

**“The UNIDROIT Principles of International Commercial Contracts:
Present State and Prospects for the Future”**

by

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“The UNIDROIT Principles of International Commercial Contracts:
What Do They Mean for Australia?”

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1. It is a great honour and pleasure for me to be here and take the floor at this important seminar. Within the next half hour or so I shall first provide a general overview of what the UNIDROIT Principles are and what they have achieved so far in practice. I shall then offer you some suggestions and ideas as to how to promote the Principles from their present status as a mere soft law instrument. In so doing I strongly hope that there will be sufficient time left for discussion, thus enabling you to raise questions and comments on issues relating to the UNIDROIT Principles.

2. The UNIDROIT Principles of International Commercial Contracts – now available in their second enlarged edition of 2004 while a third edition is under preparation – are a non-legislative codification – or if you prefer, a “restatement” - of the law of international commercial contracts in general.

They are the product of a group of independent experts from all the major legal systems and geo-political areas of the world – from Australia first Patrick Brazil and then Justice Finn who is with us today.

Apart from their wider scope – they cover virtually all the areas of general contract law: from contract formation, interpretation, validity, content, performance, non-performance and remedies to third party rights, agency, assignment and limitation periods – the only difference with respect to other internationally widely used soft law instruments, such as the INCOTERMS or the UCPs issued by the International Chamber of Commerce, is that they have been prepared under the aegis of an intergovernmental organisation such as UNIDROIT.

I think it is fair to say that in practice the reception of the Principles – emphatically welcomed by an eminent American scholar as “a significant step towards the globalisation of legal thinking” – has gone far beyond the initial expectations.

They have been taken by a number of national legislatures as a source of inspiration for the reform of their domestic contract laws.

Moreover, also in view of the fact that the Principles are available in virtually all the principal languages of the world, they are more and more frequently used by parties in negotiating and drafting cross border contracts.

Finally, and most importantly, not only arbitrators but also domestic courts increasingly refer in their decisions to the UNIDROIT Principles. In a number of decisions – all arbitral awards – they have been applied as the rules of law governing the substance of the dispute. In other decisions – by both domestic courts and arbitral tribunals – they have been used to interpret international uniform law instruments, in particular CISG. In still other decisions they have been invoked in support of a particular solution adopted under the applicable domestic law or in order to fill gaps in the latter.

3. All is well then? Not necessarily.

First and foremost, there can be no doubt that much remains to be done to make the Principles even better known to potential users world-wide.

We in Rome are doing our best – let me just mention UNILEX, a database on international case law and bibliography concerning the UNIDROIT Principles freely accessible on the Internet at <http://www.unilex.info> and which at present contains some 165 decisions from all over the world referring in one way or another to the UNIDROIT Principles. By the way, the total number of decisions of this kind is in fact much higher, but as you know most arbitral awards for not always compelling reasons remain confidential.

Yet obviously the Principles have to be promoted also in other parts of the world – and in this respect seminars such as our meeting today, bringing together both academics and practitioners, are certainly of utmost importance.

Equally beneficial are other initiatives such as – to remain in this region of the globe – the empirical evaluation of the utility of the UNIDROIT Principles as compared to other models of contract law recently undertaken by Professors Ellinghaus and Wright with the involvement of 1800 Australian university students, or the Annual

Intercollegiate Negotiation Competition, sponsored by the Japan Arbitration Association and White & Case Law Office, in which students from Japanese and Australian Universities are invited to solve a hypothetical dispute on the basis of the UNIDROIT Principles.

Finally, a particularly significant recognition of the importance of the Principles is their formal endorsement by UNCITRAL, as happened last year. UNCITRAL has already endorsed other soft law instruments that have proved particularly successful in practice, such as INCOTERMS or the UCPs. The fact that UNCITRAL now formally commends to the international legal and business community also the use of the Principles will definitely enhance their prestige and popularity worldwide.

4. Yet to increase in actual practice awareness of the Principles around the globe, important as it is, is not enough. Maybe it is time to think of ways to promote the Principles from their present status as a mere soft law instrument.

