Some Features of the Law of Contract in the Third Millennium[1]

Ole Lando

Contents

1 This paper is with some additions based on an inaugural lecture, entitled *Common Principles of European Contract Law* held on 2 November 1995 at the *Erasmus University of Rotterdam* where I was visiting professor in the autumn of 1995. The additions have elements of writings published before and after 1995 which have been revised for this article. I am grateful to Professor Fillip De Ly of the *Erasmus University of Rotterdam* whose writings on the *lex mercatoria* and whose help and encouragement have been a great asset.

II How Should a Europeanisation of the Contract Law be Brought About?

III The lex mercatoria

IV Salient Features of the Principles of European Contract Law

1 Plan

1. This paper brings some thoughts about a future unified or harmonised contract law in Europe and in the world. It is influenced by developments of contract law in the last decades of the 20th century and by the author's work in the Commission on European Contract Law which is preparing the *Principles of European Contract Law*[2] and in the UNIDROIT Working Group which established the *Principles of International Commercial Contracts*[3]

In the first part of the paper it is discussed whether in Europe as well as in the world the law of contract needs to be unified or harmonised.

If a unification or harmonisation is to be established the next question is how this should be done. In the European Union should a unification be achieved through legislation or in a "creeping" way by persuading the courts to harmonise in their cases. This is the topic of the second part.

The third part deals with the so called "*lex mercatoria*". Should parties be permitted to submit their contract to general principles of law such as international customs and usages, the *Principles of European Contract Law* and the *Principles of International Commercial Contracts,* and other common rules of law?

---

2 See Lando & Beale (eds.), *Principles of European Contract Law. Parts I & II*, the Hague 1999 (hereinafter *PECL I & II*). On the Commission on European Contract Law see section 19.

3 See on the Principles of International Commercial Contracts, UNIDROIT Rome 1994, infra section 24.

The fourth part of the paper will bring an account of some of the salient features of the common principles of contract law, notably those embodied in the *Principles of European Contract Law.*

I Is a Unification of European Contract Law Needed? Is it Feasible?

2 *Why Unify Contract Law? Why Unify the European Contract Law?*

Why should contract law be unified and why should it be Europeanised? To Europeanise means to unify or harmonise European law. The term Europe covers those countries which are or will become members of the European Union.

Many of the reasons for and against a unification of contract law are valid both for Europe and for the world. However, the Europeanisation is in some respects to be treated separately because the Union has brought its members close together and now has the institutions and the tools for bringing about a unification by way of legislation.

The Union of today is an economic community. Its purpose is the free flow of goods, persons, services and capital. The idea is that the more freely and abundantly these can move across the frontiers the wealthier and happier we will get. It should therefore be made easier to conclude contracts and to calculate contract risks.

Anyone doing business abroad knows that some of his contracts with foreign partners will be governed by a foreign law. The unknown laws of the foreign countries is one of his risks. They are often difficult for him and his local lawyer to get to know and to understand. They make him feel insecure, and may keep him away from foreign markets. This is an impediment to world trade. In Europe the existing variety of contract laws is a non-tariff barrier to the inter-union trade. It is the aim of the Union to do away with restrictions of trade within the Communities, and therefore the differences of law which restrict this trade should be abolished.

3 Can we not Content Ourselves with the Existing Europeanisation?

A The Existing European Contract Law is Fragmented and Uncoordinated

In the last decades there have been important developments of what may be called the EU contract law. Most important is perhaps the Directives on Unfair Terms in Consumer Contracts and on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees.[4] In addition the EEC has issued several other directives providing protection of the consumer as a contracting party.[5] Some of the directives on labour relations provide rules for the protection of the employee. Furthermore, the EEC has established a law of competition which provides restrictions of the parties' contractual freedom by laying down which contract terms are permissible

4 See 93/13 of 5 April 1993, OJEC No L 95/29 and 1999/44 of 25 May 1999, OJEC No L 171/12 respectively.

5 See directives on Doorstep Sales (2o Dec. 1985, no 85/577), Consumer Credit (22 Dec. 1986, no 87/lo2), Package Tours (13 June 1990, no 90/3l4), Time Share Agreements (26 Oct. 1994, no 94/47) and Distant Sales (20 May 1997 no 97/7).

and which are not. The Directive of l8 Dec 1986 on the Self-employed Agent[6] contains mandatory rules most of which protect the agent.

The Union legislation mentioned above has provided some Europeanisation of the contract law. However, it is only a fragmentary harmonisation. It is not well co-ordinated, and, since the national laws of contract are different, it causes problems when it is to be adjusted to the various national laws.[7] There is no uniform European law of contract to support these specific measures.

B The Choice-of-law Rules

4. The uniform choice-of-law rules of the Rome Convention on the Law Applicable to Contractual Obligations of 19 June 1980,[8] now in force in all the Member States, may give the businessman some guidance. Art 3 of the Convention gives effect to a choice of law by the parties. That should give him means to know when his contract will be governed by his own law, and when it will be subject to a foreign law. However, as will be shown, a choice of law will not always give him certainty, and if the parties to the contract have not chosen the law applicable, the rules of the Convention also leave uncertainty as to which law a court will apply. In addition, the contracts which are to be governed by an unknown foreign law will, as mentioned, cause the businessman problems. The all-sided choice-of-law rules of the Convention make any rule in any legal system applicable. That leads to what the German writer *Ernst Raape* called "a jump into darkness".[9]

This fact has had consequences.

5. First, when foreign law is applicable, it must be ascertained. This ascertainment is manageable when the parties or the court have good access to reliable sources of information on the foreign law. In general, the law of a country which belongs to the same family of laws and which is expressed in the same or a related language can be ascertained. An English court will not have great trouble with Irish law, nor will a German court with Austrian or Swiss law. Where the trade between two countries is intensive, and disputes and litigation correspondingly frequent, as in the Dutch-German trade, lawyers and courts will know how to get the information. Dutch lawyers have generally no great difficulty in ascertaining German law. But it may take time and efforts. Even if you have good access to a foreign legal system it may be a task to learn exactly what the rule is. Under French law unless the parties have agreed otherwise an aggrieved parry generally has to go to court to have a contract terminated in case of the other party's non-performance: *"La resolution doit être demandée en justice",* see c.c. art 1184 (3). The rules on when the court will do that are developed by the French courts. To some extent the Court of

---

6 18 December 1996 No 86/653.

7 See R.. Zimmermann, *Civil Code and Civil Law*, 1 Columbia Journal of European Law (1994/95) 63, 73 and *H. Kötz, Rechtsvereinheitlichung, Nutzen, Kosten, Methoden*., 50 *Rabels Zeitschrift* (1986) 3.

8 80/ 934/ EEC, se OJEC 9 Oct 1980, No L 266/1.

9 Here cited after *Keller/Siehr, Allgemeine Lehren des Internationalen Privatrechts*, 1986, 121, who refers to *Staudinger(- Raape) Kommentar zum BGB*, 9 ed. Vol. VI/2 1931 p VII.

Cassation has established rules, in other cases it has left the decision to the discretion of the trial judge. It may be difficult for a foreign court which is to apply art 1184 to put itself in the position of a French court [10]

It is also difficult to get information on the law of a country which belongs to an alien family of laws. Obtaining reliable information about the contents of such a foreign law is often cumbersome, time-consuming and costly. The difficulties increase when the language is unknown, and become almost insurmountable when the foreign law is uncertain, as for instance when the relevant case law is obscure and contradictory. So far as is known no country has managed to develop rules and procedures for the ascertainment of foreign law which are at the same time efficient, fast and inexpensive.[11]

6. On this background one can understand that many legal systems require that in matters where the parties have a right to dispose of the litigation the party who wants the court to apply foreign law must raise the issue.[12]
Further, the party who pleads foreign law will most often have to prove that the foreign law provides what he alleges. Therefore, foreign law will only be pleaded and proven when a party believes that he, in some cases he and the court, can provide the information which is necessary to convince the court that the foreign law should be applied to his advantage.

The difficulties for a court to get a true picture of foreign law is often considerable. In the common law countries the parties often use expert witnesses to convince the court. *Max Rheinstein* once told about an investigation he had made of about 40 cases reported in Case Books on Conflict of Laws where American courts have applied foreign law. *Rheinstein* found that in 32 of these cases foreign law was applied wrongly. In four cases the result had been very doubtful, and in four cases the result had been correct, by a mere coincidence.[13]

So the courts may have reason to be sceptical about what they hear about foreign law. If the evidence which a party provides or the court tries to obtain is insufficient to convince the court it will generally apply the law of the forum.

In some cases it is difficult to adjust foreign rules to the rules of the forum, especially when they have close links to procedural rules or to specific institutions

---

10 See *Ghestin & Billiau, Traité de droit civil, les obligationns, les effets du contrat,* Paris 1992, no 386ff, 415 ff.

11 See for a recent survey *Maarit Jänterâ- Jareborg, Svensk Domstol och Utländsk Rätt,* (Swedish courts and foreign law) 1997 235.

12 See *Materialien zum ausländischen und internationalen Privatrect 10, Die Anwendung ausländischen Rechts im internationalen Privatrecht,* 1968. Most of the authors reporting on their national systems wanted the court to raise the issue also in these cases, see p.185. It appeared, however, from the national reports that the courts in many countries did not do so. See also *Maarit Jäntera-Jareborg,* op.cit. previous note, 146 and Lando, in Cappelletti, Seccombe, and Weiler (eds.), *Integration Through Law, Europe and the American Federal Experience Volume 1, Methods and Tools, Book 2, Conflict of Law as a Technique for Legal Integration* by Hay, Lando and Rotunda, 161,183ff.

13 *Materialien zum ausländischen und internationalen Privatrect 10. Die Anwendung ausländischen Rechts im internationalen Privatrecht,* 1968, 187.

of the foreign country.[14] A Continental court faces difficulties when it is to handle some of the rules which in the common law are based on *equity*, such as the rules on *trust* and *specific performance*. The same holds true of a court who is to apply the unknown rules of the French *astreinte*.[15]

7. The choice-of-law rules do not take into account whether the foreign rule that is applicable leads to a result which the court will accept. As the American author *Cardozo* has said, the choice of law rules are, "more remorseless, more blind to the final cause than in other fields".[16] Many courts resent this blind neutrality and apply the rules they like best, and very often they prefer the rules of the forum to the foreign rules.[17]

Most writers on the conflict of laws believe that the courts are wrong in preferring what they believe to be the "better law". The choice of-law rules provide a special kind of justice which is to distribute in a fair and equitable manner the power of the legal systems to govern legal situations.[18] It is in the interest of international trade that courts treat all the laws of the world as equally just and good.

The courts, however, do not follow the writers. There has been a strong and often hidden antagonism between their doctrines and the practice of the courts. The courts pretend to go by the rules in the books, but they do not. Most courts persevere in believing that their job is to do justice in the individual case, and that this is more important than to follow the abstract and elevated justice of the choice-of-law rules. Often covert techniques are used to reach the outcome which the court wants. This impairs the predictability which the choice-of-law rules should provide.

To take an example of a covert technique. In the latter half of the 19th and the first half of the 20th century the courts in England, France, Germany and other countries professed the rule that in the absence of an express or tacit choice of law by the parties a contract was to be governed by the law which the parties must be presumed to have intended. It was obvious that in most of the decided cases it was impossible to tell which law the parties would have agreed upon if they had reached agreement. The presumed intention of the parties which the courts invoked was a fiction. This was confirmed by the fact that the courts very often found that the parties had intended the law of the forum to govern their contract. The courts asked a question which they had no intention to answer. They used the presumed intention of the parties as a window dressing.[19]

---

14 See *Keller/Siehr, Allgemeine Lehren des Internationalen Privatrechts*, 1986 § 35 on *Anpassung* especially pp 457 ff.

15 See in this means to force a party to perform specifically, Terré, Simler & Lequette, *Droit civil, les obligations* 6. ed. 1996 no 1023ff.

16 Cardozo, *Paradoxes of Legal Science*, 1928 68.

17 See European University Institute, *Integration Through Law*, (eds. Cappelletti, Seccombe and Weiler) Volume 1, Book 2, Part II, p 161ff, *Conflict of Laws as a Technique for Legal Integration*, by Hay, Lando and Rotunda, at pp 168ff.

18 See Kegel *The Crisis of Conflict of Laws*, Recueil des Cours de l'Academie de Droit International 1964 II, 94, 185. Bernard Audit, *Droit international privé*, 1991 no 96 ff, and Jan Kropholler, *Internationales Privatrecht*,2 nd. ed. 1994 § 4 seem to agree with *Kegel.*

19 See Lando, *Kontraktstatuttet* (The law applicable to the contract) 1962 34 f (France), 85f

Even if the books tell a party who appears in a foreign court that his law should be applicable to the case, he still has no assurance that it will be applied. The average lawyer is afraid of private international law. So the party will often find that his counsel in the foreign country and the judge try to avoid the refined mechanisms of private international law and an unknown foreign law with the result that his law is not applied.[20]

However, other temptations than this homeward trend may seduce the courts. Three decisions from different countries had a particular common feature. The court was to choose between two legal systems. In one of them a modern rule was applicable to the issue. In the other system the same rule or a similar rule had recently been enacted, but the old and out-dated rule was still applicable because the facts were prior to the coming into force of the new statute. In all three cases the court developed a new choice-of-law rule in order to show that the contract was governed by the law of the country whose modern statute was applicable to the case.[21]

8 The Choice of Law Rules of the Rome Convention

One could ask whether the Rome Convention on the Law Applicable to Contractual Obligations has brought about some of the discipline which the writers wish, and established the needed foreseeability for the European citizen.

Art 4 (1) provides that in the absence of a choice of law by the parties the law applicable to a contractual obligation is the law with which the contract is most closely connected. Art 4 (2) provides a general presumption. It shall be presumed that the contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has his principal place of business. In addition, art 4 (3) provides a specific presumption for contracts relating to immovable property and art 4 (4) a presumption for certain transport contracts. Art 4 (5) then makes an exception for cases where it appears from the circumstances as a whole that the contract is more closely connected with another country.

On the presumption of the characteristic performance and the other presumption established in art 4 the official "gloss" on the Convention, the so called *Guiliano Report* says that they greatly simplify the problem of determining the law applicable to the contract. On the relationship between the presumptions in art 4 (2)-(4) and the rule on the closest connection in art 4 (1) and 4 (5) it says that the contract is to be governed by the law of the country with which it is most closely connected, that the flexibility of this principle is substantially modified in paragraphs 2-4, that the presumptions in paragraphs 2-4 may be disregarded when

---

(Germany), 121 (England).

20 See European University Institute, *Integration Through Law* , (eds. Cappelletti, Seccombe and Weiler) Volume 1, Book 2, Part II, p 161ff, *Conflict of Laws as a Technique for Legal Integration*, by Hay, Lando and Rotunda, at pp 168ff.

21 *Milliken v .Pratt*, 125 Mass.374 (1878) (USA); *The Irma-Mignon*, Norsk Rettstidende 1923 II 58; (Norway), French *Cour de Cassation* 19 Febr.1930, *Sirey* 1933 -1-41.

all the circumstances show the contract to have closer connections with another country. It also says:

> "Art 4 (5) obviously leaves the judge with a margin of discretion as to whether a set of circumstances exists in each specific case justifying the non-application of the presumptions in paragraphs 2,3 and 4. But this is the inevitable counterpart of a general conflict rule intended to apply to almost all types of contract"[22]

From this statement one may infer that the presumptions are meant to ease the task of the courts. The courts are not expected to weigh and count the connecting factors of each contract in order to select the applicable law. They can rely on the presumption unless it is obvious that the contract is more closely connected with another law. On the other hand, since with a few exceptions the presumption in paragraph 2 applies to all contracts covered by the Convention, there must be some flexibility. However, the Convention does not allow the parties to adopt a result selective approach. There are some security valves. Strong governmental interests, be they expressed in the so-called directly applicable mandatory rules,[23] or in the rules of public policy of the forum[24] have to be considered, and the directly applicable mandatory rules of a foreign country having a close connection with the situation may be taken into account.[25] Apart from that the courts cannot apply the law they like best. It is against the spirit of the Convention the purpose of which is to establish legal certainty so that " the same law is applied irrespective of the State in which the decision is given".[26]

9 The Courts and the Rome Convention

How strong are the presumptions provided in art 4 of the Convention ? How close must the connection to another country be to rebut the presumption? When considering this question have the courts acted as they were supposed to, or have they had an eye to the result and chosen the law which brought about the solution they liked best?

This question is difficult to answer since European courts may not admit openly that they have cast covetous eyes on what they consider to be the just and equitable outcome of the case.

Two cases, one French and one Dutch show opposing views as to the strength of the presumption.

> The first is a decision from 1991 by the Court of Appeal of Versailles. The French Mr Bloch was manager and shareholder of a French company which was the distributor in France of certain products delivered by an Italian company. On a visit to Italy Mr Bloch had signed for the debts of the company. The creditor was the

22 See the Report on the Rome Convention on the law applicable to contractual obligations by *Mario Giuliano* and *Paul Lagarde, (the Giuliano Report*) OJEC 1980 no C 282/ 1,22.

23 Art 7 (2).

24 Art 16.

25 Art 7 (1).There are also result selective provisions in art 8 (2) and art 9 of the Convention.

26 See *the Giuliano Report* OJEC 1980 no C 282/4.

> Italian supplier. The guarantee was invalid under French law because Mr Bloch had not signed a document which recorded the amount for which he stood surety. The guarantee was valid under Italian law. Mr Bloch who lived and did business in France was the party who was to effect the characteristic performance of the contract. However, the debt for which he stood surety had arisen out of the distributorship contract which was governed by Italian law. The guarantee had been signed in Italy, and had been drafted in the Italian language.

The Court found that these contacts were sufficient to apply the exception clause in art 4 (5) under which the presumption in favour of the characteristic performance was to be rebutted when it appeared from the circumstances as a whole that the contract was more closely connected with another country. Consequently the court applied Italian law and upheld the guarantee.[27]

The second case was decided by the *Hoge Raad* (Supreme Court) of the Netherlands.

> A Dutch seller had sold a machine to a French buyer. The sales contract had been negotiated in France where the seller's agent had received the buyer's order. The purchase price was expressed in French currency, and the seller had delivered and assembled the machine in France. The question in the case was whether the Dutch courts had jurisdiction to try the dispute. Under art 5 (1) of the Brussels Convention on Jurisdiction and Enforcement of Judgements the Dutch court would have jurisdiction if the sales contract was governed by Dutch law.

