law (also traditionally referred to as *lex mercatoria*) has received strong support in certain academic circles, but has been met with scepticism by legal practice.[32] The main reasons for this scepticism are that it is quite demanding to determine what the exact content of the *lex* is, that the principles that can be determined as being part of the *lex* are mainly quite vague and therefore cannot be used to decide specific disputes of a legal-technical character,[33] and that the content of the *lex* is quite fragmentary, leaving many areas of the law uncovered.

Some of these negative aspects may be remedied by the restatements, systematisations and standardisation of the *lex* that have been produced in recent years, such as the UPICC and the PECL. However, subjecting a contract to regulation by commercial practices or generally acknowledged principles or restatements thereof would leave too much room for discretion, thus representing an uncertain ground for the solution of potential disputes. The theory of the *lex mercatoria* seems to be based on the assumption that the parties desire a flexible system in which the interpreter (judge or arbitrator) can adapt to their needs. On the contrary, practitioners emphasise that they desire a predictable legal system

[31] For an extensive evaluation of this matter, as well as references to literature and to the legislative history in this respect, see A. Kritzer, *Pre-Contract Formation*, editorial remark on the internet database of the Institute of International Commercial Law of the Pace University School of Law, www.cisg.law.pace.edu/cisg/biblio/kritzer1.html, pp. 2ff. (last accessed 15 March 2010), also featuring extensive references to the Minority Opinion of M. Bonell, who was representing Italy under the legislative works. According to Bonell, an extensive interpretation of the CISG would justify application of both the concepts of pre-contractual liability and good faith. See also R. Goode, H. Kronke, E. McKendrick and J. Wool, *Transnational Commercial Law – Text, Cases and Materials* (Oxford University Press, 2007), pp. 279ff.

[32] As Lord Mustill incisively put it twenty years ago: 'the commercial man is a conspicuous absentee from the writings on the lex mercatoria', in Mustill LJ, 'The New Lex Mercatoria: The First Twenty-Five Years', *Arbitration International* 4, 2 (1987), 86–119, 86. The same may be affirmed today.

[33] In the words of Mustill LJ, these principles are 'so general that they are useless': 'The New Lex Mercatoria', 92.

that can be objectively applied by the interpreter; the task of adapting the contract to the specific needs of the case is the task of the contract drafters, not the interpreter.[34]

UNIDROIT has taken a measure that is to be commended for contributing to the development of a body of case law that may enhance a harmonised interpretation and thus predictability of the UPICC: following the example of CLOUT, a system established by UNCITRAL for the collection and dissemination of court decisions and arbitral awards relating to UNCITRAL instruments, UNIDROIT has established UNILEX,[35] 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) otherwise would be scattered among the publications issued by different arbitral institutions all over the world is a valuable step 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 general contract law.

To test the ability of the UPICC to harmonise contract law with the help of UNILEX, it is interesting to examine the case law collected in respect of Article 2.1.17 of the UPICC. This Article recognises the abovementioned Entire Agreement clauses, 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. However, the UPICC provision specifies 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; however, it is 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

[34] For an interesting analysis of this aspect, see W. Grosheide, 'The Duty to Deal Fairly in Commercial Contracts', in Grundmann and Mazeaud, *General Clauses and Standards in European Contract Law*, pp. 197–204, 201.

[35] www.unilex.info.

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 inconsistent with reasonable expectations that it has created in the other party. According to this logic, the detailed discussion during the phase of negotiations of 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 into the contract; their subsequent exclusion on the basis of the Entire Agreement clause may be deemed to be against good faith.

UNILEX contains two decisions on Article 2.1.17: the ICC award No. 9117 of 1998 and an English Court of Appeal decision.

In the ICC award, 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'.[36] The contract also contained a no oral amendments clause, which is recognised in Article 2.1.18 of the UPICC, 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 above. Consequently, it considerably restricts the applicability of the principles underlying the UPICC.

The other decision mentioned in UNILEX under Article 2.1.17 is by the English Court of Appeal.[37] There Mummery LJ stated that, under English law, extrinsic evidence could be used to ascertain the meaning of a term contained in a written contract. On the contrary, extrinsic evidence could not be used to ascertain the content of the contract.[38] Lady Justice Arden considered this distinction too conservative and argued for

[36] The award may be found at www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13621&x=1 (last accessed 12 March 2010), clicking on 'full text'. The paragraphs are not numbered.

[37] *Proforce Recruit Ltd* v. *The Rugby Group Ltd* [2006] EWCA Civ 69. [38] *Ibid.*, at 41.

a larger use of extrinsic evidence, referring to the UPICC in support of her view.[39]

UNILEX, in summary, shows two decisions on Article 2.1.17 of the UPICC: an arbitral award advocating the primacy of the contract's language and an English Court of Appeal decision assuming in an *obiter dictum* that the UPICC provide for the primacy of the principle of good faith (in this case, the real intention of the parties).