To be sure, the fact that the Principles are the product of a group of independent experts without direct involvement of governments undoubtedly has its advantages. Not only does it permit wider discretion in their preparation but also renders them more flexible and capable of rapid adaptation to the changing conditions in international trade practice.

Not surprisingly therefore there are those who openly state that the non-binding nature of the Principles, far from being problematic, makes them even more attractive. As pointed out by an eminent German scholar, “[...] the informal approach taken by the UNIDROIT Working Group has had a decisive influence on the success of the Principles [...] Informal, not formalized codification of transnational commercial law is the order of the day.”

However, the present status of the UNIDROIT Principles clearly also has its shortcomings. Like any other soft law instrument in the field of contract law they are binding only within the limits of party autonomy, whereas in the absence of voluntary acceptance by the parties, courts and arbitral tribunals will apply them, if at all, only if persuaded by their intrinsic merits.

Hence repeated calls for the transformation of the Principles into a binding instrument.

The legislative codification of the Principles would certainly be the most radical way of promoting them from their present status as a mere soft law instrument.

But is it also the best way? I don't think so. After all, it is – to say the least – rather unlikely that governments will ever be willing to embark upon such a costly project as the transformation of the UNIDROIT Principles into an international convention.

In my opinion, there are other less radical but maybe even more appropriate options I would like to present to you in order to hear your comments.

5. A first significant step to promote the legal status of the UNIDROIT Principles would be a formal Recommendation by UNCITRAL to use them as a means of interpreting and supplementing the CISG.

Art. 7 CISG provides that the Convention should be interpreted and supplemented autonomously, i.e. according to internationally uniform principles and rules, whereas recourse to domestic law is admitted only as a last resort. In the past such autonomous principles and rules had to be found by judges and arbitrators themselves on an ad hoc basis. Now that the UNIDROIT Principles exist, the question arises whether they may be used for this purpose.

Among scholars opinions are divided. While according to the prevailing view the answer is in the affirmative, others deny the possibility of using the Principles to interpret or supplement the CISG on the basis of the rather formalistic argument that the former were adopted after the latter.

Despite such scholarly doubts, in practice not only arbitral tribunals but also domestic courts seem to have few if any scruples in referring to the Principles to interpret and supplement CISG.

Only in a few cases has this been justified – as I think it should – on the ground that the individual provisions invoked can be considered an expression of a general principle underlying both the UNIDROIT Principles and the CISG.

Generally no explanation is given at all or it is argued that the Principles in their entirety coincide with or - to quote Justice Thomas of the Court of Appeal of New Zealand - “refine and expand” the general principles underlying the CISG referred to in Art. 7 (2) of the Convention, or represent “trade usages widely known in international trade” applicable in accordance with Art. 9(2).

So why not have UNCITRAL adopt a formal Recommendation to use the UNIDROIT Principles to interpret and supplement the CISG whenever the issues at stake fall within the scope of the CISG and the individual provisions referred to can be

considered an expression of a general principle underlying both the UNIDROIT Principles and the CISG.

Such a Recommendation – a precedent of which may be seen in the Recommendation of 2006 regarding the interpretation of Arts. II (2) and VII (1) of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards – would have the merit of promoting uniformity in the application of the CISG world-wide, while at the same time ensuring that in practice recourse to the UNIDROIT Principles is made only within the limits and on the conditions provided by Art. 7 CISG.

6. Another even more significant promotion of the legal status of the UNIDROIT Principles would be a formal recognition of the parties' right to choose the Principles as the law governing their contract.

One may think of a variety of situations in which parties to an international commercial contract – be they powerful “global players” or small or medium businesses – may wish to, and actually do, avoid the application of any domestic law and instead prefer to subject it to a genuinely neutral legal regime such as the UNIDROIT Principles.

Also an increasing number of Model Contracts prepared by international agencies such as the ICC or the ITC UNCTAD/WTO contain a reference to the Principles either as the exclusive *lex contractus* or in conjunction with other sources of law (e.g. a particular domestic law; general principles of law prevailing in a given trade sector; usages).

However, the effects of the parties' agreement on the application of the Principles vary considerably depending on whether such agreement is invoked before a domestic court or an arbitral tribunal.

Only in the context of international commercial arbitration parties are nowadays permitted – think of Article 28(1) of the UNCITRAL Model Law on International Commercial Arbitration – to choose a soft law instrument such as the UNIDROIT Principles as the law governing their contract in lieu of a particular domestic law.

By contrast, as far as court proceedings are concerned the traditional and still prevailing view is that the parties' freedom of choice is limited to a particular domestic law, with the result that a reference to the Principles will be considered as a mere agreement to incorporate them into the contract and as such can bind the parties only to the extent that they do not affect the mandatory provisions of the *lex contractus*.

To be sure, recently there have been some significant developments suggesting that things may change in the near future – suffice it to mention the 1994 Inter-American Convention on the Law Applicable to International Contracts, or the Official Comments to § 1-302 of the UCC, as revised in 2001, the latter expressly providing that parties may vary the effect of the Code’s provisions by stating that their relationship will be governed by – quote – “recognised bodies of rules or principles applicable to commercial transactions such as the UNIDROIT Principles”.

On the other hand, it is fair to say that the Inter-American Convention has so far been ratified only by 2 countries, and that in the UCC reference to the UNIDROIT Principles is made in the context of the section laying down the principle of freedom of contract and not in the context of § 1-301 dealing with the parties’ right to choose the applicable law, with the consequence that a parties’ agreement to have their contract governed by the UNIDROIT Principles will be respected only to the extent that the Code grants parties the right to derogate from its provisions

Even more regrettable the latest developments in this field within the European Union. Indeed, while in 2005 the European Commission put forward a proposal to amend Art. 3 of the 1980 Rome Convention on the Law Applicable to Contractual Obligations to the effect that parties may choose as the applicable law not only the law of a particular State but also – quote – “principles and rules of the substantive law of contract recognized internationally”, this proposal was eventually vetoed by EU Member States, apparently concerned about the risk of excessive legal uncertainty deriving from the choice of a-national principles and rules as the law governing the contract as compared to the alleged certainty and predictability of the choice of a particular domestic law.

Despite all that – or maybe just because of it – I think it would be a good idea formally to recognise at universal level the right of parties to an international commercial contract to choose as the governing law a soft law instrument such as the UNIDROIT Principles.

The Hague Conference on Private International Law would obviously be the most appropriate body to launch such a project, and it would have the merit of rendering the principle of party autonomy consonant with the needs of businesses engaged in international trade, while at the same time eliminating the totally unjustified differentiation in the parties’ freedom to choose the applicable law depending on whether they decide to have their disputes settled by arbitration or in court. By

coincidence, according to the latest news the Hague Conference is currently exploring the possibility of preparing a parallel instrument to the 2005 Convention on Choice of Court Agreements and concerning choice of law in international contracts: what is proposed here could perfectly fit in that project.

7. I pass now – and with this I conclude – to a last and under the circumstances the most ambitious – way of fostering the legal status of the UNIDROIT Principles.

While I have already pointed out that transforming the Principles into an international convention is not a realistic and perhaps not even a desirable objective, it may still be worth considering adopting them in the form of a model law. The direct involvement of governments would certainly enhance the authority of the Principles; at the same time the risk that they might lose much of their innovative character and be reduced to the lowest common denominator among existing domestic laws is certainly less acute given the non-binding nature of the chosen instrument.

What still remains to be seen is whether the UNIDROIT Principles should be the subject of a model law on its own or be part of an even farther reaching project such as a Global Commercial Code.

Such a Code – to be prepared in the form of a model law by UNCITRAL in co-operation with other interested international organisations – should be a sort of consolidation of existing international uniform law instruments (e.g. CISG, the various transport law conventions, etc., as well as soft law instruments such as INCOTERMS, the UCP, etc.). The UNIDROIT Principles – this is my proposal – could play the role of the “general contract law” of the Code: more precisely, the Code could contain a provision declaring the Principles applicable to the specific contracts covered by the Code unless parties have excluded them by choosing another law or otherwise.