The court of first instance had held that the contract was governed by French law, and had denied jurisdiction. The Court of Appeal in Arnheim reversed and held that the contract was governed by Dutch law being the law of the country of the party who had effected the characteristic performance. The Hoge Raad affirmed and said:

> "When applying the exception... (in art 4 (5))... it follows both from the wording and the structure of art 4 as well as from the uniformity of application of the law which was intended by the Convention that this exception to the general rule in paragraph 2 has to be applied restrictively, so that the general rule should be disregarded only if, in the special circumstances of the case, the place of business of the party who is to effect the characteristic performance has no real significance as a connecting factor".[28]

As was shown above, *the Guiliano Report* does not endorse this statement. The presumption in art 4(2) is to be set aside when in the particular case it is clear that the contract has a closer connection with another country. In this case, there was such a closer connection. A sales contract should be governed by the law of the buyer's country when in that country the sale has been negotiated, the seller's agent had received the buyer's order, the machine sold was delivered and assembled, and

---

27 See *Revue critique de droit international privé* 1991 745 annotated by *Lagarde.*

28 1992 *Nederlandse Jurispudentie* no 750. The translation is that of *Teun H. D. Struycken*, see *Some Dutch Judicial Reflections on the Rome Convention art 4(5*) in *Lloyds Maritime and Commercial Law Quarterly* Part 1, February 1996 18, 20.

when the purchase price was expressed in the currency of the buyer's country. To hold that will not create any legal uncertainty.

And one may ask whether the Dutch court would have stuck to its inflexible approach, and considered French law applicable to a contract where the tables had been turned, and the sales contract had been negotiated in Netherlands where the French seller's agent had received the Dutch buyer's order, the purchase price had been expressed in Dutch guilders, and the seller had delivered and assembled the machine in the Netherlands.

In the case before the Court of Appeal of Versailles the contacts were more evenly balanced. On the one hand the guarantee was signed by Mr Bloch in Italy, the distributorship contract to which the guarantee related was governed by Italian law, and the recipient of the guarantee was Italian. On the other hand the surety, Mr Bloch, was French. He guaranteed the debts of a French company which was acting for the supplier in France. It seems that if you rely on the contacts of the case the presumption in favour of French law should have been upheld.[29] However, from a moral point of view Mr Bloch had a weak case. If he did not know, he ought to have known that the guarantee which he issued was not valid under French law.[30] Should he then be allowed to invoke French law, when the guarantee was valid under the law of Italy? One has reason to believe that the court was guided by what was fair and reasonable more than what was considered to be law with which the contract had its closest connection.

One can also find cases which in applying art 4 show a homeward trend.[31]

10. Art 5 of the Rome Convention provides a "hard and fast" rule for *consumer contracts* . The law of the country where the consumer has his habitual residence governs, but only in cases where in the ways described in art 5 (2) the other party has been active in "seeking out "the consumer in his home country. In these cases the consumer cannot be deprived of the protection afforded to him by the mandatory rules of the governing law.

---

29 See the Giuliano Report, OJEC 1980 C 282/ 2l, first column, penultimate paragraph.

30 Even from a choice-of-law point of view the court came to the correct result. The question was whether the guarantee was formally valid. Under article 9 of the Rome Convention a contract concluded between persons who are in the same country is valid if it satisfies the formal requirements of the law of the country in which it was concluded. Mr Bloch had issued the guarantee in Italy where it was valid.

31 A Portuguese court was faced with the law applicable to a contract for the sale of nuts from a foreign seller to the Portuguese buyer. The buyer brought an action against the seller claiming damages for defects. The court held Portugal to have the closest connection with the contract since it had been made in Portugal and since the defective goods had been delivered to a buyer in Portugal. As an additional ground for applying Portuguese law the court referred to art 4 (1) of the Commercial Code of 1888 under which the contract was governed by the law of the place where it was made. See *Relacào de Lisboa* 5 Dec 1995, *Colectànes de Juisprudència* 1995 V. 131 here cited from Kohler and Jayme, *IPRAX* 1996 377, 388 where the decision is commented upon. Kohler and Jayme write that the court must have overlooked the presumption on the characteristic performance in art 4 (2) of the Rome Convention which would have led to the application of the foreign law of the seller; the general clause on the closest connection in art 4 (1), they say, involves the danger that the courts in determining the closest connection will rely on criteria which were applied in their former private international law.

In other cases the rules in art 3 and 4 apply. Consumers who approach a foreign enterprise from their home or who go abroad and are contacted there, are not covered by art 5. As art 5 is drafted the law of the consumer's habitual residence should not be allowed to protect the consumer in these cases. If, for instance, the public policy of the forum country could be invoked to protect consumers who are domiciled in the forum country the limitations which art 5 (2) has set for its application would be meaningless.

However, there has been several German cases about German tourists who were contacted during their holidays on the Canary Islands and induced to buy woollen bed linen which they soon regretted. The sellers had seen to it that the purchases were to be governed by Spanish law[32] which had not then implemented the EC Doorstep Sales Directive, and which did not give them the right to cancel the purchase. However, in almost all the German cases the courts found a way which allowed the buyers to call off the contract under the law of Germany which had implemented the rules of the directive. The ways in which this was done were not by the book.[33] The cases show that when the courts felt a need to protect the consumers in situations other than those covered by art 5 (2) they did so. The courts held it more important to help the German consumers than to administer the special kind of justice provided by the choice of law rules.

It is submitted that like other choice of law rules those of the Rome Convention cannot establish the legal uniformity necessary for an integrated market. There is still some truth in what in his colourful language professor *Anton Friedrich Justus Thibaut* said in 1814 about the situation in Germany when the country was divided in a multitude of states each having their own legal institutions:

> " If there is no unity of laws then the terrible and odious practice of the conflict of laws will arise..... so that in their intercourse the poor subjects will be stuck and suffocated in such a constant maze of uncertainty and shock that their worst enemies could not advise them worse. Unity of law would, however, make smooth and safe the road of the citizen from one state to the other, and wicked lawyers would no longer have the opportunity to sell their legal secrets and thereby to extort and maltreat the poor foreigners"[34]

This fault of the choice of law rule is even more serious in relationships with partners outside of the Union. The choice of law rules of the foreign courts are often different from those of the Rome Convention, and the applicable law will therefore

---

32 See decisions reported by Peter Mankowski in his article "*Zur Analogie im internationalen - Schuldvertragsrecht"*, IPRAX 1991 305ff.

33 AG Lichtenfels 24 May 1989 invoked German public policy, OLG Frankfurt 1 June 1989 held that art 5 was applicable as the seller who was a German enterprise" in reality" had received the order in Germany, see art 5 (2) no 2 .The LG Hamburg 21 Feb 1990 invoked the doctrine of abuse of right (*Rechtsmissbrauch)* in order to apply German law. See on these decisions reported in IPRAX 1991 235 ff, Peter Mankowski, *Zur Analogie im internationalen Schuldvertragsrecht,* IPRAX 1991 305ff.

34 Thibaut, *Über die Notwendigkeit eines allgemeinen bürgerlichhen Rechts in Deutschland*, Heidelberg 1814, reprinted in *Hattenhauer, Thibaut und Savigny, Ihre programmatischen Schriften,* München 1973, 61ff p 33 f.

depend upon where the action is brought to an even greater extent than in the inter-union relationships.

11. The Rome Convention does not apply to contracts of insurance which cover risks situated in the territories of the Member States of the Union. For these contracts a number of Directives have been issued and implemented by the Member States. The Directives seek to further the policy of establishing freedom to provide services within the Union by enabling an insurer in one Member State to provide insurance in another Member State with a minimum interference from the latter State's regulatory authorities. At the same time they purport to give the insured party some protection. As the Governments could not agree on uniform substantive rules special choice of law rules were enacted to achieve these purposes. These rules are so complicated that even the most sophisticated conflicts lawyer has difficulties in fully understanding how they are to be applied[35]

12 C Is the Europeanisation of the Contract Law Feasible?

We must conclude that the choice-of-law rule is a poor tool of legal integration. Its greatest weakness is that it involves the application of a foreign law which has to be ascertained and adjusted. The growing commercial intercourse in the world and the rapidly increasing commerce in the European Union have given rise to more conflict cases than earlier. The only way out is to limit the operation of the choice-of-law rules. That can be achieved if the substantive law rules are unified so as to avoid that conflicts cases arise as often as they do today.

Can the 15 or more States agree on a unified contract law?

European lawyers are divided by different legal methods and rules and by different legal languages. The greatest divergence is between the legal method and language of the civil law countries of the European Continent and the common law countries of the British Isles.

The private law of the continental countries is mainly to be found in the Civil Codes, in the Nordic countries, which have no codes, in statutes. Most legal terms and classifications and many rules have their origin in Roman law, and here there is some uniformity. In each country the law courts have developed and supplemented the codes and statutes in a dialogue with the writers who have established system and method.. However, also on the continent we find considerable differences in institutions and rules.

On the British isles the laws have been established by the law courts. Roman law never reigned in England as it did in most parts of the Continent. It was the courts that established the institutions and many of the peculiar terms of the common law. For centuries the British Parliament did not legislate in contract matters, and even today's statutes, although they are more numerous than earlier, do not change the

35 See Fritz Reichert-Facilides & Hans Ulrich Jessurun d'Oliveira (eds), *International Insurance Contract Law in the EC*, Deventer, 1993, and more recently the attempts to bring some guidance to the rules made by C.G.J.Morse in Dicey and Morris, *Conflict of Laws* 13 ed. 2000, Rules 185 and 186, nos 33-138-33-197 (pp 1349-1375).

picture of contract law which is mainly judge made law. Although the influence of the English law professors is growing their writings are still considered a secondary authority.

13 a The Common Core

However, there are also similarities between the legal systems.

Although England and Ireland never experienced a reception of Roman law they never isolated themselves from Continental law. From the middle of the twelfth century Roman law was taught in England. In the equity practice of the Chancellor one could find some influences of Roman law. In the commercial and maritime law of the special commercial courts which existed until the nineteenth century the Roman law influence was still stronger, and is still reflected in the common law of to day. Also in many decisions of the courts one can see that English judges have read and learned from the Continental writers and their codes.

The most striking similarity is however one of ideology and results.

Lawyers who have read foreign court decisions have often discovered that a court which has applied rules that are different from those governing in his own country has come to a result which in a similar situation his own courts had arrived at. These lawyers have wondered whether this was a coincidence or whether there was any regularity in this phenomenon. This made legal scholars search for what is called the *common core* of the legal systems. In the nineteen sixties *Rudolf B Schlesinger* conducted the Cornell project to find this out. His investigation covered the formation of contracts. He engaged about a dozen scholars from the various legal families in the world. As the common core had been discovered by comparing court decisions *Schlesinger* decided to base the investigations on cases. Together with the scholars he produced cases on the basis of which questions were made and answers given and discussed in the group. The results were published in a book.[36] It disclosed that in spite of the fact that the courts used very different techniques for the solution of legal problems there was a certain concordance in the outcome of many problems.[37]

14 b The Common Ideology among Judges

In spite of differences in the social, political and intellectual history of the various countries, and in spite of the fact that the law makers, be they legislators or courts, have pursued their policies through very different legal techniques we see that the legal values are basically the same.

This, it is submitted, has several causes.

aa. Judges have a common ideology and behaviour. The environment in which a judge was raised and now lives creates a species of mankind, the case deciding man

---

36 Rudolph B. Schlesinger, *Formation of Contracts, A study of the Common Core of the Legal Systems* I-II 1968.

37 Today a similar research work is being carried out by the so-called Trento Group headed by professors Ugo Mattei and Mauro Bussano.

(homo judicans). Most of the guardians of our law and justice grew up in well to do bourgeois homes with moral traditions.

In school and at the university the judge *in spe* was a good and relatively virtuous student with strong ties to his home. He was often a right-winger.[38] His life in court has maintained his bourgeois attitude, and has confirmed his conservative response to life, which promotes scepticism towards new ideas and trends.

Most judges have a strong sense of responsibility. They face people who are often in a critical situation, and they feel that they must do justice. These features may explain some of their common habits.

bb. The second factor is the common roots of the laws of Europe as in other countries whose laws have a European origin. Everywhere there has been the strong impact of Roman law, the Christian ethics, the great European moralists, in modern times the democratic institutions, and in Europe the unified and harmonised laws of the European Union.

To day there is a European Law and it is growing. It has and will establish a considerable uniformity of legal thinking. Also in the world the mass and importance of the harmonised or unified law is increasing. In commercial law the flagship is the United Nations Convention on the Contract for the International Sale of Goods, (hereinafter *CISG*). It has already had an influence on the domestic sales law of several member states.[39] This growing mass of unified law increases the common core.

cc. A third factor is the similarity of economic and social conditions in the countries of the Union, the market economy and the industrial states. This similarity is shared by many other countries outside of the Union. In these societies the legal problems that arise are similar and so are the answers which economic consideration give to the problems. The agents of the market need safety and predictability; they also wish rules which make the conclusion of contracts swift and inexpensive.

The ideas of how the rules should be have always travelled. From early times the legislators have borrowed from foreign sources, and to day they do so to an increasing extent. Modern mass media make it easy for political ideas to gain ground. When, for instance, some leading nations have provided protection of the consumer this idea spreads all over the world.

15 The Common Ideology among Academics

In the UNIDROIT Working Group which drafted the *Principles of International Commercial Contracts* and in the *Commission on European Contract Law* the participants often found the common core in the positive law.

---

38 See for what was then West-Germany W. Kaupen, *Die Hüter von Recht und Ordnung. Die soziale Herkunft , Erziehung und Ausbildung der deutschen Juristen,* 2. Aufl 1971 and Ralf Darendorf, *The Education of an Elite. Law Faculties and German Upper Class,* Transactions of the 5th World Congress of Sociology. Louvain 1964, 259-274.

39 See on Nordic law Hellner, *Die Bedeutung des UN-Kaufrechts in Skandianvien, Festgabe für Karl Heinz Neumayer,* Basel 1997, 151, 159f.

In the discussions and when preparing the meetings the participants would consider how the courts of their own country have or would have reacted to the problems discussed. They often found that the laws would reach the same results, especially when they tried to illustrate the problems with decided or imaginary cases. The consensus was greater than one should think when one compared the legal rules and techniques of the various countries.

The same was discovered when the participants discussed how the law should be.

There were admittedly differences of opinion. Most of them, however, did not reflect national attitudes but rather the political attitude of the individual members, notably on how much freedom of contract the parties should have.

One of the few differences I remember, which reflected national attitudes, was on the issue whether a person is obliged to disclose information in contract negotiations. It was illustrated by the case about the ignorant seller of a painting who accepts a modest bid by a buyer who can see but does not tell the seller that the painting is a *Poussin* and therefore worth many times the purchase price. Under English law, which the British members of the Commission on European Contract Law supported *de lege ferenda*, the buyer was not obliged to reveal his knowledge and therefore the seller should not have any remedy. The French,[40] German and Nordic members supported their laws in holding that the buyer ought to have disclosed his knowledge, and that the seller should be allowed to avoid the bargain. This difference is perhaps connected with the fact that in mercantile matters the English superior courts take the businessman's attitude. More often than the courts of other European countries they have had to do with business transactions such as charter parties and commercial sales. Their concern has been to uphold the businessman's freedom of contract and to establish predictability so that commercial transactions can be performed smoothly and safely. These considerations are sometimes given preference over social considerations.[41]

By and large, however, the members of the two groups nourished the same legal values. We discovered that there was less convergence among the legal systems than consensus among us about which rules should be adopted as fair and appropriate.

The Court of Justice of the European Communities has judges from all the Member Countries and some of these Judges have told me about a similar experience. There is often agreement about the outcome of a case although the reasons for the decision vary considerably.

This attitude makes it likely that the courts in Europe will give a unified European contract law a uniform application.

---

40 See on the famous French "*Affaire du Poussin*", *Cour de Versaille* 7 January 1987, Gazette du Palais 21.-11 January 1987 and Ghestin, *Traité de droit civil*, 3d edition 1993 no 528.

41 See Kötz, The Common Core of European Private Law: Presented at the Third General Meeting of the Trento Project, 21 Hastings International and Comperative Law Review 803, 80 ff.

16 c Is There a Will to Europeanise?

One must realise that today many, if not most, lawyers in Europe do not wish a Europeanisation of contract law.

Some consider the national law to be part of the nation's cultural heritage. It reflects the spirit of the people. The law of a nation is based on its entire past. The law must develop, but a people should not cut off its historical roots. They are innate in the people. The present law cannot be understood in isolation; it is tied to the past from which it has emerged. In each epoch the nation should reasonably take cognition of, rejuvenate and keep fresh its laws.[42] What is true for the lawyers of one state may be false for the lawyers of another state. The truth about contract law, they argue, is not the same for a Swede as for an Italian, for an Englishman and for a German.

And they cannot be expected to give up their proud institutions such as the German rules on *culpa in contrahendo*, on hardship (*Wegfall der Geschäfts-grundlage*), and on good faith as a paramount principle of contract law, the rule of the Nordic Contract Act § 36 making unfair contract terms unenforceable, the British rules on misrepresentation etc.

To introduce a new contract law in Europe will admittedly cost sweat, tears, and money. And many lawyers will hate to see all that which they themselves have learned and practised disappear and to have to learn a new contract law. They will no longer be able to "sell their legal secrets" as *Thibaut* said.

No doubt the emotional wish to preserve the peculiar character of each national law will prove to be a serious political obstacle to unification, but it is one which must be overcome if the European Union is to function satisfactorily. Contract law and commercial law are not folklore. And who to day in Paris mourns for "*Les coutumes de Paris"* or in Prussia for "*Das allgemeine Landrecht für die preussischen Staaten*"?

II How Should the Europeanisation of the Contract Law be Brought About?

17 "Creeping" or Codified European Contract Law?

Should the Europeanisation be done "from above" so that the European Parliament or the State Legislatures enact a Civil Code? Or should it develop "from below", the spirit of the people and the endeavours of the doctors being the engines that propels it?