Evidently, this is not sufficient to give guidance as to how to solve the conflict between the contract's language and the principle of good faith.

Regarding the development of the PECL, it is interesting to observe that they are central in the ongoing work on a European contract law. In 2004,[40] the European Commission entrusted a joint network on European private law with the preparation of a proposal for a CFR. The CFR is 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 lawmaking process. The Study Group on a European Civil Code and the Research Group on the Existing EC Private Law jointly used the PECL as a basis for a DCFR that was finalised at the end of 2008.[41] The DCFR is currently subject to debate, both by politicians[42] and scholars.[43] Depending on the development of this process, 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. 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.

3 Conclusion

Although international contracts are often drafted according to a relatively recognisable style that may be deemed to be loosely inspired by the common law, each contract will be subject to a specific state law, and the

[39] *Ibid.*, at 57.

[40] Communication, *European contract law and the revision of the acquis: the way forward*, COM (2004) 651 final.

[41] Study Group on a European Civil Code/Research Group on EC Private Law (eds.) *Principles, Definitions and Model Rules*.

[42] Discussion on the topic of the CFR in the Council of the European Union, initiated by the Presidency on 28 July 2008, 8286/08JUSTCIV 68 CONSOM 39.

[43] Eidenmüller *et al.*, 'The Common Frame of Reference'; N. Jansen and R. Zimmermann, '"A European Civil Code in All But Name": Discussing the Nature and Purposes of the Draft Common Frame of Reference' (2010) 69 CLJ, 98–112.

governing law will be identified without having regard to the style in which the contract is written.

Only where the drafting style clearly can be taken as a conscious choice made by the parties to apply a specific state law will it be deemed to be a tacit choice of law. Where the parties may not be assumed to have made an actual choice, the applicable law will be chosen according to the connecting factor of the conflicts rule for contracts. This may lead to applying a civilian law to a contract that was inspired by the common law.

The challenges that may arise may not be overcome by assuming that international contracts are subject to transnational rules permitting a uniform interpretation and application, thus avoiding the peculiarities of the various legal traditions. Transnational sources of soft law have proven to be extremely useful when they have a specific scope of application and can be used to integrate the parties' contract and the governing law on determined, technical matters. However, their capacity to also replace the governing law in respect of the general contract law is more doubtful.

First of all, transnational law does not have the force of law necessary to be considered by a court as applicable law. An arbitral tribunal may have the power to apply transnational sources instead of the governing law, but often this would lead to new difficulties, because these sources are not sufficiently precise to allow a uniform interpretation. Moreover, no coherent case law is developed as long as there is no centralised tribunal that applies these sources. A uniform application of transnational law assumes a common understanding of the underlying principles. For the moment, this is lacking: while commercial practice seems to adopt an approach close to that of the common law in drafting contracts that aspire to be self-sufficient and objectively interpreted, the restatements of principles seem to follow the civil law tradition and attach great importance to considerations of equitable justice. However, they also insist on detaching these criteria from the legislative, judicial and doctrinal tradition of specific legal systems in favour of an autonomous interpretation based on international standards. In turn, not many sources are available to establish the meaning of good faith and fair dealing as a standard in international trade.

In conclusion, international contracts may end up being subject to a state law that is not fully compatible with the principles underlying some of the clauses written by the parties. Part 3 of this book will illustrate some of the conflicts that may arise and how these will be dealt with in various jurisdictions.

4

Common law-based contracts under German law

GERHARD DANNEMANN*

1 Introduction

Courts must sometimes apply German law to a contract in spite of the fact that its terms are based on common law contract models. Problems may arise from such a mismatch between applicable law and contract terms. Their solutions straddle the borderline between substantive law, i.e., rules that tell us whether there is a contract and which rights and obligations arise under such a contract, and private international law, i.e., rules that tell us which country's law applies.

Normally, if a contract has been formulated with a particular contract law in mind (for example, English law), private international law rules will point to the application of that law. Within the EU, this question is governed by the Rome I Regulation, which provides:[1]

> Article 3 Freedom of choice
> 1. A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract.

If parties have given any thought to the question of which law should be applicable, they will normally choose the same law that they have used as a model. If the contract contains no choice-of-law clause, obvious reliance on one particular legal system in the formulation of a contract can sometimes be seen as demonstrating a choice by the terms of the contract.

* I am grateful to Arne Gutsche for having edited the footnotes and for further helpful comments.

[1] Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008, on the law applicable to contractual obligations (Rome I), OJ 2008 No. L 177, p. 6.

Nevertheless, there are a variety of situations which can lead to a contract being subjected to a legal system which is different from the one on which its terms are based.

First, parties can consciously model their contract on one system and then expressly choose to subject the contract to another system's law. Some might argue that this should trigger the professional liability of any legal practitioner involved, but this will nonetheless happen in practice. Sometimes, there is a trade practice of using formulations based on a particular legal system. Contracts for carriage by sea are a case in point. English law has long dominated global sea trade. Parties who are not based in England may wish to borrow from English law but would rather have any dispute brought before courts in a different country, using the contract law of that other country. A variant of this situation is a partial choice of law, by which two or more different laws apply to one and the same contract. This is rarely helpful, but is expressly permitted under Article 3(1) of the Rome I Regulation.

