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# AN INTERNATIONAL RESTATEMENT: THE UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS

E. Allan Farnsworth\*

## I. INTRODUCTION

In the past decade, two important new sets of rules applicable to the private law aspects of international transactions have come on the scene. One is the United Nations [Vienna] Convention for the International Sale of Goods. The other is the UNIDROIT Principles for International Commercial Contracts. No lawyer who practices in this area can afford to be ignorant of either. Other participants will deal with the Vienna Convention. My topic is the UNIDROIT Principles, promulgated in 1994. How did this important body of rules for international contracts come about?<sup>1</sup>

## II. BACKGROUND

The Principles are the product of the International Institute for the Unification of Private Law (UNIDROIT) in Rome. It was founded in 1926 under the auspices of the League of Nations and

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1. See INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW (UNIDROIT), PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS (1994) [hereinafter PRINCIPLES]. For discussion of the PRINCIPLES by the chair of the working group that drafted them, see MICHAEL JOACHIM BONELL, AN INTERNATIONAL RESTATEMENT OF CONTRACT LAW: THE UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS (Transnational Juris Publications 1994) (including bibliography and the text in eight languages). See generally Joseph M. Perillo, *UNIDROIT Principles of International Commercial Contracts: The Black Letter Text and a Review*, 63 *FORDHAM L. REV.* 281 (1994); Symposium, *The UNIDROIT Principles of International Commercial Contracts*, 69 *TUL. L. REV.* 1121 (1995); Symposium, *Uniform Law: A Bridge Too Far?*, 3 *TUL. J. INT'L & COMP. L.* 145 (1995); Symposium, *Contract Law in a Changing World*, 40 *AM. J. COMP. L.* 541 (1992).

has continued as an independent governmental organization to which the United States belongs. It was responsible for beginning the work on the unification of the law of international sales and for decades was occupied with drafting the predecessor of the Vienna Convention.

The idea of drafting the Principles dates back to 1971, when UNIDROIT's Governing Council included on the Work Programme a topic on the "progressive codification" of international trade law, with a steering committee composed of Professors David (France), Schmitthof (England), and Popescu (Romania).

A Working Group, consisting largely of continental European academics and chaired by Professor Michael Joachim Bonell of the University of Rome, was finally set up in 1980, but the United States did not participate for the first decade, finally joining the Working Group for fear that it would not sufficiently represent common law views — the title of the project having by then been changed to "principles." The Working Group held week-long meetings twice a year, submitting its drafts — which had been reviewed by interested lawyers in the United States — to the Governing Council as the project neared completion.

After more than a decade of semiannual meetings of the working group, the Institute's Governing Council approved publication of the Principles and, after editorial work, they were published in English and French in 1994. There are now versions in many other languages with additional versions in preparation. Unlike the Vienna Convention, but like the American Law Institute's Restatement of Contracts, which provided inspiration for the project, the Principles are accompanied by section captions, comments, and illustrations.<sup>2</sup>

### III. WHAT ARE THE PRINCIPLES?

Like the American Law Institute's Restatement of the Law, an obvious source of inspiration for the UNIDROIT Principles, the Principles are not designed for legislative enactment. It is anticipated that their impact will be largely in international arbitration. Because the Vienna Convention covers international sales of goods,

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2. There has been a similar effort, under different auspices, to prepare a set of Principles of European Contract Law. Part of the work has been published as *PRINCIPLES OF EUROPEAN CONTRACT LAW — PART I: PERFORMANCE, NON-PERFORMANCE AND REMEDIES* (Martinus Nijhoff 1995) (including comments, illustrations, and citations to largely European national sources).

it is likely that the Principles will be significant in disputes arising under other types of contracts, notably contracts for services.

What — if anything — do the Principles restate? According to the Introduction: “For the most part the UNIDROIT Principles reflect concepts to be found in many, if not all, legal systems,” but “they also embody what are perceived to be the best solutions, even if still not yet generally adopted.” Sources of the Principles include the Vienna Convention, generally recognized principles of European civil law systems, and generally recognized principles of common law systems, including the Uniform Commercial Code and the Restatement (Second) of Contracts.

#### IV. WHEN DO THE PRINCIPLES APPLY?

Because, in contrast to the Vienna Convention, the Principles are not legislative in nature, if the parties want them to apply they should incorporate them, either by name or generally. According to their Preamble, they are to be applied “when the parties have agreed that their contract be governed by [them or by] ‘general principles of law,’ the ‘*lex mercatoria*’ or the like.”