This question was also discussed in Germany in the early nineteenth century. In 1814 the Heidelberg Professor *Anton Friedrich Justus Thibaut* advocated the enactment of a civil code in Germany.[43] In the same year the Berlin professor

---

42 See von Savigny, *Von Beruf unsrer Zeit für Gesetzgebung und Rechtswissenschaft*, Heidelberg 1814, reprinted in *Hattenhauer, Thibaut und Savigny, Ihre programmatischen Schriften*, München 1973 95 ff.

43 *Über die Notwendigkeit eines allgemeinen bürgerlichen Rechts in Deutschland, Heidelberg 1814*, reprinted in Hattenhauer, *Thibaut und Savigny, Ihre programmatischen Schriften*,

Friedrich Carl von Savigny published a manifesto opposing *Thibaut*'s idea and glorifying the Common Roman Law, *Das gemeine Recht*, which was then applied in most of the German States.[44]

I will hereinafter call those who wish a codification in Europe the "Thibauts" and the antagonists of this idea the "Savignys" They want a "creeping" harmonisation of European private law to use an expression borrowed from the German writer *Klaus Peter Berger*.[45]

To use the names of *Thibaut* and *Savigny* for the two schools of thought is, I must admit, a poetic license.[46] The situation in Germany in 1814, was different from that of Europe today. However, much of the discussion in 1814 reflects current problems.

Both the Savignys and the Thibauts agree that European contract law should be harmonised or unified. The Savignys, however,[47] imagine a common law being developed through fertile debates in the European Universities, in law reviews, and in books. A European Contract Law, the Savignys say, should grow organically and slowly in the people, led by the academics and supplemented by the business community when it feels the need. In their international organisations the business people should establish common customs and practices. This new European law should be taught to the students who, when they become judges, will apply it in their decisions. The Savignys wish the new European law to "creep" onto the minds of the Europeans. They refer to the proud tradition of Roman Law, which spread in Europe from the time of the glossators of the 11th century, and which reigned in Continental Europe until it was replaced by the great codifications of the 19th century.

There is, it should be added, agreement between the Thibauts and the Savignys on several issues.

They agree on how the European Private Law should be prepared. Even if you decide to codify you must till the ground first, and the methods advocated by the Savignys may be useful also for the Thibauts.

Provided that the Principles of European Contract Law are not codified the Savignys do not object to the drafting of principles. Like the American

---

München 1973, 61ff.

44 *Von Beruf unsrer Zeit für Gesetzgebung und Rechtswissenschaft*, Heidelberg 1814, reprinted in Hattenhauer, op. cit. previous note, 95 ff.

45 Klaus Peter Berger, *The Creeping Codification of the Lex Mercatoria*, The Hague 1999.

46 One of von Savigny's main ideas was that the law of a country is based upon the entire past of the Nation being the result of the very nature of that Nation and its history, see von Savigny, *Über den Zweck dieser Zeitschrift* , Zeitschrift für geschichtliche Rechtswissenschaft (1815) p 1-12, reprinted in Hattenhauer , *Thibaut und Savigny, Ihre programmatischen Schriften,* München 1973, p 261 ff , at 264.

47 See e.g. Reinhard Zimmermann, *Savigny's Legacy. Legal History, Comparative Law and the Emergence of a European Legal Science*, 112 Law Quarterly Review (1996) 576, and Hein Kötz, *Gemein-europäisches Zivilrecht, Festschrift für Konrad Zweigert*, Tübingen 1981, 481. In several meetings Kötz has advocated this view and has been supported by many European, notably German, lawyers. His colleague Jürgen Basedow may be considered a Thibaut, who does not wish codification to come too soon see Basedow, *A Common Contract Law for the Common Market*, 33 Common Market Law Review (1996) 1169-1195.

Restatements of the law, such as the Restatement of the Law of Contracts,[48] they might provide solutions for national courts in cases where their own law is silent or where their law is in need of reform, and such reform may be brought about by the courts. The Principles could be considered by the Court of Justice of the European Communities which, when deciding issues in contract, wishes to apply a contract law common to the laws of the Member States. Furthermore, as will be shown in part III of this paper, arbitrators often apply general principles of law (the *lex mercatoria*), a "neutral" set of rules instead of national law, to international commercial disputes, and they might wish to apply the Principles. Those who, when drafting international standard form contracts for European or world use, are in need of balanced terms which consider both parties' interests may wish to use or to refer to such principles.

The European Union have promoted a European *régime* of academic lawyers whose platform is no longer their own country but Europe and whose writings and debates are concerned with the future European law. This régime is necessary also for the Thibauts who wish a European Contract Code. Also they need European Contract Law to be discussed among academics and to be taught in class room before and after it has been codified.

This new European *régime* resembles that of the American. In the United States the writings on contract law - as on other subjects - deal with the problems and issues common to the common law states. There are considerable differences between the contract laws of the several states, but these differences do not prevent a debate which can be based on common concepts and a common legal method. Such a common language and a common legal method is also slowly emerging in Europe. Furthermore, the American and the new European *régimes* are inspiring each other, and together with lawyers from other countries they are in the process of becoming a world community of academic lawyers.

To day, however, the domestic law is the main subject of the European law schools. And Europe has as many legal sciences as there are legal systems. The scholars who cultivate their own domestic garden greatly outnumber those of the new European *régime*. The main task of the national legal sciences is to gloss on domestic laws. They suffer from anaemia because, as it has been said "there is no true culture in the world which can entrench itself in the study of one single national law".[49] Sometimes the scholars have looked over the fence to see what is growing in the neighbour's garden. This, however, has mostly been done only to get ideas to improve or apply the domestic law.

This, in fact, is a great waste of efforts and talent. It will be an enormous improvement of resources and ideas and enrich the legal science considerably if in the third millennium the talents will unite to establish and later maintain a European- or a world- private law.[50] And the efforts and money which it will cost to

---

48 American Law Institute, *Restatement of the Law Second, Contracts* 2d, Vol 1-3, St Paul, Minnesota 1981.

49 This familiar quotation is attributed to Rudolph Iehring. I have it from René David who never told where Iehring had written it.

50 In 1838 Thibaut made this observation regarding Germany which was then divided in a great number of legal systems, see *Über die sogennante historische und nicht-historische Rechts-*

unify the private law will be amply repaid when it is there. Much of the work to cultivate the many domestic laws will then be saved.

18. That which divides the Savignys and the Thibauts is the question whether the law should be Europeanised by way of the ”creeping” method or by codification (legislation).

The Savignys prefer the “creeping” harmonisation. They see the universities as the main platform for the debates on the future civil law of Europe. They imagine that the writings of learned scholars and Socratic seminars under the palm trees of the *academia* will distil the *ultima ratio* and establish a European Contract Law.

However, it is questionable whether the writings of the academics of a new régime and their discussions suffice to bring about a Europeanisation of the contract law.

First, it will be very difficult to establish a system of simple and clear rules. A law based on academic debates tends to become complicated. It is likely that confusion will come to reign if the European doctors are given the task of establishing a European contract law. Although a régime is emerging European lawyers are still divided by different legal languages and methods. When the Roman Law reigned in Europe its many and contradictory sources created a great amount of insecurity.

> “It cannot be denied” said Thibaut ”that Roman law has been conductive for our learned endeavours, notably for the study of philosophy and history, and that this great enigmatic mass has sharpened the lawyers’ faculty of combination, and has given them ample opportunity to practise and to glorify themselves. The citizen, however, may rightly claim that he was not born for the lawyers... All their learning, all their variations and guessing, all that has manifold upset the safety of the citizen and has only filled the pockets of the lawyers. The citizen’s happiness does not ask for the learned counsel, and we would sincerely thank the heavens if simple laws would bring about that the lawyers were dissuaded from their learning..... I assert.... that for the citizen their learning has never helped the true genuine sense of law but only destroyed it”.[51]

This mess was to some extent cleared when the French Civil Code was introduced in a number of European countries. In comparison with the former law the Code was clear and succinct, forceful in its language and free from detailed digressions.

Like the French civil code a European Code must strive at simplicity. When drafting the Principles the Commission of European Contract Law has tried to follow the device of the authors of the French Civil Code. As was said by Portalis in his *Discours préliminaire:*

> ”The task of the legislation is to determine the general maxims of law, taking a large view of the matter. It must establish principles rich in implications (*féconde en*

---

schule, Archiv für die zivilistische Praxis (1838) 39l-419 , reprinted in Hattenhauer, *Thibaut und Savigny, Ihre programmatischen Schriften,* München 1973 p 275, 279f.

51 Thibaut, in Hattenhauer, *Thibaut und Savigny, Ihre programmatischen Schriften,* München p 23.

> *conséquences*) rather than descend into the details of every question which might possibly arise".[52]

It is possible that when framing the future common law of Europe the Savignys will also take a large view of the matter and abstain from detailed regulation. This, however, presupposes agreement in the entire European *academia* both on the approach and on the rules to establish.

To the differences in the academic background of the European professors one must add that most academics are persons of a marked individuality. *Thibaut* warned against a law which like the Roman law was based on the doctrine of the learned society.

> "There is nothing which we good jurists like more than to hold the opinions of others to be inadvisable for the very reason that they are the opinions of others".[53]

Even if the professors were to agree on the principles of a European contract law one cannot expect that this law would be adopted by the courts in the way the Savignys imagine. Today neither on the Continent nor on the British Isles the courts can free themselves of the fetters of the law laid down in the national codes, statutes or precedents. A unified law can only be applied fully by the courts of Europe if the legislator tells the courts that they must. A European Civil Code has to be prepared, passed and promulgated. It will not provide detailed rules and will therefore allow for a certain polycentrism, but there will be certainty about the main principles. Together with the practising lawyers and the judges the doctors will work them out, but they have to be passed, either by the legislatures of the Union Countries or by the Council and the Parliament of the European Union[54]

But is there not a danger that when negotiated by the government delegates the future Code of obligations will become a step backward and that the result will be a host of poor compromises? Some of the EC and Union Directives are such ailing issues.

However, if carefully structured and prepared by academic scholars as was the United Nations Convention on Contracts for the International Sale of Goods (CISG), the Code may become a great step forward. CISG was a proof that governments can co-operate to make good rules. Its success seems to show that.

19 The Commission on European Contract Law

These considerations have guided the Commission on European Contract Law. Since 1982 it has been working to establish Principles of European Contract Law.(hereinafter called *PECL*). It has drafted articles which, like the American

---

52 Translation of this passage in the *Discours préliminaire* in Zweigert & Kötz, *Introduction to Comparative Law*, 3d. edition 1998, 90.

53 Thibaut in Hattenhauer, *Thibaut und Savigny, Ihre programmatischen Schriften,* München, p 21 f.

54 Both in 1989 and 1994 the Parliament has requested the Commission and the Council to prepare a European Civil Code, see *Resolution of 26 May 1989*, OJEC 1989 C 158/ 400 and of 6 May 1994 OCEJ 1994 C 205/518. See also infra section 20.

Restatements, are supplied with comments which explain the operation of the articles. In these comments there are illustrations, ultra short cases which show how the rules are to operate in practice, and notes which tell of the sources of the rules. Part 1 of the Principles dealing with performance, non-performance and remedies was published in 1995.[55]

A new edition of the principles which includes a revised version of Part 1 treats in addition the formation, validity, interpretation and contents of contracts and the authority of an agent to bind his principal. It was published in 1999,[56] and is hereinafter referred to as PECL I and II. In 1977 the Third Commission began to prepare rules on conditions and the effect of illegality, and rules on subjects which are common to contracts, torts and unjust enrichment, such as plurality of creditors and debtors, assignment of debts and claims, set-off, and prescription.

With a few exceptions the members of the Commission of European Contract Law have been academics, but many of the academics are also practising lawyers. The Members have not been representatives of specific political or governmental interests, and they have all pursued the same objective, to draft the most appropriate contract rules for Europe.

The main purpose of the Principles is to serve as a first draft of a part of a European Civil Code. However, before they are enacted and in transactions between parties in the Union and outside of the Union and between parties outside of the Union the Principles may also be applied as part of the *lex mercatoria*, see in this part III below.

The Principles may be compared with the American Restatement of the Law of Contract, mentioned above, which was published in its second edition in 1981. However, a different method has been used to establish the Principles of European Contract Law. The Restatement purports to state the Common Law of contracts of the United States. In the European Union where a common law cannot be claimed to exist the Principles must be established by a more radical process. No legal system has been made the basis of the Principles. The Commission has paid attention to any of the systems of the Member States, but not every of them has had influence on every issue dealt with. The rules of the legal systems outside of the Communities have been considered, and so have the American Restatement on Contracts and the existing conventions, such as CISG. Some of the Principles reflect ideas which have not yet materialised in the law of any state. In short, on a comparative basis the Commission has tried to establish those principles which it believed to be best having regard to the economic and social conditions in Europe.

Like the American Restatements the articles drafted are supplied with comments which explain the operation of the articles. In these comments there are illustrations, ultra short stories which show how the rules will operate in practice. Furthermore, there are notes which tell of the sources of the rules and state the laws of the Member States.

An attempt has been made to draft short rules which are easily understood by the prospective users of the Principles such as practising lawyers and business people.

---

55 Lando & Beale (eds) *Principles of European Contract Law, Part 1. Performance, Non-performance and Remedies,* Dordrecht 1995.

56 See note 2 *supra*.

In order to ascertain this and to learn the attitude of the prospective users to the individual articles Part 1 of the Principles have been discussed with practising lawyers in six of the Member States (Belgium, England, France, Germany, Portugal and Spain).

The Commission has made an analysis of the extent to which Part 1 of the Principles are applicable to the more important commercial contracts for the provision of goods and services of various kinds and the transfer of rights (licence agreements, etc.). Although the Principles cannot provide the appropriate solution to all the issues which every of these specific contracts raises the commission has found them applicable to the great majority of these issues.

The Commission has made an effort to deal with those issues in contract which face business life of today and which may advance the trade, especially the international trade. However, the Principles do not intend to apply exclusively to international transactions.

Some salient features of the PECL are treated in part IV below.

20 Which Further Parts of the Law are Planned to be Unified? The Study Group of a European Civil Code

On the European Continent the traditional concept of private law covers family law, law of inheritance, law of property and the law of obligations with its three main branches, the law of contract, the law of restitution and the law of torts. For the time being a unification of family law and the law of inheritance appear to be less urgent although a need may come to be felt. Areas of private law where unification is needed are the law of contracts, restitution, torts and movable property. It is, however, submitted that the law of contract is the field of the law which most urgently needs unification. It is also here that we find a fragmentary European legislation enacted as directives. By 14 December 1999 56 countries including most of the leading trade nations, and 12 of the 15 Countries[57] of the EU had adopted the United Nations Convention on Contracts for the International Sale of Goods (CISG). This convention provides uniform substantive rules on the formation and effects (interpretation, performance and breach) of international sales. Most of these rules could form part of the European Civil Code. There are plans to draft uniform rules for Europe for those issues relating to sales contracts which are not covered by the CISG, for contracts for services for personal security, and secured transactions in movable property including financial services, and for torts.

In 1989 and again in 1994 the European Parliament passed Resolutions requesting a start to be made on the necessary preparatory work on drawing up a European Code of Private Law.[58] In the preamble to the 1989 Resolution it is mentioned that "unification can be carried out in branches of private law which are highly important for the development of a Single Market, such as contract law...."

---

57 Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Luxembourg, Netherlands, Spain and Sweden.

58 See Resolutions of 1989 OJEC no. C 158/401 and of 1994 OJEC no C.205/ 518.

It has been doubted whether the Amsterdam Treaty empowers the institutions of the EU to prepare a Civil Code for the Union.[59] However, this issue was impliedly touched upon at a special meeting of the European Council devoted to the Creation of an area of freedom, security and justice in the European Union which was held in Tampere in Finland on 15 and 16 October 1999. A part of the Presidency Conclusions from that meetint deals with A genuine European area of justice and with a Greater convergence in civil law. Here the Council and the Commission of the EU are invited to prepare a new procedural legislation in cross border cases, in particular on those elements which are instrumental to a smooth judicial co-operation and to enhanced access to justice. As far as substantive private law is concerned an overall study is requested on the need to approximate Member States' legislation in civil matters in order to eliminate obstacles to the good functioning of civil proceedings. The Council is requested to report back by 2001, and the European Commission has taken measures to prepare the report. It seems as if the doubts as to whether the Amsterdam Treaty allows the EU to prepare a Civil Code could be overcome.

Some of the Governments have given the idea of a codification more than a moral support. In February 1997 the Dutch Government organised a symposium on a future European Civil Code in the Hague, and since then a Study Group of a European Civil Code has been established.

Comparative studies and ensuing drafts of a code are to be carried out in centres. A centre in Hamburg in Germany is planned to deal primarily with insurance contracts, personal security and with secured transactions relating to moveable property (mortgage in moveables, retention of title, etc). A centre in Osnabrück in Germany will treat rules on torts, unjust enrichment and negotiorum gestio and centres in Utrecht and Tilburg in the Netherlands are planned to deal with sales, leasing and contracts for the renditions of services, such as construction contracts and services rendered by professionals (lawyers, doctors, accountants). The German and the Dutch Research Councils and a Greek foundation have granted funds for these enterprises, and applications have been made in other Union countries in order to enable academic lawyers from these countries to work at the centres. The work started in July 1999. It is envisaged that the general principles of the law of contracts provided in the PECL will be integrated in what will eventually become a Draft European Civil Code.

21 The Future Avenues

The future European law of contract may take several avenues.