Secondly, parties may make an express choice of one legal system without being aware that the terms of the contract are based on a different law. Parties may simply copy a contract which they have used on a previous occasion, without realising that this contract is based on a particular legal system, and add a clause which chooses the law at their seat of business in the belief that this is generally more advantageous for their position. The present author once acted as counsel in an arbitration case in which a German main contractor had insisted on a German choice of law for a contract with an English sub-contractor. The staff of the German company had copied the contract terms from another agreement, possibly their contract with the client, and this contract was obviously based on common law. Moreover, parties may simply have negotiated clauses in the order in which they are listed in the contract. Because choice-of-law clauses will usually figure at the end, parties may thus have negotiated all details of a contract in terms which are based on one law before they even begin to discuss which law should apply to this contract. Practitioners could easily avoid this unfortunate situation by reversing the usual order and placing choice of law (and jurisdiction) clauses at the beginning.

Thirdly, even where parties have agreed on a choice-of-law clause that points to the law on which the contract is based, the contract can nevertheless end up being governed by a different law. If the case is brought before an English court and neither party invokes the foreign choice-of-law clause, English courts will normally simply apply English

law. German courts, on the other hand, must apply a chosen foreign law regardless of any party relying on that choice. However, German courts conveniently construct a tacit fresh choice of law, namely of German law, in the situation where both parties argue before the court on the basis of German law,[2] even if they have failed to realise that the contract is subjected to a different legal regime. Alternatively, parties may have chosen the law on which the contract is modelled, but this choice is not valid. This will rarely happen in commercial contracts for goods or services, but can occur in areas where the choice of law is limited or excluded. Inheritance, family, employment and consumer law can serve as examples, but even in mutually commercial situations one cannot always be certain that a choice will succeed in contracts relating to company law, banking law, cartel law, competition law, etc.

Fourthly, parties may have wasted no thoughts on the applicable law, and other connecting factors, which point to a different law, prove to be more relevant than the use of a particular law as model.

2 Likely problems

What problems are likely to arise if a contract which is modelled on one legal system is subjected to the law of a different legal system? Such contracts suffer a loss of context – of both mandatory rules and fallback provisions. They may presume the existence of legal institutions which are unknown to other legal systems. They may have been written around problems which do not exist in the law which governs the contract. Worse, they may have failed to write around problems which do exist in the applicable law and may for this reason malfunction or become void.

Looking at an English–German context, it is arguably more dangerous to have a German law-based contract governed by English law than vice versa. For a German-style contract under English law, the main pitfalls are as follows.

Under the doctrine of consideration, amendments which benefit one party only may be void,[3] and offers which appear to be binding for a certain amount of time are not binding at all. As neither is a problem

[2] See, e.g., BGH 12.12.1990, NJW 1991, 1292, where the court left open whether the contract was initially governed by English law.

[3] See *Williams* v. *Roffey Bros & Nichols (Contractors) Ltd* [1991] 1 QB 1, where, however, the Court of Appeal held the 'practical benefit' of having performance completed in time to be sufficient consideration.

under German law, a German law-based contract will make no effort to write around such problems by offering some consideration or by using a deed.

German law has no doctrine of privity. German contracts make frequent use of third parties acquiring rights under a contract between two other parties. This is now possible under English law, but only if clearly provided in the contract.[4] German contracts do not need to be specific on this point.

Penalty provisions are void under English law, whereas they are valid under German law.[5] German contracts will generally make no attempt to shift penalty provisions into the safer waters of liquidated damages.

English contract law is generally more concerned with certainty and expects parties to write their contracts around deficiencies in English law. In *The Aliakmon*, copper coil was damaged on board the defendant's ship at a time when the risk, but not the property, had passed to the claimant.[6] The claimant could not recover its loss because it did not own the copper coil at the time when it was damaged. The owner of the copper coil could not recover because, due to the passing of risk, it had suffered no financial loss. Should judges try to avoid this unintended and entirely undeserved escape from liability? Not according to the House of Lords. Lord Brandon held that there was no *lacuna* in English law and this was just a case of poor contract drafting.[7] In consequence, if a clever solicitor can write around a problem in English contract law, this is not a problem with which an English judge should be overly concerned. However, this chapter deals with contracts which frequently have not been written by clever solicitors, because clever solicitors would rarely combine a German-style contract with an English choice-of-law clause. Little sympathy should therefore be expected from the English judiciary for these cases.