This is not, however, the only circumstance in which the Principles may be applied. The Preamble goes on to say that they may be applied if “it proves impossible to establish the relevant rule of the applicable law.” This might be the case if it is uncertain what law is applicable or if, though this is certain, the applicable law lacks a clear rule.

An example of a case in which it was uncertain what law was applicable appears in a recent issue of a large American law firm’s monthly summary of developments in international dispute resolution.<sup>3</sup> The dispute was between a Middle Eastern manufacturer of telecommunications cable and a leading American supplier of telecommunications systems. Faced with suggestions that the law any one of five different jurisdictions (three states and two countries) might be applicable, the arbitrators, operating under the International Chamber of Commerce rules, chose the law of New York together with the UNIDROIT Principles. The tribunal characterized the Principles as a useful source of general rules for international contracts and stated that international arbitrators are fully justified in turning to such general principles, which may present an advantage over one of several competing municipal systems no one of which is clearly applicable.

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3. See 10 International Dispute Resolution no.1, p.3 (White & Case March 1997).

## V. WHAT GENERAL PRINCIPLES ARE CONTAINED IN THE PRINCIPLES?

In contrast to the Vienna sales convention, the Principles state a number of general principles. Two of the most fundamental are freedom of contract and *pacta sunt servanda*.<sup>4</sup> As to the former, the Principles state that "parties are free to enter into a contract and to determine its contents"<sup>5</sup> and "may exclude the application of these Principles . . . or vary [their] effect."<sup>6</sup> As to the latter, the Principles provide that if "performance becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations."<sup>7</sup>

A third general principle is fairness. An article on what the Principles call "gross disparity," allows a party to avoid a contract or term "if, at the time of the conclusion of the contract, the contract or term unjustifiably gave the other party an excessive advantage."<sup>8</sup> Furthermore, an article on "surprising terms" provides that a term "contained in standard terms" that "is of such a character that the other party could not reasonably have expected it" is not effective unless expressly accepted by that party.<sup>9</sup>

A fourth general principle is good faith and fair dealing. According to the Principles, a "party must act in accordance with good faith and fair dealing in international trade."<sup>10</sup> This obligation extends to contract negotiation, for while a negotiating party "is not liable for failure to reach an agreement, . . . a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party."<sup>11</sup>

## VI. WHAT SUBSTANTIVE RULES ARE CONTAINED IN THE CONVENTION?

In some hundred and twenty articles, the Principles deal with such important matters as contract formation, validity, interpretation, performance and excuse from performance, and remedies. Some of the provisions on these matters track the provisions of

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4. In English "agreements are to be observed."

5. PRINCIPLES, *supra* note 1, art. 1.1 ("Freedom of Contract").

6. *Id.* art. 1.5 ("Exclusion or modification by the parties").

7. *Id.* art. 6.2.1 ("Contract to be observed").

8. *Id.* art. 3.10 ("Gross disparity").

9. *Id.* art. 2.20 ("Surprising terms").

10. *Id.* art. 1.7 ("Good faith and fair dealing").

11. *Id.* art. 2.15 ("Negotiations in bad faith").

United Nations Convention on Contracts for the International Sale of Goods. Others break fresh ground.

In addition to the important provisions on precontractual liability, already mentioned, the provisions on contract formation cover contracts by correspondence<sup>12</sup> and the “battle of the forms.”<sup>13</sup> Provisions on validity deal with mistake,<sup>14</sup> fraud,<sup>15</sup> and coercion.<sup>16</sup>

Among the articles dealing with interpretation, those on merger clauses<sup>17</sup> and standard forms<sup>18</sup> are of special interest. Among the articles on performance and excuse for nonperformance, those on force majeure<sup>19</sup> and on hardship<sup>20</sup> are particularly important.

The remedies provisions that deal with specific relief<sup>21</sup> and with stipulated damages<sup>22</sup> are significant. As to both the Principles take positions that differ from those of the common law and that do not mirror the Vienna Convention.

## VII. MANDATORY RULES

The Principles raise some troublesome questions in connection with mandatory (immutable) rules — rules that the parties are not free to change by agreement. Since the Principles derive their force from the agreement of the parties, two assumptions would seem to be justified. The first assumption is that none of the rules in the Principles is mandatory. The second assumption is that the Principles cannot modify mandatory rules.