One is a continuation of the fragmented Union legislation and continued debates between members of a growing European *academia* on the principles of contract law, supported by the international arbitral tribunals' application of the *lex*

59 See Winfried Tilmann & Walter van Gerven, *Die Kompetenzen det EU zur Schaffung eines einheitlichen Europäischen Schuld- und Sachenrechts und die möglichen Rechtsgrundlagen in Vergleichende Untersuchung der Privatrechts ordnungen der Migliedstaaten der EU im Hinblick auf Diskriminerungen aus Gründen der Statsangehörigkeit sowie zur Möglichkeit und Notwendigkeit der Schaffung eines europäischen Zivilgesetzbuches*, Europäishes Parlament, Generaldirektion Wissenschaft, Projekt Nr IV/98/44, 1999.

mercatoria and by the efforts of the business world to provide uniform customs, standard form contracts and contract terms. In this way an unwritten European *jus commune* may emerge. This is what the Savignys hope for. It will be somewhat diffuse and polycentric, but it may eventually straighten out some of the differences between the national laws. It will probably take a long time to achieve it as is shown by the experience of the United Kingdom. In almost 300 years the English and the Scots have lived together in a Union. They have basically the same culture and speak the same language. A major part of their law has been unwritten. Most of the uniform law they have has been brought about by legislation, but since this legislation has not touched upon the basic principles of private law the two members of the United Kingdom still have two systems of law. The Union of today has at least 16 legal systems and 11 languages. If no legislative measure is taken the peoples of the Union will probably continue to have different contract rules. Those who will establish a European Contract Law by way of a natural outgrowth must arm themselves with great patience.[60]

Another avenue is a European Civil Code covering the law of contracts. This is what the Thibauts want, and I am, as you can guess, one of them. One must expect that an intensive trade will create a need for the greater amount of legal certainty which a Code will provide. The world trade has grown very fast, and this brought CISG into existence. In the countries of the European Union where since the Common Market was established in 1958 the inter-union trade has increased still more than world trade, unification of the law of contract will become the more urgent the more the trade and communication grow.

However, things may take time. At the time of the ancient régime in France a *code civil* which was to replace the many local customs and rules in the various provinces of the country was discussed for more than a century. It met with strong opposition by most advocates and judges. But it was eventually enacted. And after the country had been united Italy got her first *codice civile* in 1865 and Germany her *Bürgerliches Gesetzbuch* in l897.

III The Lex Mercatoria

22 A What is the Lex Mercatoria?

In 1980 the International Institute for the Unification of Private Law, (UNIDROIT) established a working group to prepare *Principles of International Commercial Contracts.* The group consisted of lawyers from all over the world who sat in a personal capacity. Most of them were academics, but some were judges and civil servants. In 1994 after the work had been accomplished the Governing Council of UNIDROIT published the Principles (hereinafter *The Unidroit Principles).*[61]

As stated in the Preamble the Principles set forth general rules for international contracts. They may serve and have already served as a model for national

60 Jürgen Basedow seems to expect a long ripening period before Europe is ready for a code, see Basedow, *A Common Contract Law for the Common Market*, 33 Common Market Law Review (1996) 1169-1195.

61 *Principles of International Commercial Contracts*, UNIDROIT, Rome 1994, XX + 256 pages.

legislators. However, the Governing Council of UNIDROIT has not proposed that the Principles should become the basis of a United Nations Convention on International Contracts.

The Preamble also provides that the Principles shall be applied when the parties have agreed that their contract is to be governed by them, and they may be applied when the parties have agreed that their contract shall be governed by "general principles of law, the " *lex mercatoria* " or the like. In fact, they have already been used by arbitrators.[62] Art 1.101(3) of the PECL has a similar provision.

What is then the *lex mercatoria*?

The parties to an international commercial contract sometimes agree not to have it governed by national law. In stead they submit it to the international customs and usages of the international trade, to the rules which have been established for this purpose, such as the UNIDROIT Principles and the PECL, and the rules which are common to most of the States engaged in international trade or to the States connected with the dispute. When the judge and arbitrator cannot find guidance in these rules he will apply the rule which appears to him to be the most appropriate and equitable for a situation of this kind. In doing so he will consider the laws of several legal systems, the works of the legal writers and the published arbitral awards. This judicial process which is partly an application of rules and partly a selective and creative process may be called the application of the *lex mercatoria*. It is to be distinguished from a decision based on pure equity *(ex aequo et bono)* in that it is based on grounds of principle.

23 The Genesis of the Lex Mercatoria

The *lex mercatoria* emerged from cases where the arbitration clauses had empowered the arbitrators not to follow the strict rules of law and to decide their case *ex aequo et bono*, or as they say in French to decide as "*amiables compositeurs"*. Arbitrators who were entrusted with this task often felt that although they were not bound to apply the strict rules of a legal system, their award should nevertheless be based on grounds of principle.

From about the mid fifties the theory on the *lex mercatoria* was developed by English[63] and French[64] authors who could show that the concept was already accepted in international business circles and applied by arbitral tribunals. One of its main fields of operation were contracts that were governed by international usages and practices. The international reinsurance treaty is an example of such contracts.

> The application of the *lex mercatoria* in disputes relating to reinsurance contracts is due to the international character of the re-insurance industry.

---

62 See Bonell, *An International Restatement of Contract Law*, 2d. ed. New York 1997 229ff.

63 See on Schmitthoff's theory on the new law merchant, *Filip de Ly*, International Business Law and Lex Mercatoria, 1992 p 209f.

64 See on the theories of Goldmann and Kahn, *Filip de Ly* op. cit .previous note p 210 ff.

Insurance companies from all over the world cover their great risks by way of re-insurance. In Europe the dominant market is the English, but the German and the Swiss markets are also important. The international character of the re-insurance trade has influenced the rules of law governing the reinsurance treaties. They are dominated by the usages and practices of the big European centres.[65] For this reason the governments of most European countries have abstained from legislating on re-insurance. Thus, when in the twenties the Nordic countries enacted a Uniform Insurance Contract Act they decided to exclude re-insurance from the scope of the Act. In the *Travaux préparatoires* to the Act this was explained by the fact that these "issues are of a typically international character, and as the modern foreign laws on insurance contracts have not embarked upon them the time does no seem ripe to do it with us either".[66]

In 1976 the Finnish author *Thomas Wilhelmsson* could state that there is a uniformity of law on this subject which has been developed over a long time. The uniform law is based on customs and practices which have been established in the big centres. These customs and practices may be applied directly.[67] The German author *Prölls* has pointed out that the method has been and is to develop the rules of law in this area on the basis of the specific nature of these contracts, so that most results are reached without regard to which national law is applicable to the contract. This method will relieve the courts of the complicated question which law is applicable to the contract.[68]

In re-insurance there are important international usages and practices and they were the main element of the *lex mercatoria* . Other sources were national rules of law notably the rules of those states which were connected with the dispute, or the rules which applied at the place which dominate the international market.

24 Later Developments

Before 1985 the *lex mercatoria* was an upstart.[69] Its many adversaries rejected it invoking grounds of principle. The first was that no state authority has given

---

65 See Thomas Wilhelmsson; *Om reassurandörs ersättningsskyldighet vid skadesförsäkring*, Stockholm 1976 pp 23, and 32-33.

66 See Swedish Proposition 1927 no. 11:1 pp 35o-352, and SOU 1925: 2l p 66. An example of an award based on considerations of principle is the award in a case between a Finnish and a Danish insurance company. Relying on what seems to have been an "equity clause" in the reinsurance contract the three Danish arbitrators chose to treat a negligent misrepresentation by the Finnish reinsured party regarding the risks involved in the same way as it was to be treated under § 9 of the Nordic Draft Insurance Contract Bill which for such cases provided for a reduction of the indemnity to be paid by the re-insurer. The arbitrators found the reduction principle of the Bill, although not in conformity with what was then "the strict rules of law", to be in accordance with justice and equity, see arbitral award of 23 December 1922 reported in *Samling af Domme, Kendelser og Responsa vedrørende Forsikringsforhold* (Court decisions, awards and opinions regarding insurance) published by "*Assurandør-Societetet i København*"(the Society of Insurers in Copenhagen) 1925 78.

67 See Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadesförsäkring*, Stockholm 1976 pp 32 and 33.

68 See Pröls, *Die Rechtsfragen der Schadenexcedenten-Rückversicherung*, Zeitschrift für Versicherungswissenschaft 1966 p 512.

69 See Lando, *The lex mercatoria in international commercial arbitration*, 34 International and Comparative Law Quarterly (1985) 747, and Carbonneau (ed.) *The lex mercatoria and arbitration*, New York 1990. Among the contibutors to this work who are adversaries of the *lex*

binding force to the rules of the *lex mercatoria*, the second, that it is a diffuse and fragmented body of law without much substance*;* it gives the parties no certainty as to what will be the outcome of a dispute between them.

However, the arbitrators' application of the *lex mercatoria* has been endorsed by several legislators and by the courts, even though it is a "state-less" law. In sections 25-31 we will deal with its present status.

Although the *lex mercatoria* will never reach the level of the copious and well-organised national legal systems it has grown and will grow with the international trade and the internationalisation of trade law. [70]

After 1985 important new elements have been added to its substance. Among them should first be mentioned the Convention on Contracts for the International Sale of Goods (CISG) which entered into force on January l, 1989. Its rules may now be regarded as part of the common core of the legal systems.[71] Other important new elements to the *lex mercatoria* are the UNIDROIT Principles of International Commercial Contracts (hereinafter the UNIDROIT Principles) and the Principles of European Contract Law (PECL).

The UNIDROIT Principles may be compared with the American Restatements of the Law, notably with the Restatement on the Law of Contract. They provide non binding rules that courts and arbitrators are invited to apply. The UNIDROIT Principles are for the World. Parties, courts and arbitrators who do not wish to apply national contract rules may apply these Principles. They comprise rules on the formation, validity, interpretation, contents, performance, non-performance (breach) of contract and remedies for non-performance. The principles which were published by the Governing Council of UNIDROIT in 1994[72] comprise, as do PECL, articles and comments with illustrations. Further work has been undertaken to cover other fields of the law of contracts.

The PECL are for the European Union. As mentioned above their first purpose is to serve as a draft of a future European Code of Contracts. But they are also a part of the European *lex mercatoria*.

Another source is the *International Encyclopaedia of Comparative Law* which is published by the *Max Planck Institute of Foreign and Private International Law* in Hamburg, and which brings a comparative survey of the laws of the world on subjects within civil law, commercial law and the law of civil procedure. Several volumes of this work are dealing with contracts.[73] It brings the existing common core if any, the typical solutions of the legal systems, and often also the authors' views on what in their opinion is the "better law".

---

mercatoria are F.A. Mann,. Georges Delaume, and Keith Highet, and among the supporters. Berthold Goldman, who was one of the "inventors" of the moderne *lex mercatoria*, and futhermore Andras F. Loevenfeld and Friedrich Juenger.

70 See Lando, op.cit previous note pp 752-755.

71 See Bernard Audit, *The Vienna Sales Convention and the lex mercatoria*, in Carbonneau, (ed.) Lex mercatoria and arbitration, New York 1990. 139.

72 *Principles of International Commercial Contracts*, UNIDROIT, Rome 1994, XX + 256 pages.

73 *International Encyclopædia of Comparative Law*, Tübingen, Dordrecht, Boston, Lancaster, is published in instalments and is not yet completed. Several chapters on contract matters have been publised in Volume VII on *Contracts in General*, VIII on *Specific Contracts*, IX on *Commercial Transactions and Institutions*, XII on *Law of Transport* and XV on *Labour Law*.

There has also been important developments of the EU contract law. The Community legislation mentioned supra in section 3 has provided a certain Europeanisation of the contract law in the Member States. It is somewhat fragmented and uncoordinated, but it is there. Furthermore, as was mentioned in section 17, the EEC and the European Union have promoted the establishment of an international *régime* of - mostly academic- lawyers whose platform is no longer their own country but Europe and whose writings and debates may influence the future law.

Noteworthy in this respect is the work in two volumes by *Flessner & Kötz*, European Contract Law[74] dealing with the rules of contract law in general in Europe. Its aim is to establish the common core of the European laws, to suggest common solutions where the laws are different and thereby to satisfy the needs of a European contract law.

B The Status of the Lex Mercatoria in the Year 2000

a Before Arbitral Tribunals

25 The Laws

The field of operation of the *lex mercatoria* has for a long time been the international commercial arbitration. The idea that state courts should apply it, is of a more recent date. It will be treated below in sections 30 and 31.

Art 28 (l) of the *United Nations (UNCITRAL) Model Law on International Commercial Arbitration 1985*[75] provides:

> "The arbitral tribunal shall decide the dispute in accordance with *the rules of law* as are chosen by the parties" (emphasis added).

The term *rules of law* implies that the parties may choose the *lex mercatoria* to govern their contract.[76] The model law has been adopted by 29 countries, and by 4 of the United States.[77] The Italian, French, and Dutch codes of civil procedure have

---

74 Flessner & Kötz, *Europäisches Vertragsrecht,* Volume I by Kötz (J.C.B. Mohr, Paul Siebeck) Munich 1996. An English translation, *European Contract Law,* Volume I was published in 1998 by Clarendon Press, Oxford.

75 Adopted by the United Nations Commission on International Trade Law on June 21 1985, a print has been made by the United Nations in 1994.

76 Although this was probably the intention of United Nations Commission when art 28 (1) was drafted, and the German provision has the same wording as art 28(1), when bringing the bill introducing the Model Law before the German parliament the German government claimed that the parties were only allowed to choose the law of a state.

77 See Pieter Sanders, *Unity and Diversity in Adoption of the Model Law,* 11 Arbitration International (1995) p 1. As of 14 Dec. 1999 the 29 countries were Australia, Bahrain, Bermuda, Bulgaria, Canada, Cyprus, Egypt ,Germany, Guatemala, Hong Kong, Hungary, India, Iran, Ireland, Kenya, Lithuania, Malta, Mexico, New Zealand, Nigeria, Oman, Peru, The Russian Federation, Scotland, Singapore, Sri Lanka, Tunisia, Ukraine. and Zimbabwe The 4 American States are California, Connecticut, Oregon and Texas.

similar provisions. They even allow the arbitrators to apply the *lex mercatoria* when the parties have not chosen it.[78]

A similar attitude was taken by the Austrian Supreme Court in the *Norsolor* case.

> A Turkish agent had claimed payment of commission and indemnity for contract termination from his French principal. The claim for *indemnité de clientèle* could probably have been awarded neither under French nor under Turkish law[79] In the contract the parties had not agreed on the applicable law. In their award the arbitrators abstained from applying either Turkish or French law, which, so it seems, had been touched upon in the pleadings. They could find neither a common intention of the parties when they made their contract to apply one of these laws nor a clear 'localisation' of the contract based upon its connecting factors. "Faced with the difficulty of choosing a national law the application of which is sufficiently compelling" the arbitrators applied the *lex mercatoria.* The arbitrators awarded an indemnity of 800000 French francs to the claimant. The Austrian Supreme Court refused to set aside the award. The arbitrators, it said, had not acted *ultra vires* by applying a non-national legal system.
>
> By awarding indemnity the arbitrators "applied" the law of the future. To day indemnity is provided for in the EEC Directive on the Self employed Commercial Agent of 1986 and is provided in several other legal systems.

Section 46(1) (b) of the English *Arbitration Act 1996* provides that "if the parties so agree the arbitral tribunal shall decide the dispute in accordance with such other considerations (than the law) as are agreed between them or determined by the tribunal". In the explanatory notes to the Bill of July 1995 which were made by a Departmental Advisory Committee on Arbitration,[80] it was said that the section corresponds to art 28 of the Model Law.[81]

The rule laid down in section 46 (1) (b) of the Act was applied even before the Act came into force.

> In a decision in *Home and Overseas Insurance Co. Ltd. V. Mentor Insurance Co (UK) Ltd*[82] the Court of Appeal gave effect to an agreement for arbitration in England which required the arbitrators to interpret the contract as "an honourable agreement...with a view to effecting the general purpose of [the contract] in a reasonable manner rather than in accordance with a literal interpretation of the language". In the Court of Appeal *Lloyd* L.J. said:
>
> "If the English courts will enforce a foreign award where the contract is governed by' a system of law which is not that of England or any other state or is a serious

78 See art l496 of the French Code of Civil Procedure, art 1054 of the Dutch Code of Civil Procedure, and art 834 of the Italian Code of Civil Procedure.

79 It seems as if under French law at that time indemnity could only be awarded if the agent was registered in France as *agent commercial* and that under Turkish law the agent had no such claim, see Stumpf, *Internationales Handelsvertreterrecht Teil 2.* 4 ed 1986 pp 138 and 469f.

80 Department of Trade and Industry, Consultative paper on an Arbitration Bill, July 1995. Section 1, and Section 2: Draft Clauses of an Aribitration Bill, July 1995.

81 Consultative paper (previous note) p 38.

82 [1990] 1. W.L.R. 153.

> modification of such law', why should it not enforce an English award in like circumstances"

Lloyd L.J, probably referred to the decision in *Deutsche Schachtbau- und Tiefbohrgesellschaft mbH. v .R'as Al Kharmia National Oil Co (Racnoc).*[83]

> In this case the German company sought enforcement in England of an award which had been rendered in Switzerland under the ICC Rules. The parties had not expressly agreed that internationally accepted principles should govern the substantive issues of their contract. However, invoking art l3 (3) of the ICC Rules the arbitrators had not applied national rules of law but internationally accepted principles of law governing contractual relations. The Court of Appeal found no reason to set aside the award on grounds of public policy. *Sir John Donaldson* said
>
> "I can see no basis for concluding that the arbitrators' choice of proper law, a common denominator of principles underlying the laws of the various nations governing contractual relations, is outwith the scope of the choice which the parties left to the arbitrators".
>
> The court approved that the arbitrators had referred to rules of law which were the rules most legal systems would endorse. This "common core" of the legal systems is an important element of the *lex mercatoria.*[84]

26 Standard Form Contracts. Professional Rules and Recommendations

Arbitrators have more and more often applied the *lex mercatoria* to international commercial disputes.[85] Clauses to this effect are to an increasing extent inserted in international contracts.

Thus art 23 of the widely used *ICC Agency Model Contract*[86] gives the parties an option either to apply "the provisions in this contract and the principles of law

---

83 [1987]All English Law Reports 769.

84 It is not clear whether the English courts will set aside or refuse to enforce an English award where the arbitrators have applied the *lex mercatoria* even though the parties had not made an agreement under art 46 (1) (b). In some earlier decisions the *English* courts did not recognise what has been called "extra-legal" arbitration which comprises awards based upon "equity" i.e. made *ex aequo et bono.* The same applied, so it seems, to an application by arbitrators of the *lex mercatoria*. This attitude is resounding among the authors. In his comments to section 46 of the Arbitration Act 1996 in Dicey & Morris, *The Conflict of Laws,* Dr Collins notes "that unless the parties agree to application of 'other considerations' the arbitral tribunal is required to apply the law chosen by the parties or (in the absence of a choice) the law determined by the the applicable conflict rules. There is therefore no scope for the arbitrators to apply (in the absence of an agreement by the parties) the *lex mercatoria* or *general principles of law,* because neither constitutes 'law' which can only mean a specific system of law" see Dicey & Morris, *Conflict of Laws,* 12 ed. 1993, 1997 Supplement [102].