Moreover – and this is a related point – the traditionally more literal interpretation under English contract law leaves less room for judges to bridge the gap between the applicable English law and the 'model' of German law.[8]

[4] Section 1 of the Contracts (Rights of Third Parties) Act 1999.
[5] §341 of the Bürgerliches Gesetzbuch (German Civil Code, BGB).
[6] *Leigh & Sillivan Ltd* v. *Aliakmon Shipping Co. Ltd* [1986] AC 785.
[7] *Ibid.* See also *Surrey County Council* v. *Bredero Homes Ltd* [1993] 1 WLR 1361.
[8] Some of this gap has been bridged by *Investors Compensation Scheme Ltd* v. *West Bromwich Building Society (No. 1)* [1998] 1 WLR 896, where Lord Hoffmann held that 'the law does not require judges to attribute to the parties an intention which they plainly could not have had'.

Such problems which German law-based contracts may experience under English law can serve as a contrast foil for the main topic of this chapter, which is concerned with the reverse situation. What can go wrong if German law applies to contracts which are based on common law?

There are fortunately few if any pitfalls which would make an entire contract void. To a certain degree, English-style contracts travel more easily because they typically attempt to combine all rules into one agreement, to a level of detail which will frequently astonish German lawyers. They would, for instance, not specify in a contract what should happen if a contractual time period ends on a public holiday, because that is set out in the German Civil Code (§193 BGB). However, even though English contracts tend to contain an extensive set of rules which expressly cater for a multitude of situations, there are nevertheless several dangers.

English-style contracts are written with common law remedies in mind. They ignore the fact that specific performance is the primary remedy in German law and that a party who wants to rely on a different remedy will normally have to do something to convert the primary claim for performance into a secondary claim for, say, damages or restitution, such as issuing a warning in case of delay[9] or making time of the essence (§323 BGB).[10] Even a very detailed common law-style contract may thus fail to alert a party who wishes to rely on its remedies that these essential steps must be taken.

English-style contracts are also written against the background of default strict liability for contractual promises. Under German law, mere failure by a party to provide what is owed under the contract will, as a default rule, not in itself attract liability, as the party must additionally be responsible for this

[9] *§286 BGB Delay by the obligor*

(1) If, after notice from the obligee to perform, such notice having been given after performance became due, the obligor fails to perform, that notice puts him in default.

The English translation of this and of the following provisions has been taken from Geoffrey Thomas and Gerhard Dannemann, *German Civil Code – Bürgerliches Gesetzbuch*. Bilingual edition of the provisions amended by the Law of Obligations Reform Act, German Law Archive (2002), www.iuscomp.org/gla/statutes/BGB.htm.

[10] *§323 BGB Termination for non-performance or for performance not in accordance with the contract*

(1) If under a synallagmatic contract the obligor fails to effect performance when due or to perform in accordance with the contract, the obligee may terminate the contract, if he has fixed, to no avail, an additional period of time for performance.

failure under §280 BGB. So, if a party should be strictly liable under the contract, this must be made clear.[11]

More interventionist statutes apply, in particular relating to the use of standard terms (§§305–310 BGB). Contracts modelled on English contract law will do nothing to make their provisions conform to German law controls of standard terms in commercial contracts, with the result that some clauses may be void.

More interventionist German judges will interpret English-style contracts. The combination of nitty-gritty detail regulation in English contracts (which would primarily call for a literal interpretation) meets purposive interpretation and occasionally social engineering on the basis of good faith designed for German contracts, which generally leave much more open to interpretation.

Arbiters may be less interventionist, but they are frequently not as familiar with German law as German judges. In most situations where German law applies to a common law contract, one of the parties is German, and a 'neutral', i.e., a non-German arbiter, is appointed. It is easier to find an expert in English law who is not a British citizen (who might, for example, carry an Australian, Canadian, Irish or New Zealand passport) than it is to find an expert in German law who is not a German citizen.

3 Court practice

Cases in which courts have had to deal with English-style contracts governed by German law are numerous, but not easily accessible. Scholarly writing in Germany may have underestimated the scale of those contracts and the scope of associated problems. The largest commentary on the German Civil Code and its Introductory Act, *J. von Staudingers Kommentar zum Bürgerlichen Gesetzbuch*, presently consists of more than 100 parts which together fill perhaps three metres of library shelves. This commentary devotes exactly one sentence to our topic, from which we learn that this is a matter of contractual interpretation.[12]

[11] *§280 BGB Compensation for breach of duty*

(1) If the obligor fails to comply with a duty arising under the obligation, the obligee may claim compensation for the loss resulting from this breach. This does not apply if the obligor is not responsible for the failure.

For an example of where a common law-based clause was clear enough to attract strict liability under German law, see BGH 28.09.1978, BGHZ 72, 174 (discussed below).

[12] *J. von Staudingers Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen*, 13th edn (Sellier, 2002), Article 32 EGBGB No. 30 (U. Magnus).