The first assumption — that none of the rules in the Principles is mandatory — would mean that the parties are completely free to exclude or modify the Principles, an assumption that would seem to be confirmed by the principle of freedom of contract. Surprisingly,

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12. See *id.* art. 2.4 (“Revocation of offer”); *id.* art. 2.5 (“Rejection of offer”); *id.* art. 2.6 (“Mode of acceptance”); *id.* art. 2.9 (“Late acceptance. Delay in transmission”); *id.* art. 2.10 (“Withdrawal of acceptance”).

13. See *id.* art. 2.22 (“Battle of forms”).

14. See *id.* art. 3.4 (“Definition of mistake”); *id.* art. 3.5 (“Relevant mistake”).

15. See *id.* art. 3.8 (“Fraud”).

16. See *id.* art. 3.9 (“Threat”).

17. See *id.* art. 2.17 (“Merger clauses”).

18. See *id.* art. 2.19 (“Contracting under standard terms”); *id.* art. 2.20 (“Surprising terms”); *id.* art. 2.21 (“Conflict between standard and non-standard terms”).

19. See *id.* art. 7.1.7 (“Force majeure”).

20. See *id.* art. 6.2.2 (“Definition of hardship”); *id.* art. 6.2.3 (“Effects of hardship”).

21. See *id.* art. 7.2.2 (“Performance of non-monetary obligation”).

22. See *id.* art. 7.4.13 (“Agreed payment for non-performance”).

then, the Principles qualify this assumption by subjecting the general rule that the parties can exclude or vary the Principles to an exception where "otherwise provided in the Principles."<sup>23</sup> These exceptional rules that are mandatory rather than default rules include those on good faith and fair dealing<sup>24</sup> and on gross disparity.<sup>25</sup> It is, to be sure, unlikely that parties would include in their contracts explicit provisions derogating from either of these rules, but if they were to do so it might be difficult to explain why such provisions should not be given effect.

The second assumption — that the Principles cannot modify mandatory rules — would mean that the parties could not change or exclude mandatory rules of the applicable domestic law. This assumption seems to be confirmed by a provision that the Principles do not "restrict the application of mandatory rules . . . which are applicable in accordance with the relevant rules of private international law."<sup>26</sup>

Surprisingly again, the Principles seem to contemplate exceptions as to the requirement of a writing,<sup>27</sup> the requirement for modification of an agreement,<sup>28</sup> the availability of specific performance,<sup>29</sup> and the enforceability of a provision for stipulated damages.<sup>30</sup> As to all of these, the Principles state rules that change common law rules that the parties cannot change by agreement — common law mandatory rules. As to all of these there seems to be an underlying assumption that these mandatory rules are altered by the Principles.

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23. *Id.* art. 1.5 ("Exclusion or modification by the parties").

24. *See id.* art. 1.7 ("Good faith and fair dealing").

25. *See id.* art. 3.10 ("Gross disparity").

26. *Id.* art. 1.4 ("Mandatory rules"); *see also id.* art. 3.1 ("Matters not covered") (stating that the Principles do not deal with invalidity due to "lack of capacity," "lack of authority," or "immorality or illegality").

27. *See id.* art. 1.2 ("No form required") ("Nothing in these Principles requires a contract to be concluded in or evidenced by writing.").

28. *See id.* art. 3.2 ("Validity of mere agreement"). Article 3.2 provides: "A contract is concluded, modified or terminated by the mere agreement of the parties, without any further requirement." *Id.*

29. *See id.* art. 7.2.2 ("Performance of non-monetary obligation"). Article 7.2.2 provides that the aggrieved party may "require [specific] performance," with an exception if that party "may reasonably obtain performance from another source." *Id.*

30. *See id.* art. 7.4.13 ("Agreed payment for non-performance"). Under Article 7.4.13, an aggrieved party is generally entitled to a sum stipulated as damages "irrespective of its actual harm." *Id.*

### VIII. ACCEPTANCE OF THE PRINCIPLES

In less than three years since the Principles were first published, they have had a remarkable success. Dozens of symposia around the world have been devoted in whole or in part to them. More than two thousand copies have been sold, roughly half in English and the rest in the several other languages in which the Principles are now available. While it is too early to know how many contracts have already referred to the Principles, the arbitration I described is by no means the only one in which arbitrators have already paid attention to the Principles.

And what of the future? At the meeting of the Governing Council of UNIDROIT in April 1997 it was decided to continue the work to produce a UNIDROIT Principles *Second*, covering additional topics not now included. This decision testifies not only to the Council's appreciation of the present success of the Principles but to its confidence in their prospects for the future.