It has been argued that in the absence of an agreement under art 46 (1) (b) an award based on the *lex mercatoria* may be set aside under section 68 (2) b) of the Act on the basis that the arbitrators have exceeded their powers, see Fraser Davidson: *The New Arbitration Act- A Model Law?,* Journal of Business Law 1997 101,122, but there is no authority.

85 In his book, *International Business Law and Lex Mercatoria,* from 1992 at p 254 ff Filip De Ly has listed a number of cases decided by the Court of Arbitration of the International Chamber of Commerce (ICC) where the court has applied the *lex mercatoria.* To this may be added a number of the ICC Court's unpublished cases and cases decided by other arbitral tribunals.

86 See Bortollotti (ed), *The ICC Agency Model Contract. A Commentary* 1993 p 95 ff.

generally recognised in international trade as applicable to international agency contracts with the exclusion of national laws", or to have their contract governed by a national law. Parties using the Model Contract who fail to choose a national law are considered to have chosen the first alternative.

On October l 1994 the World Intellectual Property Organisation (WIPO) adopted dispute settlement rules which parties may adopt, primarily but not necessarily, for intellectual and industrial property disputes. One set of these rules are the *WIPO Arbitration Rules* which in art 59 provide that arbitral tribunals acting under them should apply the law or *the rules of law* they deem appropriate to the merits of the dispute. This the arbitrators may do also in cases where the parties have not chosen this approach.[87]

Art 17 of the new Rules of Arbitration of the International Chamber of Commerce which were published in 1998 has gone a step further. It provides that the parties shall be free to agree upon the *rules of law* to be applied by the arbitral tribunal to the merits of the dispute. In the absence of any such agreement the Arbitral Tribunal shall apply the *rules of law* which it determines to be appropriate.

27 The Writers; the Situation in Scandinavia

The *lex mercatoria* has supporters and opponents among the writers both inside and outside of Europe.[88] Most of the writers have dealt with the *lex mercatoria* and arbitration.[89] The whole-hearted supporters are those who maintain that the *lex mercatoria* is to be treated as a legal system which replaces national law[90] The more cautious supporters are those who believe that it can only operate as an *incorporation* in a national legal system. [91] Their view is that parties contracting

---

87 See WIPO Meditation Rules, WIPO Arbitration Rules, WIPO Expedited Arbitration Rules, Recommended Contract Clauses and Submission Agreements, published in 1966 in Geneva by the World Intellectual Property Organisation. In the Recommended Contract Clauses and Submission Agreements it is, however, presupposed that the merits of the dispute are to be governed by a national law.

One should also note the 1992 Cairo Resolution of the International Law Association (hereafter referred to as "ILA") adopted by its Committee on International Commercial Arbitration at the occasion of the 65th ILA-Conference held in Cairo in April 1992. The Committee recommended that international commercial arbitrators should be permitted to apply transnational rules of law such as general principles of law, principles common to several jurisdictions, international law or usages of trade in two situations: 1) where the parties have agreed that the arbitrator may apply any such transnational rules; or 2) where the parties have remained silent concerning the applicable law. In these two cases, the transnational rules are to substitute the law of a particular State. The second part of the recommendation says that the validity and enforceability of arbitral awards should not be affected when in the absence of any indication by the parties regarding the applicable law the arbitral tribunal has based its award on transnational rules.

88 See among the authors in Carbonneau (ed.) *Lex mercatoria and arbitration*, New York 1990 , the American authors Andreas W. Lowenfeld, *The Lex Mercatoria, An Arbitrator's View*, p 37 and Friedrich Juenger, *The Lex Mercatoria and the Conflict of Law*s p 213.

89 See Carbonneau (ed) *The lex mercatoria and arbitration*, New York 1990.

90 See Berthold Goldman, *The applicable law, general principles of law - the lex mercatoria,* in Lew (ed), Contemporary Problems in International Arbitration, London 1986 113.

91 See Hans Smit, *Proper choice of law and and Lex Mercatoria Arbitratis,* in Carbonneau (ed) The

under a legal system, for instance Swedish law, as the proper law of the contract may shape their contract as they desire within the limits set by the mandatory rules of Swedish law. This they may do either by defining the desired conditions in express terms or, more succinctly, by referring to the provisions of another system**.** The latter is called *incorporation*. The law applicable to the contract will govern issues not covered by the chosen system of rules, and it will only apply to the extent its rules do not violate mandatory rules of the applicable law. Finally there are those who assert that the *lex mercatoria* should operate as a supplement or a corrective to national law, and be applied when no clear or no equitable and reasonable answer to the issue is provided in the applicable national law.[92]

The application of the *lex mercatoria* has been discussed by Scandinavian authors.[93] The Swedish author *Gillis Wetter* seems to prefer that parties make a choice of a national law to govern the contract, but he admits that parties may choose the *lex mercatoria*. "The will of the parties is supreme", he says.[94] The parties are free to choose the rules of law applicable to their contract But "the avenue of approach would normally lie via municipal conflict-of-law rules which lead to one or several municipal substantive law rules".

Sjur Brækhus who does not seem to greet the *lex mercatoria* with any great enthusiasm admits that under Norwegian law the parties are permitted to agree on an " equity clause" and therefore also on the application of the *lex mercatoria* which, as *Sjur Brækhus* says, has firmer outlines than "pure equity".[95]

Without discussing the issue whether to give effect to arbitral awards which apply the *lex mercatoria* the Norwegian Supreme Court in 1987[96] gave full legal effect to an ICC arbitral award which had been decided under the *lex mercatoria*. Apart from this we have not been able to find *Nordic* court decisions expressing any view on whether it is permissible for parties to choose the *lex mercatoria* to replace national law. Equity clauses are valid.[97] As the *lex mercatoria* is now recognised by the UNCITRAL Model Law and by the arbitration laws of the United Kingdom, France, Italy and the Netherlands which are important trade partners of the Nordic Countries, and since the courts allow parties to have the arbitrators decide the matter *ex aequo et bono* the parties also be allowed to select the *lex mercatoria.*

---

lex mercatoria and arbitration, New York 1990 77.

92 Andreas Lowenfeld, *Lex mercatoria, an arbitrator's view*, in Carbonneau (ed) *The lex mercatoria and arbitration*, New York 1990 37,51. See also on the *1994 Inter-American Convention on the Law Applicable to International Contracts* infra section 30.

93 See for Denmark, Lando, *Lex mercatoria i international handelsvoldgift*, (Lex marcatoria in internantional commercial arbitration) Ugeskrift for Retsvæsen 1985 B p 1.

94 Gillis Wetter, *Choice of Law in International Arbitration Proceedings in Sweden*, Yearbook of the Arbitration Institute of the Stockholm Chamber of Commerce 1984 ,16, 18. At p 21 he writes "Similarly parties may expressly stipulate that general principles of law shall govern their contract, and arbitrators have rightly so held in disputes concerning international investment contracts betweeen States and aliens even in the absence of clear provisions to such effect."

95 Sjur Brækhus, *Lokaliseringsproblemer i internasjonal kommersiell voldgift* (Issues of localization in international commercial arbitration) Lov og Rett, Vol 11 (1995) 641, 688.

96 See Justice, later Chief Justice, Carsten Smith's majority opinion in Judgement of 5 December 1987, NRt 1987 p 1449 at p. 1456.

97 See *Ugeskrift for Retsvæsen* 1955 436 (Supreme Court) and Hjejle, *Voldgift* 1987, 88. On "eqiuty clauses" in Swedish law see *Arbitration in Sweden 2 ed.* 1984,126.

Even if the parties have not agreed that the arbitrator shall apply equity the Danish courts allow arbitrators to decide the case "*ex aequo et bono*" provided that they do not violate mandatory rules of the applicable law.[98] Consequently Danish courts would probably also permit arbitrators to apply the *lex mercatoria* even though the parties have not expressly agreed on its application.

28 May the Lex Mercatoria Replace National Law?

It is the prevailing view that *arbitrators* deciding international commercial disputes may apply the *lex mercatoria*. The fact that laws, conventions and court decisions recognise the application of non-national rules of law has persuaded most lawyers that the *lex mercatoria* has come to stay.

It is, however, a question to which extent the *lex mercatoria* should replace national law. Some writers will allow it do so, some will only apply it as an incorporation in the applicable national law, and some will only apply it as a supplement to the applicable national law when it gives no answer or no reasonable answer to the issue.

Those authors who will apply the *lex mercatoria* as an incorporation will only allow the arbitrator to apply those of its rules that exist, Only they will replace the rules of the law applicable to the contract. In their opinion the arbitrator should not act as a social engineer when he cannot find any answer in the *lex mercatoria*. He then has to apply the rules of the law applicable to the contract. And the arbitrator may only apply the *lex mercatoria* to the extent it does not violate the mandatory rules of the law applicable. In addition he will also have to give effect to those mandatory rules of the forum or another law closely connected with the issue which are directly applicable to the issue or which are rules of public policy.

Under the theory which will let the *lex mercatoria* replace national law no national legal system applies to the contract. When the arbitrator cannot find existing rules in the *lex mercatoria* and when he does not find them suitable for the dispute in question he will "apply" the rules which appear to him to be the most appropriate and equitable. He must, however, give effect to the mandatory rules of the *lex mercatoria* and to those mandatory rules of the forum or another law closely connected with the issue which are directly applicable or which are rules of public policy.

It is submitted that this solution is the most appropriate. You can provide greater consistency and harmony in adjudication if you let an open system of rules such as the *lex mercatoria* replace national law in its entirety than if you try and shake a cocktail of the rigid rules of national law and the open and more flexible rules of *the lex mercatoria*. Unless the parties have agreed otherwise, the *lex mercatoria* should therefore replace national law.

In international cases it has one great advantage. When the *lex mercatoria* is applied, and those who are involved in the proceedings -parties, counsels and arbitrators- are from different countries, all plead and decide on an equal footing:

98 See Hjejle, *Voldgift*, 1987, 88 and the Supreme Court's decision of 8 March 1956 in Ugeskrift for Retsvæsen 1956, 436.

nobody has the advantage of having the case pleaded and decided by his own law and nobody has the handicap of seeing it governed by a foreign law.

29 May the Lex Mercatoria be applied when it has not been Chosen by the Parties

It is much in dispute whether arbitrators should be permitted to apply the *lex mercatoria* when *the parties have not chosen it*. The French, Italian and Dutch laws allow the arbitrators to do so. English law and the laws which have incorporated the UNCITRAL Model Law seem to permit the arbitrators to apply non-national rules of law only when the parties have chosen them as applicable to the substance of the dispute.[99]

Should then the courts of these countries set aside a domestic award or refuse to enforce a foreign award where in the absence of such a choice by the parties arbitrators have nevertheless applied the *lex mercatoria*?

The UNCITRTAL Model Law on International Commercial Arbitration of 1985 does not permit any review on the merits of a domestic award. A court may not review the rules of law which arbitrators have applied, see arts 34 and 36 . The Model Law and the New York Convention of 1o June 1958 on the Recognition and Enforcement of Foreign Arbitral Awards which in December 1999 had been adopted by 121 countries, and the European Convention of 21 April 1961 on International Commercial Arbitration do not permit any review of the merits of a foreign award either.

If, however a court, applying its municipal law, sets aside a domestic award because it is based on the *lex mercatoria* a foreign court may refuse to enforce it under art V (1) e) of the New York Convention and art.36 (1) (v) of the Model Act. However, between countries which are members of the European Convention of 11 April 196l on International Commercial Arbitration,[100] this ground for setting aside a foreign award is normally excluded, see art IX.(2)of the European Convention

It has been the policy of most modern legislators to establish guarantees for a fair trial by unbiased arbitrators within the framework of the submission, but, unless public policy is involved, not to interfere with the arbitrator's decisions of the substance of the dispute. Most modern arbitration laws provide for a review neither of the conflict of laws rules nor of the substantive rules of law applied by the arbitrators to the merits of the dispute.[101] The only substantive issue the courts will try is whether the arbitrators have violated the public policy (*ordre public)* and the so called 'directly applicable' laws of the forum. The application of the *lex mercatoria* does not in itself violate public policy. In most countries a court cannot

---

99 See supra no 25.

100 In force in Austria, Belgium, Bulgaria, Cuba, Czechoslovakia, Denmark, France, Germany, Hungary, Italy, Poland, Romania, Russia, Spain, Ukraine, Upper Volta, White Russia and the states of the former Yugoslavia.

101 See e.g. *Danish* Arbitration Act 1972 and Hjejle, *Voldgift* 3 ed 1987 88 and 130 *French* Code of Civil Procedre arts 1496 and 1502 *Italian* Code of Civil Procedure art 834 *Netherlands* Arbitration Act (Code of Civil Procedure) 1986 arts 1054 and 1065 *Swedish* Arbitration Act 1929 ss.20 and 21, see *Arbitration in Sweden,* published by the Stockholm Chamber of Commerce 2 ed. 1984 126, and *Swiss* Private International Law Act 1987 art 190.

set aside an award which is claimed to be based on the law but which in stead is based upon the arbitrator's opinion on how the law is or should be. Such awards are more frequent than many arbitrators like to admit.[102]
The awards published do not always disclose the true reasons for the arbitrators' application of the *lex mercatoria* to cases where the parties have not agreed on its application. In some cases the arbitrators have found the solution of the applicable national law to be unsatisfactory. In other cases it may have been impossible or very difficult to ascertain the contents of that law. In such a situation a court would apply the law of the forum. There may be reason to do this when the case has some connection with the forum country. When, however, the case has no or little connection with the forum country it is more appropriate to apply the *lex mercatoria* than the- often incidental- law of the forum.

However, the courts might consider to review a domestic or foreign award where in their contract or in their pleadings the parties have agreed on the application of a *certain national* legal system. If the tribunal then has applied the *lex mercatoria* one could argue for an application of the principle laid down in art 34(1) (a) iii and 36 (1) (a) iii of the UNCITRAL Model Law and V (1) c) of the New York Convention where upon a party's request an award may be set aide or the enforcement of a foreign award refused if the award deals with a difference not contemplated by *or not falling within the terms of the submission to arbitration*. In some of the cases where the courts have upheld an award based on the *lex mercatoria* they argued that the arbitrator had not acted outside of the terms of the submission.[103] One might conclude from these dicta that the award would have been set aside or refused enforcement if in his choice of rules applicable to the merits of the dispute the arbitrator had acted *ultra vires.*

b Lex Mercatoria Before State Courts

30 Drafts and Proposals

Should state courts be permitted (and even encouraged) to apply the *lex mercatoria*?

In favour of permitting the courts to apply the *lex mercatoria* it has been argued that the ancient relics and peculiar institutions of the national legal systems are not fit for application to international contracts. And as was mentioned before, in some

---

102 In 1971 and 1972 the present writer took part in a sociological investigation on how arbitrators in Sweden and Denmark conducted themselves. We sent out questionnaires and had interviews with lawyers and with judges which in Sweden and Denmark could and did act as arbitrators. The answers of the lawyers and judges included how issues on points of law were to be treated. They were published in the report "Arbitration as means of solving conflicts," *New Social Science Monographs* E6, Copenhagen 1973 by Britt Mari Blegvad, P.O. Bolding and Ole Lando in co-operation with Kirsten Gamst Nielsen. I remember interviews with prominent Danish jurists who told me that as arbitrators they always applied the strict rules of law. Later I had the opportunity of seeing how two of these jurists, one of which was a judge and the other a lawyer, handled the merits of references which were to be decided by the rules of law. I discovered that they let their sense of equity and not the rules of law dictate their awards which, in my view, profited from this.

103 E.g. in the *Deutsche Schachtbau- und Tiefbohrgesellschaft* case, supra section 25.

areas such as reinsurance the rules are laid down in international customs and usages which replace national law.

It was the inadequacy of national law when applied to international contracts which persuaded the draftsmen of the *1994 Inter-American Convention on the Law Applicable to International Contracts* (hereinafter *ICA),* to introduce the *lex mercatoria* to be applied by *state courts.*

ICA gives the parties freedom to choose the law applicable to the contract, see art 8. But it does not provide that the parties may choose the *lex mercatoria.* Art 9 (1) provides that in case the parties have not made a choice of law, the contract shall be governed by the law of the State to which it has its closest ties. In art 9 (2), first sentence, it is laid down that "the Court shall take into account all the objective and subjective elements of the contract to determine the law of the State with which it has its closest ties. By "law" the Convention understands " the law current in a State", see art 17. However, art 9 (2), second sentence, provides that the Court "shall also take into account the general principles of international commercial law recognised by international organisations." Art 10 which is to be applied both to cases where the parties have and to cases where they have not chosen the law applicable provides that "in addition to the foregoing articles, the guidelines, customs, and principles of international commercial law as well as commercial usages and practices generally accepted shall apply in order to discharge the requirements of justice and equity in the particular case."[104]

These provisions are a compromise between those delegates who wished to give the *lex mercatoria* a more prominent role and those who wished a national law to govern in all cases[105] It reflects the attitude of those who wish the *lex mercatoria* to operate as a supplement and corrective to national law, see supra at section 27.

The Convention has, as far as is known not yet entered into force.

It is the general opinion that under the Rome Convention on the Law Applicable to Contractual Obligations the courts must apply national law even though the parties should have chosen the *lex mercatoria*.[106]

The Dutch professor *Katharina Boele-Woelki* has proposed that in a future amendment to art 3 (l) of the Rome Convention it should be provided that the parties be permitted to choose the *Unidroit Principles of International Commercial Contracts* or *the Principles of European Contract Law* as the rules of law governing the contract.[107]

Professor *Boele-Woelki* seems to be of the opinion that the parties should be permitted to combine their choice of the Principles with the choice of other

---

104 *Organisation of American States' Fifth Inter-American Specialized Conference on Private International Law:* Inter American Convention on The Law Applicable to International Contracts (done at Mexico City March 17, 1944)" see *International Legal Materials* Vol XXXIII 1994 p 732.

105 See Juenger in 42 American Journal of Comparative Law. (1994) 381 , 391.

106 Lagarde says in *Revue.critique de droit international privé,* 1991 p 300: "La Convention de Rome s' est placé dans la perspective d'un choix par les parties d'une loi étatiquet."