The leading work on international contracts by Reithmann and Martiny consists of 3,529 sections, of which exactly one – No. 254 – addresses our problem, and also considers this as an issue of interpretation.[13] There is the odd article which explores the same topic,[14] but apparently not in the same depth as achieved outside Germany.[15] There also appears to be no larger German contribution or monograph on this issue.[16]

Database searches yield some results, but are unlikely to provide a comprehensive overview. There are no obvious search categories which would reveal cases of common law-based contracts governed by German law. Moreover, sometimes courts may not even have been aware that a contract they were struggling to come to terms with under German law was so unruly because it was modelled on a common law legal system.

The cases which the present author has managed to identify come from four categories: shipping, financial securities, brokerage and works contracts.

3.1 Shipping contracts, exclusion and penalty clauses

Some shipping cases reveal that the issue of German law applying to English-style contracts is older than the German Civil Code. There are several late nineteenth-century cases decided by what was then Germany's highest court, the Reichsgericht (Imperial Court), which concern contracts for carriage of goods by sea or other charterparties with English-style contract terms, or at least some English-style clauses.

The oldest such case may be a decision of 16 July 1883, in which the Reichsgericht had to interpret a very long-winded clause in which the carrier attempted to exclude any liability, and this long clause included,

[13] C. Reithmann and D. Martiny (eds.), *Internationales Vertragsrecht*, 6th edn (Dr. Otto Schmidt Verlag, 2004), at No. 254 (Martiny).

[14] G. Weick, 'Zur Auslegung von internationalen juristischen Texten', in G. Köbler, M. Heinze and J. Schapp (eds.), *Geschichtliche Rechtswissenschaft*, *Freundesgabe für Alfred Söllner zum 60. Geburtstag am 5.2.1990* (Giessener rechtswissenschafliche Abhandlungen, 1990), pp. 607–628, at pp. 619–627 (discussing mainly a case of a common law-inspired FIDIC (civil engineering) contract being subjected to Libyan law).

[15] 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, 1 (2007), Article 3.

[16] Scholarly writing can be found on the more general question of how law which is not applicable according to conflict rules may nevertheless have a bearing on a case, the most recent monograph being G. Dannemann, *Die ungewollte Diskriminierung in der internationalen Rechtsanwendung. Zur Anwendung, Berücksichtigung und Anpassung von Normen aus unterschiedlichen Rechtsordnungen* (Mohr Siebeck, 2004).

inter alia, the expressions 'Peril of Navigation excepted' and 'Freight earned, ship lost or not lost'.[17] The contract, which was between two German parties, was subjected to the law in force at Bremen. The goods were placed on board and, while the boat was still in port and both the captain and the first officer were away overnight, the boat was flooded and the goods damaged. Was that a case of '[p]eril of navigation excepted'? And was this clause to be interpreted in the meaning of the applicable law of Bremen or of English law, on which this clause was obviously based?

In this decision, the Reichsgericht demonstrates a rather ambivalent approach towards interpretation. On the one hand, the judges firmly reject that they should in any way be bound by English law notions when applying German law:

> Apart from the fact that one would have to sacrifice any independent legal development, it would amount to an unjustified imposition if one were to expect him [the carrier] to accept words being used in a particular meaning only because this meaning has repeatedly been applauded by English judges.[18]

On the other hand, the same judgment also holds that, when interpreting the bill of lading, it is 'naturally useful to draw on opinions of English judges for help and suggestions'.[19] Ultimately, the Reichsgericht quotes two English judgments to show that they come to the same conclusion as English judges would have – namely, that perils of navigation do not require the ship to be in motion.[20]

Fourteen years later, the Reichsgericht adopted the approach which has prevailed ever since.[21] At issue was an indemnity clause, which might have been considered to be a penalty clause, which in turn would have been void under English law. The Reichsgericht held that the contract had to be interpreted according to the true intention of the parties

[17] RG 16.6.1883, RGZ 11, 100.

[18] *Ibid*., at 105; all translations are mine unless indicated otherwise. The German original reads: 'es ist, ganz abgesehen davon, daß man bei anderen Grundsätzen auf eine selbständige Rechtsentwicklung überhaupt verzichtet, eine nicht berechtigte Zumutung, daß er [der Verfrachter] die Worte in einem bestimmten Sinne bloß deshalb gelten lassen müsse, weil dieser wiederholt den Beifall englischer Richter gehabt habe.'

[19] *Ibid.* The German original reads: 'selbstverständlich die Verwertung der Meinungen englischer Richter als Förderungs- und Anregungsmittel durchaus nützlich.'

[20] *Ibid*., at 107; *Good* v. *London Steam Ship Owners Mutual Protection Association* (1870–71) LR 6 CP 563; *Hayn Roman & Co* v. *Culliford* (1877–78) LR 3 CPD 410.

