Denver Journal of International Law & Policy

Volume 34
Number 1 *Spring*
2005 Sutton Colloquium

Article 7

January 2006

Soft Law for Solid Contracts - A Comparative Analysis of the Value of the UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law to the Process of Contract Law Harmonization

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Keywords
Contracts, Soft Law

SOFT LAW FOR SOLID CONTRACTS? A COMPARATIVE ANALYSIS OF THE VALUE OF THE UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS AND THE PRINCIPLES OF EUROPEAN CONTRACT LAW TO THE PROCESS OF CONTRACT LAW HARMONIZATION

*Lars Meyer**

I. INTRODUCTION

The globalization phenomenon constantly confronts legislative bodies all over the world with one urgent question: How to draft new laws and adjust existing rules to secure their effectiveness in times of "global marketplaces" with internationally operating corporations and individuals? The expansions of transnational business interactions, the worldwide accessibility of goods and services over the internet, and the borderless lifestyles and habits of consumers are far ahead of the legal rules created to govern international transactions. Globalization on this sector calls for more international legal coherence and perhaps even the unification of domestic and supranational trade laws.[1]

Accordingly, there are many "internationalization" efforts that have been and continue to be promoted across various institutional levels covering a number of legal areas, especially in the area of contract law.[2] Harmonizing, i.e. making more congruent, international contract law under various legal forums is the basis of an internationalization of law that arose in response to the eroding importance of borders in today's business world. Two innovative non-legislative contributions to this process have been presented: the UNIDROIT Principles of International Commercial Contracts,[3] provided by the UNIDROIT Institute for the Unification of Private Law, and the Principles of European Contract Law,[4] which were published by the Commission on European Contract Law.

This article will discuss the legislative motives and political and economic arguments that underlie ongoing activities in contract law harmonization, and it will introduce the major institutions pursuing this goal (section II). This article will then give an overview of and compare the UNIDROIT and European Principles as two of the most extensive non-legislative efforts, examining whether their ap-

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1. Larry A. DiMatteo, *Contract Talk: Reviewing the Historical and Practical Significance of the Principles of European Contract Law*, 43 HARV. INT'L L.J. 569, 570 (2002).

2. *Id.*

3. Hereinafter referred to as UNIDROIT PRINCIPLES or UP.

4. Hereinafter referred to as EUROPEAN PRINCIPLES or PECL.

proach is an effective and favorable alternative to institutional solutions (section III). Finally, the passing of the first 10 years after the first publication of the two sets of Principles and the recent release of an extended version of the UNIDROIT Principles provide an occasion to discuss how effective this *soft law* has proven towards the harmonizing of international contract law, and whether it makes sense to apply and further develop both sets of Principles in tandem (section IV).

In some parts of the discussion and analysis, slight emphasis will be placed on the state of affairs in Western Europe. This is due to the comparably high level of synchrony in contract law in the European Union as well as the region's significant share in international trade,

II. HARMONIZATION AND UNIFICATION OF INTERNATIONAL CONTRACT LAW

A. Why Harmonize International Contract Law?

The convergence of the ways business is being done in different countries and regions of the world is an almost automatic result of the globalization of deals and markets. Quality standards in manufacturing and services in South East Asia must meet the expectations of European companies that outsource production facilities; business customs in the Arab World must adapt to the ways investors from North America negotiate; young market economies in Eastern Europe must secure a system where parties can rely on investor-friendly, efficient and fair bureaucracies. In this context, the establishment of a legal environment that ensures conditions such as equal protection of intellectual property rights or globally reliable enforcement of foreign judgments is one of many steps necessary to disburden cross-border business interaction.

A reliable contractual fixation of the relationship between two or more parties doing business with each other poses a crucial condition for the success of any such transaction. This is because, ideally, a contract authoritatively determines the parties' obligations regarding the deal, and it is the evidential basis of any actions taken if the contract fails.[5] Therefore, especially on the international level, where legal uncertainties and linguistic misunderstandings occur frequently, a contract is perhaps the most essential fundament of a successful transaction.

From a legal perspective, however, international contracts[6] raise specific questions that are a result of their relation to multiple cultural, economic and legal environments. Among these are the following: the question of which languages are to be used in the contract and for any correspondence connected to it; the question of to which currency the contract refers; and the question of which holidays or business hours apply to an employment relationship. Although domestic laws do not offer sufficient solutions for these issues, the respective conflict of law rules,

5. *See, e.g.*, D. Reed Freeman, Jr., *What is a Contract?*, http://profs.lp.findlaw.com/contracts/contract_1.html (last visited October 10, 2005).

6. International contracts can be defined most practicably as any contractual relationship which involves parties from more than one country, or which refers to performance occurring in more than one country.

e.g. Private International Law, refers back to them, or to some more practical but rather specialized supranational regulations.[7]

The practical deficits that arise from the strict application of domestic legal forums are evident—national laws on contracts differ widely, which often leads to legal uncertainty and financial risk in cross-border transactions. As a result, transaction costs are higher because the parties have to rely on increased legal counseling in negotiations or litigation.[8] Also, consumers and smaller businesses are almost always at a disadvantage when dealing with transnational corporations that have better resources for dealing with different legal systems and languages and are often in a position to impose their preference of which shall govern the contract.[9] Under these circumstances, more "neutral" and synchronized options, accessible and comprehensible to all participants, would establish more equal chances and encourage potential participants to venture into the opportunities of today's easily accessible global markets.[10]

To avoid insufficiencies of domestic laws in global business, "internationalizing" contracts themselves, i.e. drawing from model rules provided by trade organizations or legal professionals,[11] has become one alternative. In many cases, however, parties select a patchwork of rules from different sources to create their individual terms. Such "legal forum shopping" often results in even more confusion and insecurity, higher transaction costs and greater "legal risk".[12] In the worst cases, contractual terms are not equally valid under different domestic laws or domestic courts apply foreign law incorrectly. Facing such legal incongruence and insufficiency of domestic laws in the face of the globalization of business transac-

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7. The system of conflict of law rules will be described in more detail below. The strictly procedural approach of Private International Law is regarded by some as being insufficient nowadays, because it were not sufficiently solving the injustices, uncertainties (Which law applies to the contract? What consequences does the law impose?), and economic deficits caused by divergences between colliding legal forums. *See, e.g.*, Klaus Peter Berger, *The Lex Mercatoria Doctrine and the UNIDROIT Principles of International Commercial Contracts*, 28 LAW & POL'Y INT'L BUS. 4 (1997)); G. GREGORY LETTERMAN, *UNIDROIT's Rules in Practice: Standard International Contracts and Applicable Rules* 44 (2001).

8. *See A More Coherent European Contract Law – An Action Plan: Communication from the Commission to the European Parliament and the Council*, at 10-11,COM (2003) 68 final (Dec. 2, 2003) [hereinafter Action Plan]; Ole Lando & Christian von Bar, *Joint Response of the Commission on European Contract Law and the Study Group on a European Civil Code*, at 10, http://www.sgecc.net/media/download/stellungnahme_kommission_5_final1.pdf; *see also* Sandeep Gopalan, *The Creation of International Commercial Law: Sovereignty Felled?*, 5 SAN DIEGO INT'L L.J. 267, 288 (2004) (pointing out specifically the increase of transaction costs due to the fact that any unusual financial risk caused by "legal unpredictability" in foreign legal systems is usually passed on to the debtor in the form of higher interest rates).

9. *See* Berger, supra note 7, at 986.

10. *See* Sandeep Gopalan, *Transnational Commercial Law: The Way Forward*, 18 AM. U. INT'L L. REV. 803, 804-09 (2003).

11. *See generally* INTERNATIONAL CHAMBER OF COMMERCE, INCOTERMS 2000: ICC OFFICIAL RULES FOR THE INTERPRETATION OF TRADE TERMS (2000).

12. *See* Action Plan, *supra* note 8, at no. 26.

tions, many commentators have called for an institutional or legislative harmonization of international contract law, or even a "Global Commercial Code."[13]

In the European Union (upon which the PECL legal systems are based), the harmonization of private law in general and contract law in particular would simplify trade activities between the Member States and benefit the Union's Internal Market.[14] Inconsistency and divergence within European legislation itself and between the Member States' contract law systems is widely considered a non-tariff barrier to trade.[15] A major objective of the European Parliament and the European Commission is the facilitation of inter-European transactions through Directives and Regulations, or even in the form of a possible "European Civil Code" or "European Contract Code."[16] In this context, more congruent laws would be more beneficial because ten new Member States, most former socialist countries providing even more differing "legal origin", joined the Community in 2004.[17] Finally, uniform rules can provide valuable legislative orientation for other countries in Eastern Europe that are preparing to become members of the Union.[18]

Thus, while acknowledging the eligibility of domestic laws to deal with domestic questions, the EU pursues universal standards for those sectors that immediately impact the Internal Market. Additionally, the establishment of uniform rules that are accessible in a number of languages and that do not expose the "weaker" party to legal uncertainty or risks greater than those faced by a multinational corporation is in line with a substantial part of the Union's legislative efforts to secure consumer protection.[19]

The same thought pattern also applies on a global level, where borders become increasingly irrelevant in the face of consumer trade in virtual marketplaces and with the spread of the English language among younger generations. Interna-

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13. *See, e.g.*, Rachel Rasmussen, *KPMG's Graham Calls for Global Commercial Code at U.S. Chamber's E-Commerce Forum*, DMREVIEW.COM, Nov. 3 1999, http://dmreview.com/article_sub.cfm?articleId=1625.