107 See K. Boele-Woelki, *Principles en IPR* , Utrecht 1995. (ISBN 90-5458-287-l) and *Principles and Private International Law,* in Uniform Law Review 1996 652 ff.

elements of *the lex mercatoria* to govern those issues in contract which are not covered by the Principles.[108]

This would mean that parties to an international commercial contract would have their contract governed by the Principles, be it the UNIDROIT Principles or the PECL, by the usages and practices of international trade, by the common core of the legal systems or of those systems to which the contract is connected and by other sources which make out the *lex mercatoria*.[109]

31 Should State Courts Apply the Lex Mercatoria?

Many of the arguments in favour of applying the *lex mercatoria* to international arbitration may also apply to the court's adjudication of international disputes.

Although the *lex mercatoria* is more ample and full bodied now than before it still has *lacunae*, and some gap filling will be left to the creative mind of the judge who applies such a system. Parties who have their dispute governed by a national law must expect more rigidity but will often have the benefit of greater predictability. Parties who choose the *lex mercatoria* must be prepared to have a more open and flexible system govern their dispute. The judge who applies the *lex mercatoria* will act as a social engineer more than the judge who applies national law.

However, national law also has white spots, and it has rules which the courts do not find appropriate for the situation at hand. Judges sometimes find it necessary to substitute the rules of law by their concept of what they believe to be expedient, fair and just. In fact many judges are sometimes very inventive.[110] If by the law of a country one understands what the courts do in fact the national legal system is more pluralistic than many lawyers would like to think. Applying the *lex mercatoria* is not something to which most judges will be unaccustomed.

---

108 Op cit, previous note Uniform Law Review, p 664 f.

109 In a decision of 11 July 1991, reported in *Journal de Droit International (Clunet)* 1991 330 the Commercial Court of Nantes in France applied the general principles of law, usages of international trade, and the *lex mercatoria* to a contract between a Saudi Arabian agent and a French principal. The agent had been successful in procuring the desired contract for the principal in South Arabia. The defendant principal had only paid the plaintiff agent a minor part of the agreed commission of 7 % of the contract price. The court awarded the agent the remainder of the commission. In doing so it invoked the *pacta sunt servanda* principle and the *lex mercatoria*. Under the Rome Convention the contract would probably have been governed by the law of Saudi Arabia. It may have been difficult for the parties and the court to procure reliable information on the Saudi Arabian law of agency. The court did not find it appropriate to apply French law either. To support its selection of the *lex mercatoria* the court made reference to the article by Lord Munstill in the *Liber Amicorum for Lord Wilberforce*, Bos and Brownlie (eds.) Oxford 1987 149-182. In that article Lord Munstill had brought forward the arguments in favour of the *lex mercatoria* but had not expressed any support for it. Lord Munstill had obviously presented the arguments which did not convince himself so well that the judges in the French court found them more persuasive than Lord Munstill's own opinion. The court's decision was in line with the opinions of notable French writers who with ardour had advocated the application of the *lex mercatoria*, see B. Goldmann, *The New Lex Mercatoria*, in J. Lew (ed.), Contemporary Problems in International Arbitration (1986) 113 and P. Fouchard, *L' Artbitrage Commercial International*, Paris 1965 401 ff.

110 See on the Dutch BW art 6:2 infra at no 41.

And state courts have accepted that arbitrators apply a non- national legal system. Why should the courts not be permitted to do so themselves? The experienced judges of those courts which frequently deal with international commercial cases are at least as well suited to apply the *lex mercatoria* as are the arbitrators. It seems therefore that state courts should be allowed to apply the *lex mercatoria* to replace national law, and that they should be able to do in the same situations as arbitrators do. Even if the *lex mercatoria* will replace the national law as the law governing the contract both courts and arbitrators must observe the public policy of the forum country and in some cases also the directly applicable rules of another country closely connected with the contract.

Also when the courts do not consider themselves authorised to let the *lex mercatoria* replace national law or if they consider the *lex mercatoria* to be too diffuse and reject it on that ground, they will probably have to give effect to the parties' choice of the UNIDROIT Principles or the PECL as an *incorporation* , see *supra* section 27. The contract will then be governed by a national legal system. The Principles will apply to the extent that their rules do not violate mandatory rules of that system.

IV Salient Features of the Principles of European Contract Law

32 Plan

In the following we will deal with some principles which have been included in the PECL.[111]

It is a universal principle that a party must keep his contract, but it is controversial whether he shall also keep a promise which has not been made in writing, which is not supported by consideration and which has no *cause*. May a party revoke his offer to make a contract before it has been accepted? May a third party require performance of a contractual obligation when his right to do so has been agreed upon between the parties? May a party who did not get the performance which was stipulated in the contract claim that very performance, or must he contend himself with damages. These issues are dealt with below in sections 33-37.

Another problem is whether a party may be released from his obligations under the contract, either because the other party has not performed his obligations or because his own obligations have become excessively onerous. These issues are dealt with below in sections 38-40.

Finally, one may ask whether the parties' contractual behaviour is subject to constraints. Are they under a duty to act in accordance with good faith and fair dealing when they make, perform or seek enforcement of a contract? May contracts or contract terms be so onerous or unfair for a party that he should not be bound by

111 See Klaus Per Berger, *The Creeping Codification of the Lex Mercatoria*, The Hague, Boston, London 1999, 278ff. Klaus Peter Berger has made up a list of those principles and rules which the legal systems and the international business community accept as applied or which have been suggested. Berger's list contains 78 principles, rules and institutions most of which are related to contracts. They are based on the laws, the conventions, the UNIDROIT Principles, the PECL, writings and arbitral awards.

the contract or by the unfair terms? These problems are dealt with in sections 41 and 42.

A Principles which Enforce a Party's Promise

33 Is a One-sided Promise Binding? Are you Bound by an Offer?

A party to a contract must be able to act in reliance of it. It is therefore a basic principle in all countries that you shall keep your contract. The laws stick to this principle with vigour. The binding character of the contract is expressly provided in the UNIDROIT Principles art 1.3: A contract validly entered into is binding on the parties.[112] The duty to keep the contract is implied in art 1:102 of the PECL which proclaims the freedom of contract, and in other articles, such as art 6:111 on change of circumstances which provides that a party is bound to fulfil his obligations even if performance becomes more onerous, see section 40 below.

The laws seem to agree that an agreement only becomes a binding contract if the parties have intended to become *legally* bound. Even when it has been accepted a dinner invitation is morally but not legally binding. Further, the parties must have agreed on terms which are *sufficiently definite*. This also seems to be a common core of the laws and is provided in PECL article 2:101.

a Form, Consideration and Cause

Is a party bound by an informal promise, is he bound by a promise which has no *cause* and which is unsupported by consideration? Several of the Romanist legal systems require writing as a condition for the enforceability of contracts and request that the contract must have a *cause*.

CISG art 11 has provided that a contract of sale need not to be concluded or evidenced in writing and is not subject to any other requirements as to form. The same rule applies to most contracts in the UK, Germany and in the Nordic countries, and has also been provided in the PECL art 2:101 and the UNIDROIT Principles art 1.2. PECL art 2:lol (l) provides that the contract is concluded if the parties intended to be legally bound, and have reached a sufficient agreement *without any further requirement.*

It is not possible to give a universally accepted description of what *cause* is. In his report for the PECL on French law *Denis Tallon* points out that according to the majority of French authors and courts *cause* has two aspects: one which is "objective and abstract" and one which is "subjective and concrete". Under the first the *cause* must exist and may not be erroneous. Thus, a promise to pay a debt already paid has a false *cause*. Under the second aspect the *cause* must be legal. Therefore, the sale of an object intended to be used for committing a crime is void.[113]

---

112 See also Berger, (op. cit. previous note) 279.

113 See Lando & Beale (eds) *Principles of European Contract Law*, Part I & II, 1999 (PECL I & II) 141, and Terré, Simler and Lequette, *Droit civil, Les obligations*, 6.ed. 1996 no. 312 ff., and for Belgium, t'Kint in *Les Obligations Contractuelles*, 1984, 138.

In German and Nordic law *cause* is not a requirement for the validity of a contractual obligation, and it has been generally agreed that there is no need for it. Also the draftsmen of the PECL and the UNIDROIT Principles were of the opinion that you could do without it, see art 2:101 and UNIDROIT Principles art 3.2. The words in PECL "*without any further requirement"* also dispense with *cause*.

These words are also meant to cover consideration.

In England and Ireland a promise by one party which is not supported by consideration is generally not binding. The doctrine of consideration is complex and unclear, but its essence seems to be that a promise, even if seriously meant and accepted by the promisee, will not be binding unless the promisee gives or does something ('unilateral' contract), or promises to give or do something ('bilateral' contract) in exchange for the promise. Thus a 'gratuitous promise' for which there was no exchange is not binding.[114] Equally, a promise made in respect of an act which has already been performed (e.g. a promise to someone who has just rescued the promisor) is not binding, since the rescue was not exchanged for the promise,[115] and past consideration is no consideration.

The English courts, however, have had problems with the doctrine of consideration especially where a promise is made in a business relationship. They have tempered the doctrine by invoking commercial usages and estoppel and by "inventing consideration" to avoid some of the inconveniences which the doctrine creates.[116]

The Commission of European Contract Law found that in business there are promises, such as promises to pay for work or services already done, which should be enforced though they lack consideration. The same applies to promises to make a gift or donation. A wealthy industrialist who in public announces that he will pay l million Euro into a fund for the benefit of wives and children of soldiers killed when doing service in the peace keeping forces in Ex-Yugoslavia, should be held by his promise.

For these reasons the Commission decided to follow the continental rule which does not require consideration, see on PECL art 2:101 (1) above. Art 3.2 of the UNIDROIT Principles has the same rule.

34 b Is an Offer Revocable Before it has been Accepted?

In German law an offer is binding when it reaches the offeree, in Nordic law when it comes to his knowledge. Unless the offer itself indicates that it is revocable it cannot then be revoked. However, most laws of the Union will allow a party to revoke his offer before it has been accepted. This also is the rule in CISG art 16,

---

114 See e.g. *Re Hudson* (1885) 54 LJ Ch 811.

115 See *Re McArdle* [1951] Ch 669, C.A.

116 See on letters of credit and on-demand guarantees Goode, *Commercial Law*, 2d. ed. (1995) 986f . The validity of these abstract payment undertakings is claimed to be based on commercial usages. However, it is generally held that parties cannot agree to dispense with the requirement of consideration. Usages are based on the parties' conduct. How can then a commercial usage permit parties to do something which the law will not permit them to do? For a civil lawyer this seems to be strange. On "invented consideration" see Treitel, *Law of Contract*, 9.ed 1995, 67ff.

and in the UNIDROIT Principles art 2.4, and the Commission on European Contract law decided to follow suit, see PECL art 2:202.

But there are exceptions. Offers which indicate that they are irrevocable, and offers which state a fixed time for their acceptance will create an expectation in the offeree that they will not be revoked. This expectation is to be protected. And if in other cases it is reasonable for the offeree to rely on the offer as being irrevocable, and if the offeree has acted in reliance on the offer, it should not be revocable either. If, for instance, a contractor gets a sub-contractor to submit an offer which the contractor then uses in his bid for a construction contract, the sub-contractor should not be permitted to revoke his offer.

CISG art 16 and the UNIDROIT Principles art 2.4 are drafted in accordance with these considerations.

PECL art 2:2o2 follows CISG art l6 and the UNIDROIT Principles art 2.4, however with one important modification. Art l6 (2) (a) of CISG and UNIDROIT art 2.4 (2) a) provide that an offer cannot be revoked if it indicates *, whether by stating a fixed time for its acceptance or otherwise,* that it is irrevocable. A reader of this provision could believe that the fixing of a time for the acceptance of an offer would always make it irrevocable, but that is not certain. On this issue there was disagreement between the delegates who drafted art l6 of CISG in Vienna. The common law delegates would not accept that the fixing of a time for acceptance should make the offer automatically irrevocable. The civil law delegates would. The outcome of the debate, although not very clear, seems to have been that whether the offer is irrevocable or not depends upon the intention of the offeror as it was reasonably understood by the offeree, see CISG art 8.

The rule may cause uncertainty, and it has not been adopted by the Commission on European Contract Law. PECL art 2:102(3) provides that a revocation of an offer is ineffective if the offer stated a fixed time for its acceptance.[117]

35 c Stipulation in Favour of Third Parties

There may be several reasons for making such stipulations. One is that a party who wishes to furnish support or in other ways give a third party the benefit of a performance may do it by making the other party promise him to perform to the third party; another reason may be that the party owes something to the third party and wishes to discharge that obligation by having the other party perform. He thereby avoids an additional transaction. If this way of performing an obligation was not possible, the other party would first have to perform to the party who would then perform to the beneficiary. Or the party, having obtained a promise from the other party to perform the obligation to himself, would have to assign the claim to the third party beneficiary.

In the civil law countries stipulations in favour of a third party are valid and enforceable. In England the doctrines of privity of contract and of consideration has

117 See on art l6 (1) a) and its genesis, Honnold (ed.*), Documentary History of the Uniform Law for International Sales,* Deventer 1989 pp 280f, 307, 374f, 499ff. Farnsworth in Bianca & Bonell (eds.), *Commentary on the International Sales Law*, Milano 1987, *Schlechtriem in von Caemmerer & Schlechtriem, Kommentar zum Einheitlichen Kaufrecht*, 2.ed.. München 1995 p 154f , Honnold, *Uniform Law for international Sales*, 2.ed. Deventer, 199l no l4l ff.

hitherto prevented such stipulations. This created obstacles for a person who wishes to confer an enforceable right upon a third party. In order to do so it was necessary for him to make the other party who is to effect performance execute a deed in the third party's favour, or for himself as promisee to make a declaration in trust in the third party's favour, or - provided that the third party was furnishing some consideration - for the promisee to act as an agent of the third party. However statute had created exceptions to the doctrine of privity, for instance in the field of insurance, and in 1999 it was abolished by the Contracts (Right of Third Parties) Act.[118] As in the civil law system a person who is not a party to the contract may in his own right enforce a term in a contract which expressly provides that he may, or which puroports to confer a benefit to him; whether this is the case depends upon a construction of the contract.

PECL art 6:110(1) provides that a third party may require performance of a contractual obligation when his right to do so has been expressly agreed upon between the promisor and the promisee, or when such agreement may be inferred from the purpose of the contract or the circumstances of the case.[119]

The rule does not cover cases where the person who receives the promise acts as agent of the third person, since in that case the third person is in fact the promisee. The rule does not apply either when the promisee acts as a trustee for the beneficiary or where, even though the promisor did not intend to give the third party any right under the contract, the law extends his obligation *vis-à- vis* the promisee to cover other persons as well. Under the laws of some countries the seller's warranty of goods sold to the buyer extends to members of the buyer's household. If a breach of warranty causes personal injury to them, they have a direct claim in contract against the seller.

The third party only obtains a claim when the promisee intended to confer a right to him. This is most often not the case where the promisor has undertaken to pay the promisee's debt to the third person. If the promisee has not notified the beneficiary of his right, the latter cannot claim performance. If, for instance, the buyer B has promised the seller S that B will pay the purchase price to T who will finance S's acquisition of the goods, T cannot claim the purchase price, if S has not notified T about the agreement. B and S may later agree that payment shall be made to S.

However, the beneficiary can claim performance from the promisor if this was intended by the parties, and he has been informed about the agreement. If, for instance, F opens a bank account in his own name to which he regularly pays a monthly sum, and if he makes the bank undertake to pay this sum to his son S on S's demand S who has got notice from the bank may at any time draw what there is on the account.

The rule applies even though the beneficiary is not known when the promise is made. An insurance company may promise the policy-holder to pay the insurance proceeds to any future owner of the goods insured. A bank may promise a customer to pay the purchase price to any seller who delivers a certain piece of equipment to the customer.

---

118 1999 Chapter 31.

119 See PECL I & II 317 ff.

It goes without saying that the promisee himself may require performance to the beneficiary and that he may do so also in cases where the beneficiary himself may claim performance.

If the third party renounces the right to performance the right is treated as never having accrued to him, see art 6:110 (2).

Even if under art 6:110 (l) the beneficiary has acquired a right to claim performance, the promisor and the promisee may nevertheless agree that his right is to be modified or revoked. If the father who has transferred 8oo Euro to the account which he has opened in his son S's favour gives the bank order to withdraw 5oo Euro and transfer them to another account of his, S may only claim the remaining 300 Euro.

However, if the promisee has promised the beneficiary not to revoke his right, the promisee will be bound by his promise. A message from him to the beneficiary that the promisor has undertaken to perform to the beneficiary, or that the beneficiary may now claim the performance, which the promisee owes him, from the promisor, usually amounts to a promise not to revoke or modify the beneficiary's right.

When having learned about the right from one of the parties, the beneficiary accepts or claims his right it cannot any longer be revoked. If a bank has informed a prospective seller of goods that the buyer has instructed the bank to pay him the purchase price, and the seller informs the bank that he accepts to deliver the goods to the buyer, his right to claim the money from the bank upon delivery cannot be revoked. And if in the case of the bank account opened in favour of S the latter has claimed the 800 Euro before the bank received notice from the father of the withdrawal of the 5oo Euro, the father's order of withdrawal is inoperative.

For these reasons it is provided in art 6:110 (3) that by notice to the promisor the promisee may depriv the third party of his right to performance unless:

(a) the third party has received notice from the promisee that the right has been made irrevocable; or

(b) the promisor or the promisee has received notice from the third party that the latter accepts the right.

36 d You shall Render in natura *the Performance you Promised*

Most contracts provide that one party shall make a performance, be it goods, intangibles (a patent or a know-how) or services, and that the other party shall pay a sum of money for the performance he has bought. If a party does not get the performance he is entitled to, can he then enforce that very performance?

Monetary Obligation

Continental laws allow a creditor to require performance of a *contractual obligation to pay money.* Also under the common law an action for an agreed sum of money is often available although it is limited in certain respects and may be brought only

when the price has been "earned" by performance, see the English and Irish Sale of Goods Acts s. 49 (l)[120]

In both systems the creditor can tender his performance to the other party and he can claim the price. This is also the main rule in PECL, see art 9:101 (l).