[21] RG 22.5.1897, RGZ 39, 65.

without clinging to the words used, as was then required under §278 of the Commercial Code and is now generally required for all contracts under §133 BGB. The court explained:

> This sentence in particular requires English legal notions to be used for establishing the meaning and scope of the individual clauses of the charter party. The appeal judge has overlooked that the form used in the present case is based throughout on an understanding of carriage of goods by sea which is particular to English law. If this was merely a translation of a contract which reveals German legal thinking and German legal views, the choice of language would matter little. But this is obviously not the case. Apart from the clause in question, which is particular to English business transactions, the contract also contains in its other parts provisions which are generally common in English charterparties, which are expressed in certain forms, reflecting a long tradition, and which in English business and jurisprudence are associated with a certain meaning, which most certainly cannot always be derived from the mere wording. This applies, for example, to the well-known exception clause:
>
> 'The Act of God, peril of the sea, fire, barratry of the Master and Crew etc. etc. excepted.'
>
> and this cesser of liability clause:
>
> 'For the freight . . . the Captain is to hold himself to the Cargo . . . and not to the Shippers. . . . whose responsibility shall cease whenever the Cargo is put on board.'
>
> Any attempt to understand the meaning of these clauses by merely translating them into the German language is futile. One rather has to assume that, if parties use such terms which are generally established in English shipping practice, they wish to associate with these clauses the same meaning which these clauses are understood to have in England.[22]

[22] *Ibid*., at 67–8. The German original reads: 'Gerade dieser Satz aber nötigt dazu, für die Ermittelung der Bedeutung und Tragweite der einzelnen Klauseln der Chartepartie auf englische Rechtsauffassungen zurückzugehen. Der Berufungsrichter verkennt, daß das hier benutzte Formular durchweg von der dem englischen Rechte eigentümlichen Auffassung des Seefrachtgeschäftes getragen ist. Handelte es sich bloß um die Übersetzung eines von deutschen Rechtsgedanken und deutscher Rechtsauffassung zeugenden Kontraktes, so würde auf die Wahl der Sprache allerdings kein Gewicht zu legen sein. Das ist aber offensichtlich nicht der Fall. Denn außer der hier in Rede stehenden, dem englischen Geschäftsverkehre eigentümlichen Klausel enthält der Vertrag auch in seinen anderen Teilen Bestimmungen, die in englischen Chartepartien allgemein üblich sind, die in einer gewissen seit langer Zeit herkömmlichen Form ausgedrückt werden, und mit denen man in England im Geschäftsverkehre und in der

With this judgment, the Reichsgericht found the appropriate reconciliation between conflict of law rules, which require courts to respect an express choice of German law, and contract terms, which are obviously based on English law. Under the applicable German contract law, contracts are to be interpreted without clinging to the literal meaning of words used; parties who consciously use English contract terms want these clauses to have the same meaning as they would under English law.

However, the same case sees the Reichsgericht struggle with one problem. Penalty clauses are void under English law, while liquidated damages clauses are permitted – what about an English-style indemnity clause on the borderline between penalty clauses and liquidated damages, to which German law applies? The Reichsgericht notes that in England, 'courts are leaning against penalties', but believes that the sum fixed is reasonable and in effect liquidated damages rather than a penalty.[23] But what if this had been a prohibited penalty clause under English law?

German law does not prohibit penalty clauses. On the contrary, §580 HGB contains something rather similar to a penalty clause for contracts for carriage of goods by sea if the freighter repudiates the contract before the journey starts. In this case, the carrier can claim half the agreed-upon rate without having to prove any loss. And because English law enters the case only through the minds of the parties, i.e., as a tool for explaining what the parties wanted to achieve with the contract, the only route by which a German court could have held the penalty clause to have no effect is also through the minds of the parties. The court would have to

Rechtspflege einen bestimmten, keineswegs immer schon aus dem bloßen Wortlaute abzuleitenden Sinn verknüpft. So die bekannte exception clause:

> "The Act of God, peril of the sea, fire, barratry of the Master and Crew etc. etc. excepted."

und dieser cesser of liability clause:

> "For the freight . . . the Captain is to hold himself to the Cargo . . ., and not to the Shippers, . . . whose responsibility shall cease whenever the Cargo is put on board."

Es kann nicht angehen, den Sinn dieser Klauseln einfach durch eine Übersetzung ins Deutsche ermitteln zu wollen. Vielmehr muß angenommen werden, daß, wenn sich die Parteien derartiger, im englischen Seefrachtverkehre allgemein eingebürgerter Wendungen bedienen, sie damit auch den Sinn verbinden wollen, der diesen Klauseln in England beigemessen wird.'

[23] *Ibid.*, at 69.

argue that the parties did not intend this clause to have any effect because it would be void under English law, and that it was included in the contract for decoration rather than for any effect. Such an argument would be very difficult to maintain.

Yet nearly 100 years later, in 1991, the Bundesgerichtshof (Federal Court of Justice), Germany's highest court in civil and criminal matters, still fails to give any explanation as to how a penalty clause, valid under the applicable German law, could become void just because it has been modelled on English contract law. This was a case of repudiation of a contract for carriage of goods by sea, where an English indemnity clause met the fallback penalty provision of §580 HGB. All connecting factors in the contract pointed to Germany, except that the contract was based on a GENCON form, which in turn was inspired by English law. The clause read as follows:

> Indemnity for non-performance of this Charterparty, proved damages, not exceeding estimated amount of freight.