14. *See* Action Plan, *supra* note 8, at no. 26; Barbara Dauner-Lieb, *Auf dem Weg zu einem europäischen Zivilrecht?*, NEUE JURISTISCHE WOCHENSCHRIFT 1431 (2004). The realization and enhancement of the internal market within the Union's borders is one of the fundamental objectives of both the EC Treaty (art. 14) and the recently drafted EC Constitutional Treaty (art. 14-III).

15. *See* Lando & von Bar, *supra* note 8, at 9.

16. *See, e.g.*, Markos Kyprianou, European Commissioner for Health and Consumer Protection, Speech at the UK Presidency Conference: European Contract Law: Better Lawmaking to the Common Frame of Reference (Sept. 26, 2005), *available at* http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/05/548&format=HTML&aged=0&language=EN&guiLanguage=en.

17. The volume of trade between the prior Member States and the ten new Member States amounted to EUR 232 billion in 2002, out of a EUR 1.977 billion total trade volume with the world; *see* Memorandum from the Commission of the European Communities on Trade Implications of EU Enlargement: Facts and Figures (Feb. 4, 2004), *available at* http://www.europa.eu.int/rapid/pressReleasesAction.do?reference=MEMO/04/23&format=HTML&aged=1&language=EN&guiLanguage=en.

18. *See* PRINCIPLES OF EUROPEAN CONTRACT LAW, PARTS I AND II xxi-xxii (Ole Lando & Hugh Beale, eds., Kluwer Law International 2000) (2000).

19. *See* Action Plan, *supra* note 8, at no. 25.

tionally, more compatible or even uniform laws will create more "legal certainty" among businesses, consumers, lawmakers and legal professionals. This will in turn reduce transaction costs and legal risks, enabling and encouraging more participants to step onto *terra incognita* and benefit from the economic advantages of global business activity.

Therefore, as one commentator has stated, the focus of any harmonization measure must be "[a]s with any legal scheme regulating commercial contracts, the ultimate aim of [harmonization] is to provide a means by which contracting parties may quickly and fairly arrive at contractual agreement under rules and terms which are understood by and acceptable to all and which render predictable and enforceable outcomes."[20]

B. Risks and Potential Problems of Contract Law Harmonization

Some critics of the increasing internationalization of private law, which evidently reduces the relevance of national legislation,[21] have not yet acknowledged a practical need for this development.[22] It is argued that the conditions and customs in international trade, e.g. regarding consumer protection, vary considerably and thus require equal diversity in legal policy.[23] Accordingly, international treaties were only compromises between the demands of each participating nation and are incomplete, often inconsistent and insufficient.[24] In addition, "legal diversity" would create healthy competition among different countries to provide the most business-friendly or the most consumer-protective legal environment.[25]

At the same time, however, businesses and consumers are most interested in the reduction of uncertainty and transaction costs. These results can best be achieved by reducing the number of obstacles to international trade and also through the establishment of more uniform rules. Besides, the harmonization of sectors where specific problems in cross-border transactions can be solved by uniform rules still leaves room for more regionally oriented lawmaking for purely domestic questions.

Other commentators are skeptical about the process itself. They state that it may well prove impossible to find a "common core" or compromise between varying legal systems' different means of statutory interpretation, to unify contradicting

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20. LETTERMAN, *supra* note 7, at 2.

21. *See* Gopalan, *supra* note 8, at 268.

22. *See* Hans Jürgen Sonnenberger, *Privatrecht und Internationales Privatrecht im künftigen Europa: Fragen und Perspektiven*, 48 RECHT DER INTERNATIONALEN WIRTSCHAFT 489, 498 (2002); *see also* Christoph Coen, *Vertragsscheitern und Rückabwicklung: eine rechtsvergleichende Untersuchung zum englischen und deutschen Recht*, ZUM UN-KAUFRECHT SOWIE ZU DEN UNIDROIT PRINCIPLES UND DEN PRINCIPLES OF EUROPEAN CONTRACT LAW 103 (Duncker & Humblot, eds.) (2003) (pointing out that there is no empirical data which proves that the differences between the legal systems of the EU Member States actually obstruct international or inter-EU cross-border trade).

23. *See, e.g.*, Michael G. Bridge, *Uniformity and Diversity in the Law of International Sale*, 15 PACE INT'L L. REV. 55, 57 (2003).

24. *See generally* J. S. Hobhouse, *International Conventions and Commercial Law: the Pursuit of Uniformity*, 106 L. Q. REV. 530 (1990).

25. *See, e.g.*, Gopalan, *supra* note 8, at 291.

terminology and untranslatable languages, and merge all these components into an effective new legislation.[26] In fact, this concern has proven true for many international treaties.[27]

Furthermore, it is predicted that the costs and efforts necessary to approximate national laws, people's legal experience and business customs, and the expertise of legal professionals will outweigh the benefits mentioned above.[28] Additionally, an entirely new contract law system would only increase confusion and uncertainty among those who would use it.[29] In Europe in particular, some fear further limitation of contractual freedom by EU legislation, whose consumer-protecting tendency has led to less flexibility and versatility of the Member States' economies.[30]

Regarding the success and efficiency of some unification efforts, one can argue whether the aforementioned warnings and predictions are still valid at all. However, regarding the fact that internationalization of private law has become a vivid reality in both legislative policy and practice, this criticism has obviously remained widely ineffective, or even ignored, as "[commercial] people demand certainty and predictability more than nationally determined notions of justice or fairness."[31]

C. Legislative and Unofficial Harmonization Efforts

Various institutions have taken on the task of pursuing the synchronization or unification of international contract laws. This pool includes official institutions and multilateral organizations as well as institutes, professional agencies and private working groups, congresses, and individual professionals.[32] Naturally, contractual parties and trade organizations also play a part in the movement, e.g. through the elaboration of model contract terms.[33] The following overview lists those institutions with the most influential and extensive contributions to the process of (not only procedural) harmonization.[34]

1. The European Union[35]

Through numerous Directives and Regulations on the contract law sector, mainly with regard to consumer affairs, the Union is continuously shaping the legal environment of its Internal Market.[36] The "Action Plan" Communication of

26. *See, e.g.*, Dauner-Lieb, *supra* note 14, at 1433.

27. *See e.g.*, Gopalan, *supra* note 8, at 307-10 (listing how little success, regarding the volume of ratification, most international conventions on contract law have actually had).

28. *See, e.g.*, Dauner-Lieb, *supra* note 14, at 1433.

29. *See, e.g.*, Coen, *supra* note 22, at 104 (providing further references).

30. *See, e.g.*, Dauner-Lieb, *supra* note 14, at 1432.

31. *See, e.g.*, Gopalan, *supra* note 10, at 809.

32. *See, e.g.*, Gopalan, *supra* note 8, at 307-10 (listing a number of institutions that have pursued the synchronization or unification of international contract laws).

33. *See, e.g.*, INTERNATIONAL CHAMBER OF COMMERCE, *supra* note 11; *see also* LETTERMAN, *supra* note 7, at 307-15.

34. For a detailed enumeration, *see* Action Plan, *supra* note 8, at 55.

35. *See* discussion *infra* Part III.B.1.

36. The European Union maintains a website (EUROPA) containing details, background, and current events regarding European Contract Law and the Internal Market. To access the website, go to

2003[37] by the *European Commission*, the EU's executive body, marks one of the most recent expressions of its commitment to pursue further harmonization of contract law. This harmonization of contract law may perhaps someday evolve into the form of a "European Civil Code" or "European Contract Code" that would be binding upon the courts of all Member States.[38]

2. The Council of Europe,[39] The Hague Conference on International Private Law,[40] and the United Nations[41]

All three multilateral organizations develop conventions that impact international civil law. Particularly, The Hague Conference's Convention Relating to a Uniform Law on the International Sale of Goods (1964)[42] has provided significant contributions to creating uniform conflict of law rules. Additionally, the UN Convention on Contracts for the International Sale of Goods (CISG),[43] which was adopted by the UN Commission for International Trade Law (UNCITRAL)[44] in 1980 and has to this point been ratified by 63 UN Member States, has also had a significant influence on the development of contract law harmonization.

3. The UNIDROIT Institute for the Harmonization of International Private Law/Institut International pour l'unification du Droit Privé[45]

Based in Rome, the *UNIDROIT Institute* is an independent, intergovernmental organization that prepares drafts for conventions, model laws and principles based on comparative legal analysis. Apart from drafting the UIDROIT Principles (UP), the *UNIDROIT Institute* contributed substantially to the formation of the UN Con-

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http://www.europa.eu.int/comm/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/index_de.htm.

37. *See generally* Action Plan, *supra* note 8.

38. Other regional trade blocks and multinational organizations such as NAFTA, Mercosur and ASEAN pursue more regional harmonization approaches and mainly focus on a convergence of commercial laws; for a general overview *see* Loukas A. Mistelis, *Regulatory Aspects: Globalization, Harmonization, Legal Transplants, and Law Reform – Some Fundamental Observations*, 34 INT'L LAW. 1055, 1061 (2000).

39. Established in 1949, 46 member states. *See* http://www.coe.int/T/e/Com/about_coe/.

40. Established in 1893, 65 member states. *See* http://hcch.e-vision.nl/index_en.php?act=states.listing.

41. Established in 1945, presently 191 member states. *See* http://www.un.org/Overview/unmember.html.

42. In the course of ratifying CISG, many countries (such as Italy, Germany and Belgium) have terminated participation in the Hague Conference Convention Relating to a Uniform Law on the International Sale of Goods (1964). *See* Convention Relating to a Uniform Law on the International Sale of Goods, Apr. 11, 1980, 1489 U.N.T.S. 3 [hereinafter CISG].

43. As the first major supranational regulation of contract law, the CISG has been extraordinarily successful, with various provisions having been transformed into national laws. It is thus still serving as a standard for international sales transactions and has consequently been a guiding source also for the UP and PECL. *Id.*

44. UNCITRAL was established in 1966 and provided with a general mandate by the UN General Assembly to promote the harmonization and unification of international trade law. 60 changing member states, who are nominated by the General Assembly, participate in the institute at a time. A second essential convention prepared by the Commission is the UNCITRAL Model Law on International Commercial Arbitration (1985). *See* http://www.uncitral.org.

45. Originally established in 1926. *See* http://www.unidroit.org.

vention on Contracts for the International Sale of Goods (CISG).[46] The institute seeks to study needs and methods for modernizing, harmonizing and coordinating private law, and it promotes the adoption of uniform rules of private law by states and groups of states. It currently lists 59 Member States from all five continents, including all members of the European Union and all other major industrialized nations.

4. The Commission on European Private Law and the Study Group on a European Civil Code

The *Commission on European Private Law* (commonly referred to as the "*Lando Commission*" after its founder, Professor Ole Lando), which created the PECL, has now been succeeded by the *Study Group on a European Civil Code.* Both working groups were co-funded by the European Union and their work has played an important role in the process of evaluating and drafting a common European contract law and domestic codes.[47]

III. "PRINCIPLES" AS AN INSTRUMENT OF HARMONIZING INTERNATIONAL CONTRACT LAW

The UNIDROIT Principles and the Principles of European Contract Law were both presented in the mid-1990s, but they differ considerably from all prior supranational instruments. In particular, their non-legislative origin and broad scope of application provoked appreciation and fear of a "de-nationalization of the legal process".[48] Before examining the question of whether their independent and innovative approach makes them an efficient alternative to other instruments dealing with international contracts, an analysis of the specifics and attributes of each Principles is necessary.

A. Overview of the UNIDROIT Principles

In 1971, the UNIDROIT Governing Council decided to participate in the process of multilateral contract law harmonization, which both socialist and capitalist countries increasingly pursued, e.g., through the 1964 Hague Convention on the International Sale of Goods. As a first step, a committee was established to

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46. The UNIDROIT Institute and the UN are collaborating on the basis of a cooperation agreement. *See* The Secretary-General, *Cooperation Between the United Nations and Regional and Other Organizations, Delivered to the General Assembly*, U.N. Doc. A/59/503 (Sep. 1, 2004).

47. Other working groups and agencies worth mentioning are the Institut de Droit International, *see* http://www.idi-iil.org; The International Law Association, *see* http://www.ila-hq.org; the "Code européen des contrats" project of the Accademia dei Giusprivatisti europei (Academy of European Private Lawyers) based in Pavia, Italy, which has published a draft of a "European Contract Code," *see, e.g.*, Giuseppe Gandolfi, *Code européen des contrats* (2001); the "Common Core Project" sponsored by the University of Trento, Italy, *see, e.g.*, Mauro Bussani & Ugo Mattei, *The Common Core Approach to European Private Law*, 3 COLUM. J. EUR. L. 339 (1998); and finally, various institutions maintaining online databases, e.g. http://www.lexmercatoria.org, http://www.cisg.law.pace.edu, http://www.transnational-law.de, and http://www.secola.org. For the possible role of the WTO in harmonizing legal issues with connection to contract law, e.g. regarding products liability, *see generally* Arie Reich, *The WTO as a Law-Harmonizing Institution*, 25 U. PA. J. INT'L ECON. L. 321 (2004).

48. *Cf.* Klaus Peter Berger, *The New Law Merchant and the Global Market: A 21st Century View of Transnational Commercial Law*, INT'L ARB. L. REV. 91 (2000).

elaborate the feasibility of the UP project, and nine years later, the Working Group took up work. The Working Group consisted of experts in contract law and international trade law from every continent, each one representing their own socialist or market-economy, civil law or common law system. The members were not delegated from their respective country but participated on an entirely private capacity.

The drafting process involved so-called *Rapporteurs*, who carried out the research on certain sectors of contract law and formulated a first version of the black-letter rules and comments for the final collection of principles. These drafts were then circulated and discussed among the Working Group members as well as with external experts, and eventually agreed upon and edited by the members. The drafters drew from the world's major contract law systems, focusing particularly on recently revised laws, including domestic codes like the United States Uniform Commercial Code (UCC), the Restatement (Second) of the Law of Contracts, treaties like the CISG, and even non-legislative international trade rules.[49] The UP are based on concepts found in the majority of the systems considered, and, in some cases, on what the Working Group autonomously considered the "best solution" to a question with regard to the specifics of international trade. Unlike the PECL, however, the UP do not contain any explicit references to the legal systems that most influenced each provision.

The UP were first presented in 1994,[50] and a revised and extended version was published in 2004.[51] The current edition contains 185 articles divided into 10 chapters, dealing with relevant questions of international commercial contracts and obligations. According to the Institute, the UP are intended to provide "a balanced set of rules designed for use throughout the world irrespective of the legal traditions and the economic and political conditions of the countries in which they are to be applied."[52] As a result of its non-legislative nature, the UP, like the PECL, only provides persuasive authority. However, its significant impact has been demonstrated by the extensive application of the UP in practice. As for the future, *UNIDROIT Institute* continues to discuss all options, including the adoption or incorporation of the UP in a binding instrument, e.g. a convention similar to CISG.[53]

B. Overview of the Principles of European Contract Law

For almost two decades, the European Union has actively shaped the contract laws of its Member States in pursuit of legal synchrony and consumer-protective economic growth in the Internal Market.[54] Simultaneously, with regard to the Un-

49. *See* Michael Joachim Bonell, *The UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law: Similar Rules for the Same Purposes?*, 26 UNIFORM LAW REVIEW 229, 231 (1996).

50. UNIDROIT INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW, *UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS* (1994) [hereinafter UP (1994)].

51. UNIDROIT INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW, *UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS* (2004) [hereinafter UP (2004)].

52. *Id.* at xv.

53. *See* Bonell, *supra* note 49, at 56.

54. The first legislative act by the European Community regulating a part of contract law in the

ion's high activity on this sector, professionals and groups of scholars like the Commission on European Contract Law have discussed the issue of harmonizing contract law in Europe. Hence, the development of the PECL must be considered prior to the historical background of contract law harmonization in and by the European Union.

1. Harmonization of Contract Law in the European Union

The European Commission titled its February 12, 2003 Communication "A more Coherent European Contract Law – An Action Plan,"[55] demonstrating the EU's new momentum in its efforts to further synchronize contract law. The German Chancellor, Mr. Gerhard Schröder, calls the creation of a "European contract law" one of the seven most decisive steps toward the Union's goal to become "the world's most competitive economy by 2010".[56]

Recent European Commission activity is in line with earlier appeals by other EU bodies considering the option of enhancing unity in contract law, perhaps with the creation of a binding so-called "European Civil Code."[57] The Action Plan acknowledges divergences between domestic contract laws as problems for the functioning of the Internal Market[58] as well as inconsistencies within EU legislation itself.[59] Even cross-border sales contracts within the Union are not governed by uniform law since some Member States are not signatories to CISG. Finally, national courts have incorrectly applied and interpreted the governing law, effec-

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Member States was a Directive by the European Commission issued on July 25, 1985. *See* Council Directive 85/374/EWG (EC).

55. *See* Action Plan, *supra* note 8.

56. Gerhard Schröder, *Seven-Up for Europe*, WALL ST. J., Oct. 26, 2004, at A24.

57. The European Parliament had already called for more extensive harmonization on the private law sector in 1989 and most recently in 2001; *see* Resolution on the Approximation of the Civil and Commercial Law of the Member States, EUR. PARL. DOC., (COM 398) (2001), *available at* http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/ce140/ce14020020613en05380542.pdf [hereinafter Resolution]. *See also* Draft Council Report 12735/01, On the Need to Approximate Member States' Legislation in Civil Matters (Oct. 18, 2001), *available at* http://register.consilium.eu.int/pdf/en/01/st12/12735en1.pdf. The current state of affairs is a follow-up Communication of the Commission dated Oct. 11, 2004, summarizing stakeholders' (mostly approving) reactions to the Action Plan and giving an outline of specific goals and measures to meet the Action Plan's goals; *see Communication from the Commission to the European Parliament and the Council on European Contract Law and the Revision of the Acquis: the Way Forward*, COM (2004) 651 final (Oct. 11, 2004) [hereinafter Acquis].

58. A vivid example is the fact that in some Member States, it is possible that the buyer of goods is granted ownership by the seller only after having paid the purchase price. In other countries, however, such conditional sale clauses are not legally acknowledged, thereby leaving the seller without a guarantee of payment; other divergences concern the use and validity of general terms of contract, or some Member States' contradicting rules on the formation and formalities of contracts. *See, e.g.*, Action Plan, *supra* note 8, at 13.

59. The Commission admits that especially some Directives on the contract law sector in some parts do not solve the problems they address in practice, that they vary considerably in terms of abstract legal terms and legislative goals, or that they even impose substantially different rules of law; *see id.* at 8. *See also* Acquis, *supra* note 57, at 3. From the perspective of the drafters of the PECL, *see* Lando & von Bar, *supra* note 8.

tively eliminating some of the certainty provided by the Rome Convention, which provides uniform choice of law rules valid in the Member States.

To reduce such non-tariff trade barriers, the Commission has set forth a three-fold course of action. First, the Commission seeks to increase the quality and consistency of the European Community's *acquis communautaire*[60] in the field of contract law, particularly through the creation of a "Common Frame of Reference" (CFR). Second, promote the work on EU-wide general contract terms. Lastly, examine whether practical problems based on divergences in contract law within the Union could be reduced by "non-sector-specific"[61] solutions, namely an optional civil code. The European Parliament and the European Commission have already begun consultation on the CFR, which is supposed to serve as a basis for determining whether a uniform instrument would contribute to the goal of more coherence.[62]

Although the Action Plan's observations were welcomed by the vast majority of stakeholders, some commentators were skeptical of the Plan. Particularly, the question of the exact authority under which the EU can enact a Union-wide civil code remains unanswered.[63] Some commentators also argue that if a general instrument on civil law, similar to much of the Union's other legislation, [64] followed its tendency of narrow contractual freedom in order to protect consumers, a uniform civil code would make the Internal Market less attractive for businesses.[65]

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60. The term *acquis communautaire* refers to the entirety of existing legislation and binding jurisprudence on the EC level.

61. Current EU legislation is being described as *sector-specific*, meaning that its Regulations, Directives and Recommendations (and hence the European Court of Justice's rulings) address and harmonize only selective areas of contract law, such as e-commerce, travel contracts, consumer credits or employment.

62. Governments and other stakeholders have already filed numerous opinions on the CFR, most recently at a conference organized by the European Parliament and the European Commission held on Dec. 15, 2004, see http://europa.eu.int/comm/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/conference_report.pdf. In addition, the Commission is setting up *CFR-net*, a network of stakeholder experts on the contract law sector, to carry out research on the CFR until 2007; *see* http://europa.eu.int/comm/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/madelin_speech1512 2004_en.pdf. A summary is also included in the Commission's Communication of Oct. 11, 2004; *see* Acquis, *supra* note 57, at 5.

63. *See, e.g.*, ANA M. LÓPEZ RODRIGUEZ, LEX MERCATORIA AND HARMONIZATION OF CONTRACT LAW IN THE EU, 252 (2003); Justus Meyer, *Auf dem Weg zu einem Europäischen* Zivilgesetzbuch, BETRIEBS-BERATER 1285, 1287 (2004); Schmidt-Kessel, *supra* note 61, at 486; LETTERMAN, *supra* note 7, at 56; DiMatteo, *supra* note 1, at 580; Dominik Kallweit, *Towards a European Contract Law: For a Prosperous Future of International Trade*, 35 VICTORIA U. OF WELLINGTON L. REV. 269, 291 (2004).

64. A big portion of the EU Directives and Regulations aim primarily at consumer protection and therefore limit the autonomy of businesses to design contractual terms independently; *see, e.g.*, Council Directives 85/577, 1985 O.J. (L 372); 87/102, 1987 O.J. (L 042); 90/314, 1990 O.J. (L 158); 93/13, 1993 O.J. (L 095); 94/47, 1994 O.J. (L 280); 97/7, 1997 O.J. (L 144); 99/44, 1999 O.J. (L 171); 2000/31, 2000 O.J. (L 178); 2002/65, 2002 O.J. (L 271); Commission Regulations 295/91, 1991 O.J. (L 036); 1103/97, 1997 O.J. (L 313); 974/98, 1998 O.J. (L 139). Moreover, the Commission has made clear that it aims at maintaining the "high level of consumer protection" in its legislation; *see* Acquis, *supra* note 57, at 20.

65. *See, e.g.*, Dauner-Lieb, *supra* note 14, at 1432. Especially those commentators who advocate

Finally, some commentators doubt whether the practical feasibility of the project, especially with regard to allegedly insurmountable divergences between 25 (or more) different legislations. These doubts are particularly due to the linkage of each Member States' laws to its own regional economic and sociological traditions, and because of the alleged incompatibility of terminologies and basic legal principles.[66]

In light of the idea's broader approval, however, the Commission—in line with the European Parliament—states that it will pursue further elaboration of the CFR as a non-binding instrument until 2007.[67] The Communication suggests that the CFR could serve various purposes, such as providing a "toolbox" for future EU and national legislation, offering a collection of standard contract terms for the use of legal practitioners or businesses, or assisting the European Court of Justice in interpreting laws and contract clauses.[68] As will be discussed in detail below, the proposed structure and purposes of the CFR closely resemble those of the PECL. Thus, the Principles may serve as a recognized and proven model during the drafting process. Moreover, if the feedback and reflections generated by the Action Plan indicate the need for more general, non-sector-specific legislation, the PECL may likely play a significant, if not an exemplary, role toward the formation of a European Civil Code or European Contract Code.

However, whatever shape future EU and national legislation will take, it is important to state that cross-border trade does not stop at the EU's borders. Any harmonized instruments applicable in the Union must be open to and compatible with even more embracing legal internationalization efforts like those described above.[69] Particularly, before this background, an analysis of how much the PECL and the globally oriented UP are synchronous with regard to their purposes and content, is a valuable indicator of the PECL's quality as a model for any harmonized contract law in Europe.

2. Origin of the PECL

The First Commission on European Contract Law, consisted of legal scholars from every Member State of the European Community, began its work in 1982 after two years of preparations. Professor Ole Lando of Copenhagen was the leading force behind the deliberations and Chairman of the Commission. He eagerly championed the formation of a "European Uniform Commercial Code" since 1976. The Group held frequent meetings, during which comparative examinations of dif-

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the interests of multinational corporations argue that CISG or the Principles, whose use is optional, provide sufficient alternatives to institutional contract laws.

66. *See* LÓPEZ RODRIGUEZ, *supra* note 63, at 254. The most obvious example is made up by the divergences between the British common law system and the civil law traditions of the systems of Continental Europe.

67. *See* Acquis, *supra* note 57, at 9; *see also* Action Plan, *supra* note 8, at 17. The European Parliament, in its 2001 Resolution, explicitly called for the enactment of a European Civil Code by the year 2010; *see* Resolution, *supra* note 57, at 5.

68. *See* Acquis, *supra* note 57, at 3, 5.

69. *See* Meyer, *supra* note 63, at 1292.

ferent fields of contract law in the Member States of the European Community[70] were presented and eventually formulated as Principles. The European Commission sponsored the work through its coverage of travel expenses.

The Lando Commission working procedures closely resemble those of the UNIDROIT Working Group. Similarly, inspiration was drawn not only from the domestic codes of the Member States, but also from additional sources such as the UCC, the American Restatements of the Law of Contracts, and conventions such as CISG.[71]

The Second Commission commenced in 1992 and published Part I of the PECL, covering performance, non-performance and remedies, in 1994. A revised edition of Part I and a second part (on the rules of formation of contracts, authority of agents, validity of contracts, and interpretation) were released in a single volume in 1999, followed by a third part dealing with plurality of parties, set-off, illegality, conditions and capitalization of interest among other topics, in 2003. During this period, the further development and consolidation of the PECL was assumed by the Study Group on a European Civil Code, which broadened the scope of the PECL to include property law and the broader law of obligations.

According to its drafters, the PECL is supposed to provide uniform principles with a uniform terminology, cutting across of the legal systems and socio-economic conditions in the countries that were Members of the European Union at the time of their creation.[72] Since it embodies the "common core" of European contract law,[73] it is intended to facilitate cross-border trade within the EU and strengthen the Common Market. In addition, the Study Group on a European Civil Code envisions the integration of its work into the possible drafting of a "European Civil Code" as well as future domestic legislation.[74]

C. Methodology, Legal Character, Substance and Application of the Principles

1. Methodology of the Working Groups

Commentators have described the methodology underlying the Principles as "functional legal comparison", meaning comparative analysis of different legal systems regarding certain features of contract law.[75] The Principles are comparable to the American Restatements of the Law of Contracts:[76] They summarize the differences and similarities in the contract law forums to which they refer and pro

70. Members of the EC (now the European Union) at the time were Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxemburg, the Netherlands, and the United Kingdom. Portugal and Spain joined the Community in 1987, followed by Austria, Finland and Sweden in 1995.

71. *See* PRINCIPLES OF EUROPEAN CONTRACT LAW, PARTS I AND II, *supra* note 18, at xx.

72. *See id.* at xxv.

73. *See id.* at xxiv.

74. *See* OLE LANDO, THE RULES OF EUROPEAN CONTRACT LAW (1999), *available at* http://www.cisg.law.pace.edu/cisg/biblio/lando2.html.

75. *See* Berger, *supra* note 7, at 950.

76. The Restatements are drafted and published by the American Law Institute (http://www.ali.org); the currently valid RESTATEMENT (SECOND) OF CONTRACTS was released in 1981.

vide a collection of black letter rules, supplemented by explanatory comments (and notes) for each rule.[77]

In contrast to the Restatements' descriptive nature, however, the Principles are intended to provide the most practicable rules found with regard to the legal systems considered, often transcending and amplifying the considered contract law systems.[78] Furthermore, where the drafters found it appropriate, the Principles offer entirely innovative solutions not found in any of the sources.

The Principles contain very little criticism or preference of the examined sources,[79] instead they focus exclusively on presenting the most practicable and representative rules from a pool of different legal systems. Since the Working Groups were independent from political interests,[80] the Principles are broader and less compromising than most supranational legislation and treaties.[81] This approach also provides for an incomparably "autonomous" or "neutral" character, which accounts for much of the Principles persuasive value.

The UNIDROIT Principles and the Principles of European Contract Law were both constructed broadly and flexibly to allow for further development, additions, or the inclusion of case studies from their application.[82] The drafting process benefits from an extensive timeframe[83] and the included comparative material has led to wide recognition of the methodological approach, particularly relating to the Principles' value as model laws for lawmakers,[84] as a resource for the drafting of contracts,[85] or the supplementation of other sets of contractual rules.[86]

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77. *See* PRINCIPLES OF EUROPEAN CONTRACT LAW, PARTS I AND II, *supra* note 18, at xxvi.

78. *See id.* at xxv-xxvi.

79. Sources used by both groups of drafters include the respective domestic legal systems, especially the AMERICAN UNIFORM COMMERCIAL CODE (UCC), as well as supranational law and soft law such as the CISG or the above mentioned RESTATEMENTS OF THE LAW OF CONTRACTS; also, ideas and experiences were transferred from the UNIDROIT INSTITUTE to the COMMISSION ON EUROPEAN CONTRACT LAW and vice versa, and some participants were members of both institutions. *See id.*

80. The "representatives" of the different legal systems were not delegated by the respective countries, but chosen by the working groups. *See* Gopalan, *supra* note 8, at 301.

81. For instance, the CISG, as well as the Hague Conference's Convention Relating to a Uniform Law on the International Sale of Goods, only cover sales law; similarly, legislation in the EU follows a *sector-specific* approach. *See id.* at 298, 302.

82. *See* PRINCIPLES OF EUROPEAN CONTRACT LAW, PARTS I AND II, *supra* note 18, at xxvii. In this context, PECL art. 1:106(1) states that the "Principles should be interpreted and developed in accordance with their purposes." *Id.* at 4.

83. The UP were published after 15 years of work, and another 10 years passed before a revised edition was published; the complete version of the PECL is the product of frequent meetings over more than 20 years. *See* Ole Lando, *Salient Features of the Principles of European Contract* Law, 13 PACE INT'L L. REV. 339, 340 (2001).

84. The Principles (mainly the UP) have served as inspirational model laws and as interpretation guidelines for a number of national legislations, among them new civil codes of the Russian Confederation, the Netherlands, Lithuania, Israel, Germany, New Zealand, China, Estonia, and the Canadian province of Quebec. *See* Lando, *supra* note 83, at 341.

85. *See* THE UNIDROIT PRINCIPLES IN PRACTICE, CASELAW AND BIBLIOGRAPHY ON THE PRINCIPLES OF COMMERCIAL CONTRACTS xii (Michael Joachim Bonell ed., Transnational Publishers, Inc.) (2002).

86. Among these are the interpretation of the CISG, and supplementation of national legislation

2. Structure and Language

Each provision of the PECL contains three levels: first, the *rule of law*;[87] second, *comments* explaining the rule's purpose and systematic context and adding brief illustrations; and finally, *notes* referring to the source(s) on which the rule is based, and comparing it to different approaches from other legal systems.[88] Although both instruments are generally similar in structure, the UP does not provide comparative notes to the rules.

A core appeal of both instruments is their abstract and generalizing language[89] and simplistic terminology. This feature, coupled with the provisions' concise structure and good translatability, allows for even non-lawyer to use them verbatim as contractual statutes. In addition, the Principles' availability in multiple languages to members of the legal and business communities[90] provides a broad basis for their appreciation in practice. Most consumers and small or mid-size businesses can find translations of the provisions in at least one language in which they conduct business. Moreover, transnational corporations can use the provisions to provide identical contract terms when they conduct business in multiple countries.

3. Legal Character

A major characteristic of both sets of rules is that neither of the drafting bodies bears any legislative authority.[91] In fact, the Principles merely provide a consensual catalogue of rules found under different national or international contract law forums.[92] Although both instruments have already gained a certain "legal relevance," their authority remains persuasive and their application is entirely optional.[93] To date, they have been used as supplementary sources for the develop-

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inspired by the Principles.

87. The Principles thus follow the structural appearance of civil law codes like those of Western Continental Europe.

88. It is being debated whether the comments and notes shall be binding in the same way as the rule itself if the PECL are being applied as the law governing a contract. *See* FRIEDRICH BLASE, DIE GRUNDREGELN DES EUROPÄISCHEN VERTRAGSRECHTS ALS RECHT GRENZÜBERSCHREITENDER VERTRÄGE 94 (2001).

89. *See id.* at 70.

90. The UP are available in UNIDROIT's official languages, English and French, as well as in 16 other languages of the world; *see* International Institute for the Unification of Private Law, UNIDROIT Principles of International Commercial Contracts, http://www.unidroit.org/english/principles/contracts/main.htm (last visited Sept. 27, 2005); the PECL, originally drafted in English, have been translated at least partially into Dutch, French, German, Italian, and Spanish; *see* Commission on European Contract Law, Principles of European Contract Law, http://frontpage.cbs.dk/law/commission_on_european_contract_law/ (last visited Oct. 12, 2005).

91. However, especially UNIDROIT's work has had some immediate impact on the contents and further development of international legislation because the institute participates in the preparation of UN Conventions.

92. The Principles, similar to Codes of Conduct or optional instruments provided by trade organizations, are often characterized as *soft law*, meaning that they are applicable legal rules but lack legislative authority. *See* Gopalan, *supra* note 8, at 310-13.

93. *See* BLASE, *supra* note 88, at 16; Katharina Boele-Woelki, *Principles and Private International Law – The UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law: How to Apply Them to International Contracts*, 1 UNIFORM L. REV. 652, 657 (1996).

ment and interpretation of contract law by domestic legislators and courts as well as by the European Commission and the European Court of Justice.[94]

However, it is their non-legislative origin that also fosters the main skepticism about the Principles. Critics warn that this non-legislative approach privatizes or, at the very least, decentralizes the lawmaking process, because it is not based on any legislative authority or official ratification.[95] Hence, the instruments' creation and practical use illegitimately excludes (elected) lawmakers and judiciaries from international contract regulation.[96] Some even argue that the use of such *soft law* to supplement or interpret contractual laws is incompatible with the normative primacy of national legislators.[97] The response to these concerns must be that the Principles are not intended to *replace* any mandatory contract law forum, but are only to be (legally) applied where, within the boundaries of their contractual freedom, the parties (or judicial or arbitral bodies construing the contract) exercises the option to rely on such non-legislative rules.

Other analysts criticize the Principles' scholarly nature and expansive approach. These critics argue that the Principles attempt to harmonize international law through the comparison and collection of many legal systems, but these efforts can never lead to sufficiently practical provisions.[98] Whether this type of criticism will prevail depends primarily on the Principles continued use and practical recognition in the future. Coincidently, the Principles multi-national, comparative and neutral approach mirrors consumer and business adjustments to other areas relative to the globalization of business activities. Whenever major national or regional economic, cultural and legal standards compete or are compared with each other, a "common core" evolves as the basis for a superior international standard.

What makes the Principles outstanding in comparison to other sources of *soft law* is their dual value. On the one hand, they serve as a very concise source for any contractual legislation because they were developed unhampered by singular economic interests or political tactics. On the other hand, while the harmonization process proceeds, their provisions can be applied and tested in practice. This allows for those who will be influenced and utilizing the Principles as a source of international law to simultaneously review their substance.

4. Applicability and Scope

The UNIDROIT Principles and the Principles of European Contract Law may both be used for five general purposes:[99] an express adoption in a contract; the

94. The European Court of Justice autonomously interprets EU Directives and Regulations, and its decisions are binding regarding the future application of the respective rules. *See* Amma Nyarko Appiah, *Equal Access to Fish and Chips: Irish Redress of Discrimination Under the Equal Status Act*, 9 NEW ENG. J. INT'L & COMP. L. 549, 552-555.

95. *See, e.g.*, Berger, *supra* note 7, at 951.

96. *See id.* at 956.

97. *See, e.g.*, BETTINA HEIDERHOFF, GRUNDSTRUKTUREN DES NATIONALEN UND EURPÄISCHEN VERBRAUCHER-VERTRAGSRECHTS, 214 (2004).

98. *See id.* at 212.

99. UP (2004), *supra* note 51, at Preamble, cmt. 8; PRINCIPLES OF EUROPEAN CONTRACT LAW, PARTS I AND II, *supra* note 18, at xxiii.

supplementation of domestic and international contract law; use as model codes for the development of domestic and international (i.e. European) legislation; providing a basis for further harmonization; and as the formation of a new *lex mercatoria*.[100] The Principles can be applied as the law governing a contract or a dispute with relation to a contractual relationship before either domestic or arbitral courts.

As mentioned above, the Principles do not rely on any legislative authority. As a result, an individual's choice to use the Principles is only possible *under the rule of*, not *instead of* the applicable domestic or supranational law. Thus, conflict of law rules recognize the principle of contractual freedom, i.e., "party autonomy," and allows for parties to an agreement to be base it upon *soft law* forums. The scope of this option is defined and restricted by any mandatory (or "unwaivable") rules of the applicable domestic law.[101]

On this note, art. 3(1) of the Rome Convention on the Law Applicable to Contractual Obligations[102] deals with contractual choice of law, determining which jurisdiction and domestic laws apply to contracts within the European Union. Article 3(1) states that a "contract [involving a choice between different national laws] shall be governed by the law chosen by the parties." Most commentators posit that this provision only applies to *national legal systems*, not to the choice of *soft law*,[103] meaning that parties to a contract cannot choose the Principles to *replace* the rule of the applicable domestic law. Similarly, if the contract does not designate a governing legal forum, the law of the country most closely related to the contract shall apply (art. 4).[104] The multilateral or domestic conflict-of law rules of other countries and regions provide similar regulations with regard to international contracts.[105]

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100. The term *lex mercatoria* historically refers to supranational rules of law developed by merchants in medieval Europe in response to the insufficiency and economic illiberality of the domestic commercial laws.

101. UP (1994), *supra* note 50, at art. 1.4; COMMISSION ON EUROPEAN CONTRACT LAW, PRINCIPLES OF EUROPEAN CONTRACT LAW art. 1:103 (1999) [hereinafter PECL].

102. The Rome Convention on the Law Applicable to Contractual Obligations (1980) binds all present Member States of the EU and aims at securing that any court in the EU, irrespective of the jurisdiction it belongs to, applies the same law to a contract. The treaty has been implemented by most Member States into their domestic conflict of law statutes.

103. *See* LÓPEZ RODRIGUEZ, *supra* note 63, at 343; *see also* Johannes Christian Wichard, *Die Anwendung der UNIDROIT-Prinzipien für Internationale Handelsverträge durch Schiedsgerichte und staatliche Gerichte,* 60 RABELS ZEITSCHRIFT FÜR INTERNATIONALES PRIVATRECHT 269, 275 (1996) (differentiating with regard to the UP).

104. This "closest connection" is generally determined by the fact of which country the party carrying out the characteristic performance is based in. In countries that are signatories to CISG, the convention generally applies automatically to cross-border contracts if the parties have not expressly excluded its applicability; *See* CISG, *supra* note 42, at arts. 1, 6.

105. For "inter-American" contracts, see the Inter-American Convention on the Law Applicable to International Contracts (1994), ratified at this point by Bolivia, Brazil, Mexico, Uruguay and Venezuela, which, in its substance, closely resembles the Rome Convention, but is of far more progressive character: art. 9(2) and art. 10 of the Convention reserve the option to apply to those contracts "general principles of international commercial law" (like the Principles) as well as national laws. For the MERCOSUR region, also see the Buenos Aires Protocol on International Jurisdiction in Contractual Matters(1994), also called "MERCOSUR PROTOCOL", being ratified by the institution's Member

However, most domestic civil codes allow for derogation from certain provisions in favor of private autonomy (generally referred to by the German term *materiellrechtliche Verweisung*). This flexibility opens the door for the parties to include supranational or non-binding rules like the International Chamber of Commerce's INCOTERMS or the Principles into the terms of their contract.[106] This option is limited only to the extent that national law imposes mandatory rules from which the contract may not derogate.[107] In fact, the Principles' simplistic factual language and comprehensibility often allows the parties to adopt them verbatim.[108] Moreover, arbitral rules are broader in their scope with regard to choice of law and most arbitral courts are not hampered by conflict of law rules.[109] Thus, if the parties include an arbitration clause to the terms of their contract,[110] they can choose the Principles as governing law for a majority of the contract.[111]

Finally, domestic and arbitral courts have discretion to rely (in part) on the Principles. This discretion is most common if the contract expresses or implies that it shall be governed by "general rules of law" or "lex mercatoria."[112] Additionally, a domestic or arbitral court may exercise this discretion if the parties did not previously agree upon a legal system,[113] or—at least to some extent—if there is a need to supplement other uniform international rules of law, such as the CISG,[114] or national laws.[115]

States—Argentina, Brazil, Paraguay and Uruguay. *See* LETTERMAN, *supra* note 7, at 297.

106. PECL implies that it can even be chosen for entirely domestic contracts; PECL, *supra* note 101, at art. 1:101(1).

107. *See* BLASE, *supra* note 88, at 91; Michael Joachim Bonell, *The UNIDROIT Principles and Transnational Law*, 5 UNIFORM L. REV. 199, 201 (2000).

108. For model clauses for international commercial contracts involving the UP, *see generally* LETTERMAN, *supra* note 7.

109. *See* UP (2004), *supra* note 51, at Preamble, cmt. 4.

110. With respect to arbitral clauses, the Principles can be agreed upon explicitly, or they can serve as primary or supplementary rules if the parties state in the contract that it shall be governed by "general rules of law", the lex mercatoria, or the CISG (UP Preamble, PECL art. 1:101(2) and (3), and CISG art. 7). *See* Boele-Woelki, *supra* note 93, at 672; *see generally* Bonell, *supra* note 107; Hein Kötz & Axel Flessner, EUROPEAN CONTRACT LAW, *VOL. I: FORMATION, VALIDITY, AND CONTENT OF CONTRACT; CONTRACT AND THIRD PARTIES* 19 (Tony Weir, trans., Clarendon Press, Oxford 1997) (1992).

111. *See* Bonell, *supra* note 107, at 202; Ulrich Drobnig, *The UNIDROIT Principles in the Conflict of Law*, 3 UNIFORM L. REV. 385, 392 (1998); LÓPEZ RODRIGUEZ, *supra* note 63, at 343. The ICC Rules of Arbitration permit the Principles' application in ICC arbitration; Int'l Chamber of Com. R. of Arb, art. 17 [hereinafter *ICC Rules*].

112. See *ICC Rules* at Preamble; PECL, *supra* note 101, at art. 1.101(3)(a).

113. UP (2004), *supra* note 51, at Preamble; PECL, *supra* note 101, at art. 1.101(3)(b). *See also* Boele-Woelki, *supra* note 93, at 672. Domestic courts applying the Principles exclusively in the case of absence of any declaration in the contract decide against common opinion regarding the Rome Convention.

114. For instance, CISG, *supra* note 42, at art. 78 on interest, which does not provide any rules on when interest starts to run, the method of determining the interest rate, or the currency in which it is to be calculated, can be supplemented by the Principles' provisions on the respective questions; *see* UP (1994), *supra* note 50, at art. 7.4.9; PECL, *supra* note 101, at art. 4.507).

115. UP (2004), *supra* note 51, at Preamble; PECL, *supra* note 101, at art. 1.101(4;). CISG, *supra* note 104, at art. 7(2). 670.

The Principles' substantive scope of applicability encompasses all types of contractual relationships, including contracts involving third parties[116] and contracts of indefinite validity.[117] Strictly speaking, some portions of the Principles are not limited to contracts, but may provide rules for obligations in general, e.g. their provisions set-off (UP Ch. 8; PECL Ch. 13) and assignment of rights (UP Ch. 9; PECL Ch. 11).

Geographically, the PECL applies if at least one of the parties is based in the EU.[118] They may be used for transnational and domestic contracts.[119] As already implied by their name, the UP, unlike the PECL[120], relate to *inter*national *commercial* transactions worldwide.[121] If the parties choose the Principles as applicable governing law, they have an autonomous character similar to any domestic contract law system containing provisions from which the parties may not derogate.[122] Moreover, they shall be interpreted based on and in harmony with the ideas and purposes they bear in themselves.[123] From a more theoretical perspective, the Principles are intended to provide a source of reference for lawmakers, Comparative Law researchers and academics. They are supposed to contribute to the ongoing development of a modern *lex mercatoria*.[124]

On a critical note, the Principles' entire scope of applicability must be considered through consultation of other rules of law and secondary sources since their provisions or comments do not offer any normative determinations or explanations. In fact, both texts read like appeals and require private parties, legislators and arbitral judges to apply them. To minimize confusion, further clarification and specification of this essential portion of the Principles, e.g. by implementing the countless scholarly commentaries and practical experiences into a more precise determination of the scope of applicability, must continue to be a major objective.

5. Differences in Substance

As a result of regional and material differences in their scope of applicability, the UP and the PECL exhibit slight substantive divergences. Generally, however, the provisions of these instruments bear a striking resemblance in some areas. In

116. *See* UP (2004), *supra* note 51, at art. 5.2.1; PECL, *supra* note 101, at art. 10.101.

117. *See* UP (2004), *supra* note 51, at art. 5.1.8; PECL, *supra* note 101, at art. 6.109, 9.302.

118. PECL, *supra* note 101, at art. 1:101(1).

119. *See* PRINCIPLES OF EUROPEAN CONTRACT LAW, PARTS I AND II, *supra* note 18, at xxv.

120. The PECL are intended to be applied for commercial as well as business-to-private and private-to-private contracts; *see id.*

121. *See* UP (2004), *supra* note 51, at Preamble, cmt. 1 (The terms *international* and *commercial* are supposed to be interpreted extensively , i.e. they do not necessarily require involvement of a merchant with all attributes required by most commercial codes).

122. *Id.*, at art. 1.5.

123. *Id.*, at art. 1.6(2).

124. *See* Boele-Woelki, *supra* note 93, at 658; Bonell, *supra* note 107, at 199. In this context, see especially the Principles' inclusion into respective databases, e.g., http://www.lexmercatoria.org or http://www.transnational-law.de.

fact, with the UP extension in the 2004 edition,[125] it has become a set of rules every bit as comprehensive as the PECL.[126]

The initial differences are mainly due to the two instruments' regional scope of application. Whereas the UP addresses *international* contracts, the PECL focuses on cross-border *and* domestic contracts within the European Union.[127] As a result, the PECL's general provision covering good faith and fair dealing implies that European customs shall determine these terms; however, the UP expressly refers to "good faith and fair dealing in international trade."[128] Similar differences of perspective can be found under the Principles' provisions with regard to the consideration of usages. The PECL provides that "[the] parties are bound by . . . usage considered generally applicable by persons in the same situation" and thus usages within the EU. Alternatively, the UP permits only consideration of "usage that is widely known to and regularly observed in international trade".[129]

Other divergences stem from the UP's strict focus on *commercial* contracts, in contrast to the PECL, which may be applied to *consumer* contracts.[130] As such, application of the UP is often more liberal with regard to the validity of additional or deviant terms in confirmation letters[131], or of merger clauses.[132]

The Principles' differences with regard to the types of contracts also serve to demonstrate the two instruments' unequal provisions concerning the incorporation of standard terms. Under the UP, the general rules covering the contract formation also apply to the incorporation of standard terms. However, the PECL—in line with the EU's legislative emphasis on consumer protection—are comparably more protective of consumers, providing that terms that have not been individually negotiated must be brought to the other party's attention in order to be valid.[133] Equally, under the UP, unfair terms are invalid only if they are substantially unfair *and* if one party has taken advantage of any shortcomings of the other side. But according to the PECL, significant imbalance alone is sufficient for avoidance of the term.[134] And finally, the UP's rulings on payments would pose a gross disadvantage for consumers, because UP art. 6.1.7(1) determines that the currency is to be the one used at the *place of payment*, e.g. at the seller's place of business. In

125. The 2004 edition of the UP has been extended by chapters and sections on the Authority of Agents (chapter 2, sec. 2); Third Party Rights (chapter 5, sec. 2); Set-Off (chapter 8); Assignment of Rights, Transfer of Obligations and Assignment of Contracts (chapter 9); and Limitation Periods (chapter 10). See UP (2004), *supra* note 51.

126. The fields of plurality of parties, illegality, conditions, and interest, which are covered by the PECL, are not (yet) addressed by the UP. For a more extensive comparison between the 1994 version of the UP and the PECL, *see* Bonell, *supra* note 49, at 235, who differentiates between differences of technical nature and those of "policy" nature.

127. UP (2004), *supra* note 51, at Preamble.

128. *Id.*, at art. 1.7(1).

129. *Id.*, at art. 1.9(2).

130. *Id.*, at Preamble.

131. *See Id.supra* note 51, at art. 2.1.12.

132. *Id.*, at art. 2.1.17.

133. *Id.*, at art. 2.1.19.

134. *Id.*, at 3.10.

contrast, the PECL allows for payment "in any form used in the ordinary form of business."[135]

Finally, substantial differences result from the UP's *global* perspective and scope of application compared to the PECL's *European* focus.[136] Accordingly, the PECL is not required to account for currencies that are not freely convertible.[137] By the same token, only the UP considers the requirements of permission in connection with performance, or with the determination of the relevant time zone.[138]

6. Practical Relevance

The extent to which the two sets of Principles have been embraced and applied to business transactions has led their drafters to express both satisfaction and confidence.[139] As proposed in the instruments themselves, the Principles have influenced various lawmakers in the formation of national civil codes, are being used to supplement other contract law instruments in judicial and arbitral proceedings, and have been chosen as contract terms by contractual parties.[140]

A recently established online database,[141] providing case law and a bibliography on the UP, shows consumers' interest and reliance on the instrument has continued to increase since it was first released in 1994. The database currently carries about 100 (mostly arbitral) cases in which judges and arbitrators have reviewed and adjudicated using the UP. Other evaluations and comments have also indicated a fairly wide appreciation of the UP in all fields of application suggested by their drafters.[142]

Unfortunately, comparable evaluations are not currently available for the PECL. However, commentators have stated that the European Principles have not yet achieved similar success.[143] This may be the result of the PECL's more narrow European Union contracts focus, where there already exists a fairly elevated level of harmonization between the domestic systems and less of a need for the parties to

135. PECL, *supra* note 101, at art. 7:107(1).

136. *Id.* at art. 1:101(1); UP (1994), supra note 50, at Preamble.

137. PECL, *supra* note 101, at art. 7:108.

138. UP (2004), *supra* note 51, at arts. 6.1.14, 1.12.

139. *Cf.* Michael Joachim Bonell, *UNIDROIT Principles 2004 – The New Edition of the Principles of International Commercial Contracts Adopted by the International Institute for the Unification of Private Law*, 9 UNIFORM L. REV. 5, 7 (2004) [hereinafter Bonell 2004] (recognizing that UP provisions complement many countries' domestic laws and that the UP are employed in law school curriculums worldwide); *cf.* Michael Joachim Bonell, *The UNIDROIT Principles in Practice: The Experience of the First Two Years*, 2 UNIFORM L. REV. 34, 37 (1997) [hereinafter Bonell 1997] (noting that the UP have inspired a number of countries' civil codes including but not limited to codes in Eastern European transition countries).

140. Bonell 2004, *supra* note 139, at 7-13; *see also* Pace Law School Institute of International Commercial Law, Pace Law School CISG Database, http://www.cisg.law.pace.edu (last visited Sept. 18, 2005) (referring frequently to the UP and PECL as supplementation to CISG).

141. *See generally* Bonell, *supra* note 85; *see also* Klaus Peter Berger et al., *The CENTRAL Enquiry on the Use of Transnational Law in International Contract Law and Arbitration*, *in* THE PRACTICE OF TRANSNATIONAL LAW 112 (Klaus Peter Berger ed., Kluwer Law International) (2001) (studying the use and prevalence of transnational commercial law in international practice).

142. *See, e.g.*, PRINCIPLES OF EUROPEAN CONTRACT LAW, PARTS I AND II, *supra* note 18, at xii.

143. *See* BLASE, *supra* note 88, at 101; Bonell 2004, *supra* note 139, 9 UNIFORM L. REV. at 36.

consider an alternative set of rules. Furthermore, since the PECL emphasizes the protection of the weaker party, which is not limited by any provision to only consumer contracts, they are impracticable in international trade.

Despite this fact, international commentators possess a general appreciation for the PECL and they have even been referred to by courts outside Europe.[144] This suggests that their substance is regarded as valuable as that of the UP. It is likely that the PECL's "breakthrough" may still come to pass, especially if they continue to play an expectedly substantial role in the further unification of European contract law.

Naturally, it is impossible to accurately predict the extent to which private parties and their legal counsels have adopted or relied upon the Principles when drafting cross-border contracts. However, it seems appropriate to conclude that the UP has gained their share of recognition and practical relevance in the international business community as well as among legal professionals, scholars and lawmakers.

D. The Principles' Value and Deficits as Means of Contract Law Harmonization

As mentioned earlier, the main criticism regarding the role of the Principles in harmonizing international contract law evolves from their drafters' lack of legislative power. As a result, there is no democratic legitimacy in the drafting process, and neither the UNIDROIT Institute nor the Working Groups developing the PECL can be held accountable for their work. However, if the Principles, like any other harmonization instruments, are to be implemented under domestic or international laws, they must pass a general lawmaking process, leaving the final decision to the responsible legislative bodies.[145] This process would apply especially to any imbalanced policies that resulted from any influence by interest groups can be corrected within this process.

Naturally, this protection mechanism is not triggered if contractual parties, arbitrators or even domestic courts use the Principles in practice where allowed. Some commentators have criticized the increasing "privatization" of lawmaking and litigation, such as through the growing use of arbitration instead of domestic judicial systems. This is a valid concern, especially regarding younger democracies in which legislative legitimacy has yet to be firmly established and any "privatization" bears the risk of elites and interest groups again taking disproportional influence on legislation and judicial decisions. On the other hand, the Principles, like other instruments drafted by private groups, must withstand their use and scrutiny by those who use them. Only the extent to which they will be applied can provide an indicator of their practical value and whether they should be codified as domestic or international rules of law. Fortunately, this also demonstrates the Principles' advantage over international conventions. Whereas the latter must be adopted prior to being used, application of the Principles remains independent

144. *See* GEC Marconi Sys. Pty. Ltd. v. BHP Info. Tech. Pty Ltd. (2003) 128 F.C.R. 1, 62, *available at* http://www.unilex.info *under* case number NG733.

145. *See* Gopalan, *supra* note 8, at 293 (noting that harmonized commercial laws in general must be passed by national legislatures before coming into force).

from their legislative status. This provides an opportunity for the Principles to be less of a compromise between different countries' interests, which is always necessary to ensure ratification by a sufficient number of significant nations.[146] Moreover, the Principles are far more flexible and amenable to modification in response to new, innovative trends and experiences than legislative or other instruments.[147] For example, the CISG, requires that any changes must be agreed upon by all signatory states[148] and it only applies to sales of goods transactions.

Finally, as described above, the methodology upon which the Principles are based provides sufficient reason to consider them a "neutral" and profound alternative rather than a disguise of specific interests and a rigid product of compromise. The Principles provide a wide range of applications, of which some surely will be more relevant than others, as well as a ready-to-adopt structure that makes them valuable contributions to the harmonization process. This is also why parties may rely on the Principles as trustworthy "deal-savers" if they cannot agree upon a certain legal system to govern a contract.

However, depending on the level of harmonization intensity that one prefers, "privatized" approaches always bear the risk of being applied or adopted piecemeal. Thus, unlike binding legislative harmonization, the Principles may inadvertently may hinder more homogenous internationalization.

E. Conclusions

Since the Principles can never supersede the application of domestic or supranational law they, are not a means to "escape" the authority of legislative regulation, but instead provide a "neutral" alternative to the legal insufficiencies encountered in international trade.

There is no doubt that the Principles are neither infallible nor entirely complete.[149] However, despite some early skepticism regarding the Principles' practical value,[150] most commentators have acknowledged the two instruments' combination of homogenous and comprehensive substance and their flexibility and simplicity, as significant advantages over other soft law supranational instruments like the CISG. As a result, the UP in particular has gained considerable relevance

146. *See* Arthur Rosett, *UNIDROIT Principles and Harmonization of International Commercial Law: Focus on Chapter Seven*, 2 UNIFORM L. REV. 441, 444 (1997) (asserting that sophisticated commercial parties may choose to employ international commercial codes in order to protect their interests); *see also* Gopalan, *supra* note 8, at 307-08 (highlighting very low ratification rates of various commercial conventions).

147. *See* Ole Lando, *Principles of European Contract Law and UNIDROIT Principles: Moving from Harmonisation to Unification?*, 8 UNIFORM L. REV. 123, 124 (2003).

148. CISG currently accounts for ratification by 63 state parties. *See* Rosett, *supra* note 146, at 444.

149. For example, even though the PECL are to be applied to consumer transactions, their measures of consumer protection are not always sufficient and in line with EU legislation. *See* PECL, *supra* note 101, at 2:101(2) (stating in opposition to EU Directives, that the PECL do not require consumer contracts to be in written form).

150. *See, e.g.*, Catherine Kessedjian, *Un exercice de renovation des sources du droit des contrats du commerce international: les principes proposes par l'UNIDROIT*, *in* RÉVUE CRITIQUE DE DROIT INTERNATIONAL 641, 641 (1995).

in practice and influenced judges and lawmakers alike. Thus, the Principles should be considered and are being widely received as valuable contributions to the process of international contract law harmonization.

IV. ALTERNATIVES WORTH COEXISTING, OR COMPETING VARIATIONS OF SIMILAR CONTENT?

The exemplary comparison of the most essential divergences shows that, particularly after the completion of the 2004 version of the UP, the two sets of Principles are very similar, and their few discrepancies are mostly related to their different scopes of application. This certainly begs the question of whether there is a need for both instruments.[151]

The historical explanation for why two similar instruments were being developed at the same time has been often recited. While UNIDROIT considered the project since the early 1970s, many were skeptical about its feasibility and success, mainly because other comparable instruments had been contemplated but only drew little recognition at that point. At the same time, however, harmonization in the European Union was gaining momentum and the codification of uniform contract laws with the EU seemed more promising. As it later became clear that both instruments would achieve similar success, their contents and purpose were too well-developed to abandon the completion of one or the other.[152]

Some commentators have argued that the existence of two similar and yet not identical rules of law that can be applied alternatively would increase the legal insecurity and confusion the instruments seek to ease.[153] Others have replied that the instruments' different regional scopes and the PECL's applicability to consumer contracts provide space for non-competing coexistence.[154] Surely, the PECL's strength lies in their focus on a region with high internal and outbound trade volume. Moreover, a unification of different countries' contract law systems is much more probable and reasonable in the EU, whose members share a common economic, legal and cultural foundation and enjoy a high level of institutional and legislative synchrony. Thus the PECL are very likely to serve as a model for the anticipated European Civil Code, or, at this stage, for making EU legislation more coherent.

Apart from this role, however, particularly because of the business community's imperturbable preference of national laws for purely domestic contracts, it is difficult to consider the PECL an option equivalent to the UP in practice.[155] By the same token, lawmakers, judges and professionals on other continents have been hesitant to choose the PECL, which are based on the "economic and social conditions prevailing in the Member States"[156], over the globally oriented UP.

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151. For more detailed comparisons, *see generally*, Bonell, *supra* note 49.

152. *Id.*, at 241.

153. *See* LETTERMAN, *supra* note 7, at 268.

154. *See* Bonell 2004, *supra* note 139, 9 UNIFORM L. REV. at 35-38.

155. *See id.* at 36 (pointing out that 90% of all arbitral rewards referring to the UP do not mention the PECL).

156. *See* PRINCIPLES OF EUROPEAN CONTRACT LAW, PARTS I AND II, *supra* note 18, at xxv.

The principal value of formulating common principles and a neutral instrument lays in bridging the gaps between socialist and capitalist or civil law and common law countries. The PECL themselves illustrate how (unexpectedly) close the different legal systems in Europe actually are with regard to the basic questions of contract law.[157] However, it may well be exactly this proximity of the legal systems they refer to which, in the presence of CISG, domestic laws, the Rome Convention and uniform European legislation, limits interest in the PECL to their value as a source of reference for future EU legislation.

At the same time, however, in spite of their similar contents and the passing of 10 "peaceful" years of coexistence, the UP and PECL never really competed nor asserted to offer the best solutions or the most favorable alternative. Rather, the areas in and the amount to which each rule has been applied have already assigned each instrument its respective significance and future role.

V. CONCLUSIONS

The harmonization of international contract law is necessary to provide solutions to the questions raised by the globalization of business activities and contracts. However, no single instrument seems eligible to serve as a broad-based, universal source of such harmonization. Moreover, national laws have not been sufficiently adjusted.

As long as legislative instruments lack efficient rules for international transactions, the UP and PECL are viable alternatives to existing domestic and supranational laws governing cross-border contracts. Their extensive and independent drafting process, wide scope of applicability, and innovative structure have generated both criticism regarding the lack of legislative authority and acknowledgement with respect to their combination of comprehensiveness and practical solutions found in major contract law systems.

The Principles' comparative substance has also been welcomed as a profound contribution toward harmonization. The sets are (widely) similar in methodology, legal character, applicability, and contents. In practice, the UP have been especially well received by professionals (as rules governing contracts) and arbitral courts (as governing rules or to supplementing other instruments). The PECL have not had similar success, but it will most likely play a role as Europe moves toward the further enhancement of contract law unification.

Therefore, work on the PECL does and should continue with regard to the possible creation of a "European Civil Code" and the ongoing process of EU contract law harmonization. The UP, on the other hand, will be more successful in providing a source of reference for legal professionals, judges, arbitrators and lawmakers all over the world when drafting and deciding issues connected to international contracts and cross-border transactions.

157. *See* Arthur S. Hartkamp, *The UNIDROIT Principles for International Commercial Contracts and the Principles of European Contract Law*, EUR. REV. OF PRIVATE L. 341, 357 (1994).