But should it always apply even though a buyer of goods or services does not want them and is unwilling to receive and pay for them? Here again the main rule is that the buyer must pay for a performance which he does not want. However, experience gained from common law and Scottish cases seem to indicate that there should be exceptions from the main rule. In cases other than sale of goods the rule in the common law and in Scotland now appears to be that if a party repudiates a contract, and if at the date of the repudiation the other party has not yet performed his part of the contract, the latter may complete his performance and claim the price only if he has a legitimate interest in doing so.[121] If he has no legitimate interest in performing he is confined to an action for damages, and his recovery will be subject to his duty to mitigate his loss. The repudiating party has the onus to show that the other party has no legitimate interest in performing.

Most continental systems do not know of restrictions upon a claim for payment of the price, However, in Belgian law, there are situations, for example construction contracts, in which a creditor must allow the contract to be ended and where his only claim is for damages, see Belgian c.c. art 1794. The creditor must also accept the contract to end in other situations where it would be contrary to good faith or an abuse of right to insist on performance.[122]

The predecessor of CISG, the Uniform Law on Contracts for the International Sale of Goods of 1964 (ULIS) provides in art 61(2) that a seller shall not be entitled to require payment of the price by the buyer if it is in conformity with usage and reasonably possible for the seller to resell the goods. In that case the contract shall be regarded as ended and the seller may only claim damages.

CISG however, has not imposed this restriction on the seller's right to perform and claim the price.

The PECL has done so. The underlying consideration is that a debtor should not have to pay for a performance which he does not want in cases where the creditor can easily make a cover transaction, and in other cases where it would be unreasonable to oblige the debtor to pay the price.

Art 9:101(2) therefore provides that where the creditor has not yet performed his obligation and it is clear that the debtor will be unwilling to receive performance, the creditor may nonetheless proceed with his performance and may recover any sum due under the contract unless

(a) he could make a reasonable cover transaction, or
(b) performance would be unreasonable in the circumstances.

---

120 See PECL I & II 391 ff.

121 See Attica, *Sea Carriers Corp.v. Ferrostaal Poseidon Bulk Carrier Reederei GmbH* [1976] l Lloyds' Rep 25o C.A.

122 See Belgian Court of Cassation l6 Jan.1986 *Arr.Cass* No 3l7, *RW* 1987-88.

UNIDROIT Art 7.2 lays down that where a party who is to pay money does not do so, the other party may claim payment, but it does not provide the exceptions in art 9:101(2) of PECL.

37 Non-monetary Obligations

In the common law specific performance of a non-monetary obligation is a discretionary remedy[123] based on equity. However, the discretion exercised by the courts is not an arbitrary discretion but one which is governed by rules. One is that specific performance will only be granted where damages are inadequate. It is most frequently ordered in contracts for the sale of land.

In the civil law countries the aggrieved party's right to specific performance is generally recognised.[124] In German law it is axiomatic that the obligee has a right to bring a claim for performance of the contract and to obtain a judgment ordering the obligor to fulfil it. The right to performance is also emphasised in French law. Art 1184 (2) of the Civil Code provides: *"La partie envers laquelle l'engagement n'a point été exécuté peut forcer l'autre à l'exécution de la convention lorsqu'elle est possible"*

However, the civil law makes exceptions. On the Continent specific performance is not available when performance has become *impossible or unlawful*.In several civil and common law countries specific performance will also be refused if it would be *unreasonable* to grant it, if, for instance, the cost of raising a ship which has sunk after it was sold would considerably exceed the value of the ship. Nor is performance available for contracts which consists *in the provision of services or work of a personal character*, and in several countries a performance which *depends upon a personal relationship* such as an agreement to establish or continue a partnership in which the defaulting partners is to play an active role cannot be enforced.[125] These exceptions show that the difference between the civil and the common law is not significant.

Furthermore, in the civil law countries an aggrieved party will generally pursue an action for specific performance only if he has a particular interest in performance which damages would not satisfy.[126]

> In spite of the many points of resemblance in results the civil and the common lawyers did not agree on common rules when CISG was drafted. Art 46 gave the buyer an unqualified right to require performance, but art 28 provided that if in accordance with the provisions of the Convention one party is entitled to require performance of any obligation by the other party, a court is not bound to enter a judgment for specific performance unless the court would do so under its own law in respect of similar contracts of sale not governed by the Convention. Thus art 28 preserved the common law courts' discretion.
>
> This partition was unnecessary. The civil law countries might have admitted that specific performance should be restricted to the situations for which this remedy is

123 See Treitel, *The Law of Contract*. 9 ed. 1995 9l8 ff .

124 See PECL I & II 399 ff.

125 PECL I & II 399 ff.

126 See Zweigert & Kötz , *An Introduction to Comparative Law*, 3d ed. 1998, 470, 484.

> needed in pratice. The common law countries might have conceded that in these situations specific performance should be a right which the court would have to grant the aggrieved party.[127]

Under PECL art 9:102 (l) the aggrieved party is entitled to specific performance of an obligation other than one to pay money, including the remedying of a defective performance.

Para 2 provides that specific performance cannot be obtained where

(a) performance would be unlawful or impossible; or
(b) performance would cause the obligor unreasonable effort or expense; or
(c) the performance consists in the provision of services or work of a personal character or depends upon a personal relationship; or
(d) the aggrieved party may reasonably obtain performance from another source.[128]

In the Comments it is said that the exception under c) is explained by the consideration that an order to perform personal services or work would be a severe interference with a party's personal freedom. Further, such performance rendered under coercion would often be unsatisfactory, and finally it would be difficult for a court to control the proper enforcement of the order.

The exception under d) is an equivalent of the one provided in art 9:l0l (2) (a) and is explained by the same reasons.

The UNIDROIT Principles art 7.2.2 has the same rules as PECL art 9:102.

The rules on the means, and the procedure of enforcement of a judgment for performance, are left to the national legal system. These rules are different in the civil and the common law countries, and this may render the common law phrase "specific performance", used in art 9:l02, somewhat dubious. Nevertheless it is used for lack of a better, generally understood, term.

B Principles which Release a Party

38 The Other Party's Fundamental Non-performance

a Non-performance and Remedies

In PECL and in the UNIDROIT Principles breach of contract is called *non-performance*. Under the system adopted in both set of Principles there is non-performance when a party does not perform any obligation under the contract.[129] The non-performance may consist of a defective performance or in a failure to perform at the time performance is due, be it a performance made too early, too late or never. It includes a violation of an accessory duty such as the duty not to disclose

127 See Lando in *Bianca-Bonell* (eds), *Commentary on the International Sales Law*, Milano 1987 237.

128 PECL I & II 394 ff.

129 See on non-performance and remedies, PECL I & II 123 f and 359 ff.

the other party's trade secrets. Where a party has a duty to receive or accept the other party's performance a failure to do so will also constitute non-performance.

The *remedies* available for non-performance depend upon whether the non-performance is not excused, is excused or results from the other party's behaviour, see PECL art 8:101.

A non-performance which is not excused may give the aggrieved party the right to claim performance, see *supra* section 37, to claim damages, to withhold his own performance, to reduce his own performance or to terminate the contract.

A non-performance which is excused does not give the aggrieved party the right to claim damages or performance. However, the other remedies mentioned above may be available for him. A non-performance is excused if the defaulting party proves that it is due to an impediment beyond his control and that he could not reasonably have been expected to take it into account at the time of the conclusion of the contract, or to have avoided or overcome the impediment or its consequences, see PECL art 8:l08 (l) and *infra* section 39 on *vis major*. In England the concept which in function corresponds to *vis major* is a failure to perform which is due to *frustration*. In France the nearest equivalent is *force majeure*.

If the non-performance is caused by the obligee's act - or omission - he may not resort to any of the remedies. He has no remedies against the obligor if he is unable to receive the performance even when this is due to an impediment beyond his control. His failure to receive performance may in itself be a non-performance which may give the other party remedies such as a right to terminate the contract.

The main difference between non-performance in PECL and the UNIDROIT Principles and breach of contract in the common law[130] is that in the common law breach of contract only occurs when the aggrieved party has a right to damages, i.e. in case of a non-excused non-performance, whereas in PECL there is non-performance also in case of an excused non-performance. If before the risk has passed to the buyer the object of the contract has been damaged by a fire caused by lightening the buyer cannot claim damages, but he still has a remedy, namely the right to terminate the contract or to claim a reduction of the price.

b Termination for Fundamental Non-performance

PECL requires fundamental non-performance as a condition for termination of the contract by an aggrieved party, see arts 8:103 and 9.301.

PECL defines fundamental non-performance in Art 8:103. A non-performance is fundamental if

(a) strict compliance with the obligation is of the essence of the contract; or
(b) the non-performance substantially deprives the aggrieved party of what he was entitled to expect under the contract, unless the other party did not foresee and could not reasonably have foreseen the result; or
(c) the non-performance is intentional, and gives the aggrieved party reason to believe that he cannot rely on the other party's future performance.

130 Non-performance appears to be synonymous with the term breach of contract as used in CISG, see in Part III the titles of section III in chapter 2 and of section III in chapter 3 and art 79 (5).

Art 9:301 (l) provides that a party may terminate the contract if the other party's non-performance is fundamental.

Art 8:103 (a) gives effect to an agreement between the parties that strict adherence to the terms of the contract is essential, and that any deviation from the obligation goes to the root of the contract so as to entitle the other party to be discharged from his obligations under the contract. Thus, if in a commercial leasing it is provided that the object leased *has to* be delivered at a certain date when the lessee will come and pick it up, delivery on that day is of essence to the contract, and any delay will constitute a fundamental non-performance. However, the good faith principle in art 1.106 (see *infra* section 41) may come into operation. If the non-performance is so slight that it would be unreasonable for the aggrieved party to terminate the contract he shall not be entitled to do so.

Art 8:103 (b) lays emphasis on the gravity of the consequences of the non-performance for the aggrieved party. It is the importance of the detriment which he suffers that matters. The model is CISG art 25 which defines fundamental breach as a breach which results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract. The case law relating to art 25 and its predecessor, art 10 of ULIS which has a similar text, will be relevant for the interpretation of art 8:103 (b). Art 8:101 (b) is also in accordance with Nordic law.[131]

Art 8:103(c) only applies to an intentional non- performance which gives the aggrieved party reason to believe that he cannot rely on the other party's future performance.

> Like PECL art 9:301 (1) art 7.3.1 (1) of the UNIDROIT Principles provides that a party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance. However, art 7.3-1 (2) adopts a more flexible approach than the PECL in determining whether a failure to perform an obligation amounts to a fundamental non-performance. Regard shall be had to a number of elements most of which are the same as those provided as rules in PECL arts 8:103, a-c and 9:301 (2). Additional elements to consider is whether the non-performance was intentional or reckless, and whether the non-performing party will suffer disproportionate loss as a result of the preparation or performance if the contract is terminated. Other elements may also be taken into consideration.

A party's fundamental non-performance is not the only reason for termination. PECL Art 9:301 (2) provides that in case of a delayed performance by the other party the aggrieved party may terminate the contract after having given notice fixing an additional period of time of reasonable length, and if at the end of that period the other party has not performed his obligations, see art 8:106 (3). In his notice the aggrieved party may provide that if the other party does not perform within the period fixed by the notice the contract shall terminate automatically. The model of this *Nachfrist*- procedure which is also found in art 7.3.1 (3) of the

131 See for Denmark, Møgelvang-Hansen in Dahl and others (ed): *Danish Law in a European Perspective*, Copenhagen 1996, 248, for Sweden, Ramberg & Herre, *Köplagen*, Stockholm 1995 325.

UNIDROIT Principles is CISG arts 49(l) (b) and 64(l) (b), see also arts 47 and 63.[132] It has its origin in German law[133]

The determination of which period of time is reasonable under the Principles regard should, *inter alia*, be had to

- the period of time originally set for performance. Was it short the additional time may also be short
- the need of the aggrieved party for quick performance,
- the nature of the performance. A complicated performance may require longer time that a simple one
- the event that has caused the delay. Was it the negligence of the defaulter or was it *force majeure?*

Termination is to be effected by a declaration of the aggrieved party who does not have to go to court, see on French law *supra* at section 5.

39 Vis Major and Hardship

a Vis Major

In most European countries a party is bound to perform his obligations under the contract even though it has become more onerous for him to do so. An exception from this rule, the *pacta sunt servanda,* is made in case of *vis major* which is used here to denote supervening events which make performance impossible or quasi-impossible. In case of *vis major* the obligor will be excused for his non-performance. Although the rules are not the same in the legal systems[134] most of them show the following main features:

The obligor is relieved from his obligations only if

- performance has become impossible in law or in fact. Most legal systems also accept quasi impossibility where performance, though possible, cannot be requested. Furthermore, it is required that
- the obligor could not reasonably be expected to take the impossibility into account at the time of the conclusion of the contract; and that
- the impossibility occurred outside of the control of the obligor, who is supposed to have control of himself, his employees and his equipment.

In most legal systems *vis major* ends the contract. There is no room for modification of its terms and no duty for the parties to renegotiate the contract with a view to such modification. The *vis major* rule is not mandatory. Parties may agree

---

132 See also ULIS arts 27(2) and 62 (2), on German law Zweigert & Kötz, *An Introduction to Comparative Law*. 3. ed. 1998 chapter 36, p. 492 ff and the Nordic Sale of Goods Act §§ 25 and 54.

133 See Treitel, *Remedies for Breach of Contract*, 1988 § 245ff.

134 See on French law, Zweigert & Kötz , *An Introduction to Comparative Law*, 3ed. 1998, chapters 36 and 37, on English law, *Good*e, Commercial Law 2.ed. 1995, 139 and Treitel, *The Law of Contract*, 9. ed. 1995 778 ff. For a comparative survey of the laws of 8 EC countries see Rodière & Tallon (eds), *Les modifications du contrat au cours de son exécution en raison de circonstances nouvelles*, Paris 1986, see also Treitel, *Frustratioin and Force Majeure,* London 1994.

on stricter conditions, for instance impose an absolute obligation on a party, or on more lenient conditions. This is often done in standard contract terms.

A rule similar to the one mentioned above is provided in CISG art 79[135] in PECL art 8:108[136] and in the UNIDROIT Principles art 7.1.7.

40 b Hardship

In contracts of duration such as co-operation agreements, lasting construction contracts, and contracts for a continuous supply of goods or services unforeseen contingencies may make performance excessively onerous for one party, especially in times of depression or unrest. In these contracts a hardship rule which is more lenient than the *vis major* rule is needed. Clauses providing that a party may be relieved or the terms of the contract modified in case of hardship are inserted in many contract documents, but often the parties forget to provide them, or they do not find them necessary. It has been argued that a party who is then exposed to hardship must bear the consequences. However, the hardship which a party may suffer in these cases is often too hard a penalty for his forgetfulness or improvidence.

Therefore, in addition to rules on *vis major* covering impossibility and quasi-impossibility some legal systems have relieved the obligor when performance, though not impossible, has become excessively onerous, (Italy: *essesivamente onorosa*[137]) or so different that the economic basis on which the contract was made has lapsed, (Germany: *Wegfall der Geschäftsgrundlage*).[138] A hardship rule is found in Dutch law[139] and a similar rule on *imprévision* in French administrative law[140]

CISG has no separate provision on hardship. It has been argued that art 79 dealing with "exemption" stands somewhere between the very tough French rule on *force majeure* governing civil contracts and the more lenient German rule on *Wegfall der Geschäftsgrundlage*,[141] As the rule in art 79 (1) is phrased there is a danger that each court will interpret it in accordance with its domestic rules[142]
As was mentioned above, art 8:108 PECL provides a rule similar to CISC art 79. In addition art 6:111 contains a provision on hardship.[143]

---

135 See on CISG art 79, Tallon in Bianca & Bonell,(eds), *Commentary on the International Sales Law*, Milano 1987, *Honnold*, Uniform Law for international Sales, 2.ed. Deventer, 1991 no 423ff, and Nicolas, *Force Majeure and Frustration* in 27 Am. J. Comp. L. 231(1979).

136 PECL I & II 379 ff.

137 Italian civil code art 1467.

138 See Zweigert & Kötz, *An Introduction to Comparative Law 3* ed. 1998 518 ff.

139 Civil Code of 1992 (NBW) art 6:258.

140 See Nicolas, *The French Law of Contract* 2.ed. 1992 208.

141 See Honnold *Uniform Law for international Sales*, 2.ed. Deventer, 199l p.542 with reference to authors.

142 See Tallon in Bianca & Bonell (eds), *Commentary on the International Sales Law*, Milano 1987 p 594 and Honnold loc. cit. Previous note.

143 PECL I & II 322 ff.

Art. 6:111(1) provides that a party is bound to fulfil his obligations even if performance has become more onerous, whether because the cost of performance has increased or because the value of the performance he receives has diminished. A party cannot get out of a contract merely because it has turned out to be unprofitable

If, however, performance of the contract becomes excessively onerous because of change of circumstances, the parties are bound to enter into negotiations with a view to adapting the contract or ending it provided that

(a) the change of circumstances could not reasonably have been known to the parties;[144] and
(b) the possibility of a change of circumstances was not one which could reasonably have been taken into account at the time of conclusion of the contract; and
(c) the risk of the change of circumstances is not one which, according to the contract, the party affected should be required to bear.

Like the *vis major* rule in art 8:108 art 6:111 is not mandatory. When making their contract the parties may agree on how to distribute the risks.

This hardship rule in art 6:111 (2) differs from the *vis major* rule in the following respects:

l. A party may seek relief if performance has become excessively onerous; it is not required that it has become impossible. Thus, there was hardship when a company which in 1929 had undertaken to deliver water at a fixed price to a hospital in 'times ever after', had to continue to deliver the water after 1978 when the agreed price has become derisory due to inflation[145] There was also hardship when a gas company which in 1908 had promised to deliver gas for a period of 30 years at a fixed tariff, had to continue delivery at that price when in the first world war a severe shortage of coal used to produce gas had increased the price of coal by four times.[146]

2. The contract is not always ended, but may be modified either by the parties renegotiating the contract or by the court.

3. Being the best judges of their situation, the parties must renegotiate the contract in good faith. They may adapt the contract to the new situation, and, if adaptation is pointless, end the contract.