It is difficult to see how this provision could be mistaken for a penalty clause. All it does is to place a contractual cap on ordinary damages for breach of contract. Be that as it may, the Bundesgerichtshof sensed danger, and this is how the court found its way out of this situation:

> When interpreting the contract, one cannot ignore the fact that neither the parties nor the agent used for formulating the agreement have any close connections to the Anglo-Saxon legal family. There is therefore no particular reason to assume that the contracting parties wanted to understand this clause, which is used in the same form in German language standard contracts ... and which then is doubtlessly valid, in the English sense. It is in particular the fact that the validity of indemnity clauses has been doubtful in England for decades, but that it nevertheless continues to be used in German shipping circles in knowledge of this fact, which indicates that those who employ this clause are not guided by an Anglo-Saxon understanding, at least if both parties to the contract are German merchants.[24]

[24] BGH 2.12.1991, NJW-RR 1992, 423, at para. 25. The German original reads: 'Bei der Auslegung des Vertrages kann nicht außer acht bleiben, daß er weder nach den Parteien noch nach der Person des bei der Formulierung der Abmachungen eingeschalteten Maklers nähere Beziehungen zum angelsächsischen Rechtskreis hat. Deswegen besteht kein besonderer Anlaß für die Annahme, daß die Vertragschließenden die Klausel, welche in gleicher Form auch in deutschsprachigen Vertragsformularen verwendet wird (...) und dann unzweifelhaft wirksam ist, in englischem Sinn haben verstehen wollen. Gerade der Umstand, daß die Rechtsgeltung der Indemnity-Klausel in England seit Jahrzehnten zweifelhaft ist, sie aber gleichwohl in deutschen Schiffahrtskreisen in Kenntnis dieser Tatsache weiterverwendet wird, spricht dafür, daß die Verwender sich

First, one can note that the Bundesgerichtshof backtracks a little. If a clause agreed between German-based parties looks no different from a normal German clause, English law is not relevant for interpretation. This raises difficult questions of how to interpret a common law-based contract which, as most such contracts would, contains a mixture of clauses which look very English and others which could easily figure in a German-style contract.

Secondly, if the parties to the contract had indeed been influenced by English legal thinking, this seems to imply that a clause which is valid under the applicable German law would be construed as invalid by way of interpretation if the parties to this contract had been influenced by English legal thinking and if such a clause had been void under English law. This is very difficult to reconcile with either German conflict of law rules or with substantive rules on the interpretation of contracts.

This decision by the BGH's Second Senate for Civil Matters is also not easily squared with a previous decision by the same Senate from 1978,[25] which was probably overlooked in the 1991 judgment. The 1978 case concerned a cargo which included, inter alia, seventy vats of bicarbonate of soda, which were declared as such to the Lebanese custom authorities. The declaration had failed to mention, however, that ammunition was buried within the bicarbonate of soda. The ship was seized and fines were imposed. The shippers claimed that they were entirely innocent and had no knowledge of the ammunition. The carriers nevertheless held the shippers liable under the following clause in the bill of lading:

> The Carrier has the right to have the value estimated or to have the contents, measurement or weight verified by experts and if the particulars furnished by the Shipper turn out to be incorrect the Carrier is entitled to charge double the freight which should have been charged had the cargo been correctly described, together with the cost of checking.

Under English law, this clause would in all likelihood be construed as an invalid penalty clause. However, this was again a case of an English-style contract being subjected to German law. In this case, the court did not even mention the fact that English law is hostile towards penalty clauses. The court instead discussed, as a matter of German law, whether a penalty clause can be stipulated in such a way that no fault is required for the clause to operate, as the present clause simply turned on the issue

jedenfalls dann nicht vom angelsächsischen Rechtsverständnis leiten lassen, wenn beide Vertragsteile deutsche Kaufleute sind.'

[25] BGH 28.09.1978, BGHZ 72, 174.

of whether the information was correct. The court held that this was possible without violating good faith and upheld the clause.

In summary, we have one judgment by the Federal Court of Justice which upholds an English-style penalty clause and one which expresses serious concerns about enforcing an English-style 'penalty clause' which in fact is no penalty clause at all.

3.2 *Financial securities and good faith*

The next group of cases concerns financial securities. Two German judgments relate to English-style 'standby letters of credit' which were governed by German law.[26] There is no full equivalent to standby letters of credit in German civil or commercial law, but parties are naturally free to create new types of contracts or import them from abroad. Furthermore, as 'standby letters of credit' somewhat resemble a 'Bürgschaft aufs erste Anfordern' (German demand guarantee), there could be no serious problem with enforcing such contracts. Both judgments use purposive interpretation when deciding between a literal interpretation as proposed by the claimant and a literal interpretation as proposed by the defendants. English courts would probably just do the same. In both cases, purposive interpretation confirmed what the courts rightly thought to be the correct literal interpretation.