Art 6:111 (3) deals with the situation where the parties do not reach agreement within a reasonable time. The court or the arbitrator may then either end the

144 The former article 2.117 (2) (a), see Lando & Beale *Principles of European Contract Law* Part 1, 1995, 112, has been changed by the Second Commission to exclude cases where the change of circumstance had already occurred at the time the contract was made. These cases are to be governed by the rules on mistake. See PECL I & II 322 ff. and 229 ff.

145 See the English case *Staffordshire Area Health Authority v. South Staffordshire Waterworks Co* [1978] 1 W.L.R. l387 where the Court of Appeal led by Lord Denning through an "interpretation" of the words 'for times ever after',which could not mean what the parties had said, decided to raise the price.

146 See on the *Gaz de Bordeaux* decision of the French *Conseil d'État* of 3o March 19l6 (Sirey 19l6.3.l7) *Nicolas,* The French Law of Contract 2.ed. 1992 208, 209.

contract at a time and on terms determined by the court, or adapt the contract in order to distribute between the parties in a just and equitable manner the losses and gains resulting from the change of circumstances. In either case the court may award damages to a party for the loss he has suffered through the other party's refusal to negotiate or for his breaking off negotiations in bad faith.

The UNIDROIT Principles arts 6.2.1-6.2.3 provide similar rules as PECL art 6:111.

C Principles which Police the Parties' Behaviour

41 Good Faith and Fair Dealing

Immanuel Kant's categorical imperative orders you to act as if by the principle governing your behaviour you were a legislator in a society of reasonable beings obeying common laws.

Should this moral commandment be elevated to a legal duty to act in accordance with good faith and fair dealing?

There is in Europe a considerable difference in the attitude towards good faith as a legal principle. This is most graphically illustrated if one compares German and Dutch law with the common law of England.

§ 242 of the German Civil Code provides that the obligor must perform his duty in accordance with the requirements of good faith and fair dealing having regard to commercial practices. This provision has been called a "king" in the Civil Code. It has been used to provide a moralisation of the entire German law. It has operated as a "super provision" which has modified other statutory provisions, and has been applied to change the rigorous individualism of the original contract law of the Civil Code. It has been used as a device for adapting the law to the changed social and moral attitudes of society. [147]

The principle has operated in many fields of the law; it governs the interpretation of contracts and gives relief to a party in case of changed circumstances, see section 40 above. Based on § 242 the German courts have set aside unfair contract terms, see section 42 below, and have created a number of obligations which ensure a loyal behaviour of the parties, such as a duty to co-operate, to look after the other party's interests, to give information and to submit accounts. The courts have held that a party's right may be limited or lost if enforcing it would amount to an abuse of right, and abuse of right may take many shapes, such as the attempt to acquire a right through dishonest behaviour, to claim a performance which the party will soon have to give back, to rely on a behaviour which is inconsistent with one's earlier conduct, or to act contrary to a principle of proportionality, such as when a party tries to terminate a contract or call a loan because of a trifling breach by the other party.

Dutch law comes close to German law. Art 6:2 of the Civil Code of 1992 provides that good faith shall not only supplement the parties' obligations, but may also modify or extinguish them. A rule which would bind the parties by virtue of

147 See Zweigert & Kötz, *An Introduction to Comparative Law*, 3d. ed. 1998 150ff. and PECL I & II 116 ff.

law, usage or legal act shall not apply if under the circumstances this would be unreasonable by the standards of good faith. Art 6:248 provides a similar rule for contracts.

Art 6:2 is an unusual provision. Since Napoleon the Code has been regarded as infallible. The Dutch Civil Code now permits the courts to derogate from the Code when it would be unreasonable to follow it, something which courts in all the code countries have done now and then, but never admitted that they did. Already before 1992 the Dutch courts had anticipated arts 6:2 and 6:248 and established a case law which in many respects resembles that of the German courts.[148]

Provisions laying down a principle of good faith in contractual relationships are found in the other code countries of the European Union, but it has not pervaded the laws of these countries as it has permeated German and Dutch law. The good faith principle has also been recognised by the courts of the Nordic countries although it has not been expressed in general terms in the statutes.

In contrast, the Common Law of England does not recognise any general obligation to act in accordance with good faith and fair dealing. Thus the English courts have held an obligor to a contractual undertaking even though the obligee did not have any respectable motive to hold him. Thus in *Arcos v. Ronassen* [149]a seller had contracted to sell staves which had to be of a precise dimension. Some of the staves were slightly too short. The buyer could use them for their intended purpose, to make barrels, but there was a falling market, and he wanted to get out of the contract. The House of Lords held that the seller had a duty of strict performance. The reason why the buyer wanted to get out of the contract was irrelevant. Furthermore, English law does not recognise unreasonableness and unfairness as grounds for the invalidity of contract terms.[150] This rigorous approach adopted by English law towards observance of contractual obligations has been explained in the following way:

> "(It).. is our view that in what we like to think -perhaps wrongly- is the world's leading financial centre, the predictability of the legal outcome of a case is more important than absolute justice. It is necessary in a commercial setting that businessmen at least should know where they stand.
> The law may be hard, but foreigners who come to litigate in London … will at least know where they stand. We are worried that if our courts become too ready to disturb contractual transactions then commercial men will not know how to plan their business life..... The last thing that we want to do is to drive business away by vague concepts of fairness which make judicial decisions unpredictable, and if that means that the outcome of disputes is sometimes hard on a party we regard that as an acceptable price to pay in the interest of the great majority of business litigants".[151]

---

148 See The Netherlands Civil Code, Book 6, The Law of Obligations, Draft Text and Commentary, edited by the Netherlands Ministry of Justice 1977 73ff.

149 *Arcos Ltd v E.A. Ronassen & Son* [1933] A.C. 270. It is not clear whether the rule in this case has, as far as the sale and supply of goods is concerned, been changed by the Sale and Supply of Goods Act 1994 (ch 35) section 4, see *Chitty on Contracts*, 28 ed. 1999, vol II 43-049, 43-055. 43-012, and 43-257.

150 See Treitel, *The Law of Contract*, 9 ed. 1995, 226 and Chitty (previous note) vol I 1-109 and 15-001.

151 Roy Goode, *The Concept of "Good Faith" in English Law* (Centro di studi e ricerce di diritto

However, many of the results which in the Continental systems are achieved by requiring good faith have been reached in English law by more specific rules, and these rules are becoming more and more numerous Thus the courts have imposed a strict moral code in the fiduciary relationships; and good faith is required in contracts which are characterised as *uberrimae fidei*. Furthermore, the courts have on occasion limited the right of a party who is the victim of a slight breach of contract to terminate the contract on that ground, when the real motive was to escape a bad bargain.[152] And the victim of a wrongful repudiation of a contract is not permitted to ignore the repudiation, complete the his own performance and claim the contract price unless the victim has a legitimate interest in doing so.[153] On this point English law represents an advance on many Continental laws, see *supra* section 36 on PECL art 9:101. There are several examples of the courts having interpreted the terms of a contract in such a way as to prevent a party from using a clause in circumstances in which it was not intended to be used.[154] Finally, the a duty of good faith is also required if the court is asked to grant equitable remedies.

In PECL art 1:201 it is provided that each party must act in accordance with good faith and fair dealing. The rule is similar to UNIDROIT Principles art 1.7.[155]

Practical applications of this rule appear in several provisions of the PECL, see for instance *supra* section 33 (an offer is irrevocable if the offeree acted in reliance of the offer), 37 (specific performance is denied if performance would cause the obligor unreasonable effort and expense), and 40 (a party's duty to perform his obligation may be modified or he may be released when his obligations have become excessively onerous). The concept is, however, broader than any of these specific applications. Its purpose is to enforce community standards of decency, fairness and reasonableness in commercial transactions. It supplements the provisions of the Principles and it may take precedence over other of the Principles when a strict adherence to them would lead to a manifestly unjust result. Thus, even if strict compliance with the obligation is of essence of the contract under art 3.l03 (a), a party would not be permitted to terminate because of a trivial breach of the obligation, see *supra* at section 38.

"Good faith" means honesty and fairness in mind. It is contrary to good faith to exercise a remedy if to do so is of no benefit to the aggrieved party and he only does it in order to harm the other party. "Fair dealing" means observance of fairness

---

comparato e staniero, diretto da M.J. Bonell, Saggi Conferenze e Seminari 2.) Roma 1992. See also *Chitty on Contracts*, 28 ed. 1999, 1-019. However, professor Goode himself does not appear to identify himself with this view, see Roy Goode, *Commercial Law* 2 ed 1997) at pp 117-118.

152 See *Hong Kong Fir Shipping Co Ltd v. Kawasaki Kisen Kaisha Ltd* [1962] 2 Q.B.26 (C.A.)The rule in *Arcos v. Ronassen* may have been changed in 1994 by the Sale and Supply of Goods Act 1994 (ch 35) section 4.

153 See *Attica Sea Carriers Corp v.Ferrostaal Poseidon Reederi GmbH* [1976] l. Lloyds' Rep. 250 (C.A.).

154 See Treitel, *The Law of Contract* 9 ed 1995 202f.

155 See PECL I & II 113 ff. Art 7.1 (1) of the UNIDROIT Principles provides that each party must act in accordance with good faith and fair dealing *in internationlal trade*. As the PECL are not to apply exclusively to international contracts they do not provide the words in italics.

in fact which is an objective test. It covers, for instance, the duty to show due regard for the interests of the other party.

Good faith is to be presumed. The party who alleges that the other party has failed to observe good faith and fair dealing has to convince the court.

Art 1:201 will sometimes lead to a conflict between law and equity.The law or a contract term which is normally valid may sometimes lead to an inequitable result. Always to give equity the upper hand may result in an undirected case law. However, it is not possible to give general guidelines as to when the court should let the law prevail. That will depend, *inter alia*, upon to what extent certainty and predictability in contractual relationships would suffer by letting good faith prevail. Thus, strict compliance with the terms of a contract may be of essence when the obligor knows that those of the obligee's employees who are entrusted with the control of the obligor's performance are able to see whether there is strict compliance or not, but unable to judge the gravity of a non-compliance.

Art 1:201 (2) provides that the rule in para 1 is mandatory. The parties may not exclude or limit their duty to act in accordance with good faith and fair dealing. However, some of the other articles which are applications of the principle of good faith and fair dealing may allow the parties to agree on the terms of their contract. Thus, when making the contract the parties may agree who shall bear the risk of certain contingencies, and they will not then be covered by the hardship rule in art. 6:111. Such an agreement is, however, subject to the rules on validity in art 4:l09 dealing with a party taking excessive or grossly unfair advantage of the other party's weak position and in art 4:110 on unfair contract terms, see section 42 below.

42 Unfair Contract Terms

The modern mass production of standardised goods and services has brought about standard contracts. Standardised terms of contract make individual negotiation unnecessary and bring down the transaction costs. They are often more suitable for the contract than the implied terms which the law provides. But standard terms tend to be one-sided; one party (hereinafter *the stipulator*), which is often the seller of goods or services, will impose his terms upon the other party, *(the adhering party*), and let the adhering party carry as many as possible of the risks involved in the transaction. The contract provides, for example, that the stipulator is not bound by promises and statements which he or his agents have made during contract negotiation, unless these statements have been put down in writing and signed by the stipulator. Or it provides that between the conclusion of the contract and delivery the stipulator may raise the price of his performance, or that the adhering party remains bound by the contract, while the stipulator may postpone performance beyond the agreed time, change his performance or cancel it. There are exemption clauses which in case of the stipulator's non-performance exclude his liability or exclude or limit the adhering party's right to terminate the contract, and clauses which in case of the adhering party's non-performance impose severe penalties upon him.

The consumer is the typical weak party; he or she is often not able to understand the written standard terms. For this reason, or because he is careless, he does not

read them, and if he reads them, he does not object. He believes that the stipulator will stand by his promise, make a good and conforming tender in time, and that he himself will also perform the contract as he should. Even if he might wish to have the terms changed in his favour, he cannot. The stipulator will not permit it. If he then goes to another supplier he will get similar terms.

For this reason many of the modern laws give special protection to the weak party to a standard form contract. In this respect the Germans have led the way. Invoking § 242 of the Civil Code the German courts began in the nineteen fifties to hold unenforceable contract clauses which were unfair. This happened both in consumer contracts and in business transactions. In 1976 standard terms were regulated in the General Conditions of Business Act which in many respects consolidated the earlier case law. § 9 of the Act provides that general conditions of business are unenforceable when contrary to the requirement of good faith they cause an unreasonable detriment to the adhering party. § 11 establishes a catalogue of terms which are to be regarded as invalid *per se* (a black list), and § l0 another catalogue of terms which the court *may* set aside if they cause an unreasonable detriment to the consumer (a grey list). Unlike the general clause in § 9 the two lists are only directly applicable to consumer contracts. However, under § 9 the courts may also set aside terms listed in the catalogues in §§ 10 and 11 in business contracts, and this has been done to a considerable extent.[156]

The EC Directive on Unfair Terms in Consumer Contracts[157] provides in art 3(1) that a contractual term which has not been individually negotiated shall be regarded as unfair- and therefore not binding- on the consumer, if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer, see art 6 (l). In an annex the Directive has supplied an indicative (i.e. grey) and non-exclusive list of 17 terms which may be regarded as unfair, see art 3 (3).

Art 4 (1) provides that the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.

Under art 4 (2) assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other hand, in so far as these terms are in a plain and intelligible language.

A consumer is defined in art 2 (b) as "any natural person who in contracts covered by this Directive, is acting for purposes which are outside his trade, business or profession.". She or he is the one who buys goods and services for her own and her household's needs. Contracts between private persons and contracts between business enterprises and charities and other non business organisations fall outside of the scope of the Directive. Nor are contracts between big and powerful

156 See Palandt, *Bürgerliches Gesetzbuch*, 55 ed. München 1996, AGBG §9 note 32,and notes to §§ 10 and 11.

157 93/l3/ of 5 April 1993, OJEC No L 95/29.

enterprises and the small and medium sized traders, artisans, farmers and fishermen (*weak party contracts)* covered by the Directive, although their bargaining skill and their position *vis-à-vis* the enterprise is not very different from that of the consumer. The existing European laws vary considerably in this respect[158]

Under art 3 (2) of the Directive a term shall always be regarded as not individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract. As is seen, a standard term which in fact was negotiated between the parties, although the consumer lost the battle, is outside of the scope of the Directive, whereas a term which the seller or supplier drafted in advance for this particular consumer only, and which was not negotiated, falls within the scope of the Directive.

The Directive is a so-called "minimum-directive". A Member State is permitted to provide a better protection for the consumer than that given by the Directive.

In the chapter on validity of contracts and contract clauses PECL art 4:110 provides the rules on unfair contract terms.[159] They follow in several respects the Directive. Art 4:110 provides in paragraph 1 that a party may avoid a term which has not been individually negotiated if, contrary to the requirements of good faith and fair dealing, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of that party, taking into account the nature of the performance to be made under the contract, all other terms of the contract and the circumstances at the time the contract was concluded.

The Comment to art 4:110 sets out the grey list provided in the Annex of the Directive.

PECL art 4:110 is not limited to contracts between the enterprise and the consumer. It covers any not individually negotiated contract term. Terms in contracts made between private persons, and in weak party contracts between an enterprise and a small business man, such as a farmer, fisherman, artisan etc., may also be set aside. Even the powerful enterprise is protected. Experience shows that such a party may also inadvertently subject himself to unfair terms.

Art 4:110 is mandatory; a party cannot waive its application when the contract is being made. However, the party who is disadvantaged must take the initiative to have the clause set aside or modified.

As art 4 (2) of the Directive art 4:110 does not permit a court or an arbitrator to assess whether the main subject matter defined in the contract or the price is unfair. However the rules on "procedural" unfairness may be applied to protect a disadvantaged party, notably the rules on mistake, misrepresentation, fraud and excessive or grossly unfair advantage.[160] As the case law of several countries shows, the courts tend to assume a "procedural" unfairness, if there was an inequality of bargaining power, and there is a gross disparity between value and price.

---

158 See Hondius, *Unfair Terms in Consumer Contracts*, Utrecht 1987 (Molengraaf Instituut voor Privatrecht) and the survey on "Freedom of Contract and its Limits" in the 3d edition of Zweigert & Kötz *An Introduction to Comparative Law*, Oxford 1998 Chapter 24.

159 PECL I & II 266 ff.

160 See PECL arts 4:103, 4:106, 4:107 and 4:109.

The individually negotiated contract or contract term which proves to be unfair is not covered by art 4:110, but by the rules on "procedural" unfairness mentioned above. If these rules cannot help the disadvantaged party, and there is a case of gross unfairness the general clause on good faith and fair dealing in art 1:201 may be applied to set aside an unfair contract or contract term.

V Year 2020

43 The European Civil Code and the lex mercatoria

The reader of this paper may regard some of the proposals made as fantasies. However, in the field of European integration some fantasies have become realities. Before the Second World War there were people who talked wild of establishing a European Union. They formed small clubs and met in inexpensive cafés. Their shining eyes rediatted idealism, but their faces also betrayed that they were regarded as dreamers and not taken seriously by sensible people. It took the war to produce sensible people who established a common market which eventually became a European Union.

In the year 2020 there may not yet be a European Civil Code covering the entire law of contract, torts, restitution and moveable property. If the European Union prefers a piecemeal unification of the civil law there may be a European Code of Contract, and the other parts of the Civil Code will then be enacted later.

The application by arbitrators of the *lex mercatoria* as a legal system for international commercial disputes is in the process of being recognised by legislators, courts and writers. In the year 2020 its application it will not be questioned any longer. Although some writers have spoken in favour of it its application by state courts is not likely to happen by that time. However, the more the volume of the *lex mercatoria* increases, the more desirable and therefor perhaps therefore also more likely it will be that the courts will apply it to international commercial disputes.

But what will happen in Europe to the *lex mercatoria* when a European Civil Code has established a common core of the legal systems?

The need of a *lex mercatoria* will not be the same as before when the commercial law has become uniform. However, in some areas there may be or emerge international usage and other elements of the *lex mercatoria* which will replace the rules of the Code or which are not provided there. Furthermore, and this may sound heretic, some time after its coming into force the Code may on some points be outdated. The writers will realise that, and audacious courts may eventually do the same. In these cases the *lex mercatoria* will be invoked to supplement or correct the Code.

Finally, in contracts between European and non-European parties the *lex mercatoria* may govern the contract. In these cases it will replace the European Code.