The only aspect which is particularly interesting in the present context is the fact that the headnote for one of the judgments states that 'abuse of law' can be raised as a defence under §242 BGB, the famous provision on good faith,[27] against a claim based on a poorly worded standby letter of credit. The judgment by the Oberlandesgericht (Court of Appeal) at Frankfurt clarifies that this is argued only as a safeguard, presumably in case the Bundesgerichtshof should disagree with the court's literal and purposive interpretation. It is nevertheless a clear sign that German courts would be willing to argue good faith against the wording of an English-style contract governed by German law.

[26] BGH 26.04.1994, NJW 1994, 2018; OLG Frankfurt 18.3.1997, WM 1997, 1893. No mention is made in the judgments of the Uniform Customs and Practice for Documentary Credits (UCP) or the Uniform Rules for Demand Guarantees (URDG), both developed by the International Chamber of Commerce. The 1995 UN Convention on Independent Guarantees and Stand-By Letters of Credit or an earlier draft of it might also have been available as model.

[27] §*242 BGB Performance in good faith*
The obligor must perform in a manner consistent with good faith taking into account accepted practice.

3.3 *Brokerage and good faith*

There is an interesting recent case in brokerage which confirms this suspicion. In 2005, the Bundesgerichtshof had to decide a case in which a company instructed a broker to find a buyer for the company's business, against payment of 10 per cent of the purchase price received by the company.[28] The broker found a buyer, but the business was neither sold as such, nor by the company. Instead, the buyer simply bought all shares from the shareholders and paid the price directly to them without bothering about the commission. The broker sued the company and also both shareholders for 10 per cent commission on the deal. The defendants relied on the wording of the contract. This was written in the English language, using English legal terminology, and its wording did indeed not cover this situation. The Appeal Court had therefore rejected the claim, but the Bundesgerichtshof held that this situation was covered by the economic purpose of the transaction, relied on good faith and allowed the claim. If we apply *The Aliakmon* principles, there was no gap to be bridged, as this was just a case of poor contract drafting. But, of course, the contract was governed by German law and interpreted in the German fashion. The Bundesgerichtshof held that the particular way in which the business was sold was covered by the economic purpose of the agency agreement, which would therefore be interpreted as covering the present situation. Invariably, reference was also made to good faith. It should also be mentioned that English courts have bridged some of this gap by occasionally overriding the literal meaning of contractual provisions on the ground that this flouts common business sense.[29]

3.4 *Construction contracts, warnings and fault*

The present author also has first-hand experience of a contract for works which was modelled on English law but subjected to German law by way of an express choice-of-law clause. The party which the author represented was a UK company involved as a sub-contractor in a very large construction project in which the other party was the main contractor.

[28] BGH 21.12.2005, NJW-RR 2006, 496.

[29] *Investors Compensation Scheme Ltd* v. *West Bromwich Building Society (No. 1)* [1998] 1 WLR 896, per Lord Hoffmann. An all-too-literal interpretation can also be overcome through estoppel by convention; see *Amalgamated Investment & Property Co. Ltd* v. *Texas Commerce International Bank Ltd* [1982] QB 84. I am grateful to Edwin Peel for having pointed this out to me.

The factual issues concerned conformity to the specifications of both the sub-contractor's and the main contractor's work. Legal issues between the sub-contractor and the main contractor included:

- which of two different sets of specifications the parties had agreed to;
- acceptance of the work;
- the availability of remedies for delay and for defects;
- the scope and validity of a clause which limited any damages payable by the sub-contractor to 25 per cent of the contract price; and
- the validity of a 'penalty clause' whereby, in case of delay, the sub-contractor was to pay 5 per cent of the contract price.

The case was eventually settled. This is often a very sensible solution. In that case, though, legal uncertainty played a dominant role amongst the incentives. This legal uncertainty was aggravated by a divergence between the law on which a contract is modelled and the law which applied to this contract.

On the facts of this case, German law requires that 'warnings' be issued in order to trigger a claim for damages for delay under §286 of the BGB,[30] and a similar step must be taken by the client in order to switch from a performance-based claim for repair of defects in works contracts to a claim for damages. Additionally, while there is strict liability for performance if this is possible, some remedies require the defaulting party to be responsible for non-performance. It is possible to agree otherwise, i.e., that no warning is necessary and that liability is strict, but English-style contracts do not normally include clauses on warnings being unnecessary and will frequently not say anything on whether fault or responsibility is required to trigger remedies. Thus, this opened up a number of additional legal questions which would not have arisen for either a common law-style contract under English law or a German-style contract under German law.

3.5 Control of standard terms and exclusion clauses

It may well be a coincidence that none of the cases discussed above turned on the control of standard terms. German law subjects standard contract terms, even for business-to-business transactions, to a general unfairness test,[31] which goes beyond what is provided for English law in the Unfair Contract Terms Act 1977. This might result in a situation

[30] See above, note 9.
[31] §§305–310 of the BGB. See in particular: