UNIDROIT's Rules in Practice

Standard International Contracts and Applicable Rules

by G. Gregory Letterman

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Dedication

To my wife,
Katherine Hawkins Letterman

Preface

This book deals generally with the increasingly important subject of the "internationalization" of contracts.

Much stress has, necessarily, been given here to the United Nations Convention on Contracts for the International Sale of Goods and the UNIDROIT Principles of International Commercial Contracts. As important as these two items are to the "internationalization" of contracts, they are far from the only relevant topics on this subject. Consequently, attention has also been paid to other applicable international agreements, model laws and contracts, standardized usages, and dispute resolution methodologies.

Because of the breadth of coverage of the subject of this book, the depth of treatment cannot be sufficient in such a small volume for a complete or dispositive consideration of the subject. In addition, things are changing in this field. New international agreements, new court cases, and new academic consideration of the subject—to name only a few of the causes of change—are certain to make any detailed treatise on the field soon obsolete. The reader has been referred to other sources for more detailed consideration of and updated information on the many topics covered in this book.

This book undertakes to instruct the reader generally in the various components of the "internationalization" of contracts, to advise the reader of the most important current aspects of each component, and to assist the reader in cumulatively and selectively using all the components of contract "internationalization" to his or her best practical advantage.

It is my hope that readers will find the contents of this book informative and useful. Any criticism or praise, suggestions for changes and augmented or corrected information, and comments generally are welcomed. They may be submitted to me through my publisher.

G. Gregory Letterman
Kansas City, Missouri, U.S.A.
September 1, 2000

Table of Contents

CHAPTER 1

INTRODUCTION

"INTERNATIONALIZATION" OF PRIVATE COMMERCIAL CONTRACTS

This book is written for those involved in negotiating, drafting, administering, or litigating international commercial agreements. It is not, and necessarily could not be with the constraints imposed by the limited size of this volume and the fact that new developments make achievement of such an aspiration fleeting if not impossible, a complete and definitive treatment of the individual subjects dealt with in this book. Neither, consequently, is it an exhaustive consideration of the larger theme of this book itself. Reference to other materials, including those that are regularly updated, will be necessary to make any sophisticated practical application of the topics covered in this volume. Nonetheless, this book will provide an essential understanding of the concept of the "internationalization" of commercial contracts and of the interrelationship of the different principal elements currently used by contracting parties to achieve that "internationalization."

The principal features of such "internationalization" are (1) the United Nations ("U.N.") Convention on Contracts for the International Sale of Goods ("the CISG") (and its associated U.N. Convention on the Limitation Period in the International Sale of Goods); (2) The UNIDROIT Principles of International Commercial Contracts ("UNIDROIT Principles"); and (3) the general global scheme, under various institutions and methods, of international commercial contract arbitration. In addition, other private and

governmental international agreements and conventions; broadly accepted and used trade terms, practices, and standard contracts; national statutes; and related matters may play a role in the "internationalization" of commercial contracts and will be considered here.

As with any legal scheme regulating commercial contracts, the ultimate aim of the "internationalization" of contracts 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.

"International commercial contracts" have been around for as long as there has been "international trade." They may be — and have been — defined in different ways by international conventions and agreements and the writings of scholars. Some conventions and treaties have gone so far as to identify an "international" contract as simply one that the parties to the contract say is "international." In any event, special circumstances will often make it difficult to apply any definition to determine whether a contract is or is not "international." A practical definition of what constitutes "international contracts" is that they are simply contracts for transactions in which at least two of the parties are of different nationalities or which prescribe acts of performance in more than one country.

Although each contract has many of the same common elements and concerns whether it is deemed a "domestic" or an "international" contract, there are aspects of an international contract that will rarely or never be relevant for a domestic contract. The following list of such aspects is illustrative and not exhaustive: (a) the currency to be used for various purposes in a contract; (b) the language or languages in which the definitive form of the contract is to be written, notices and other filings made, negotiations and dispute resolution proceedings to be held, *etc.*; (c) designated holidays, the work week, and working hours for various purposes in the contract; (d) the effects of customs duties and tariffs; (e) export and other necessary international transaction authorizations from pertinent governments; (f) the differences in cultural business attitudes and practices; and (g) the practical consequences of time zone and dateline differences as well as the simple effects of great distances and intervening oceans.

There is a big difference between the "international commercial contracts" of the past two centuries and the current effort to "internationalize" some commercial contracts. An "internationalized" commercial contract is

one which has been removed, to a greater or lesser degree, from any one nation's legal standards, system of dispute resolution, or commercial practices.

To some extent, this is a case of history repeating itself. During the European Middle Ages, merchants whose trade encompassed all Europe and beyond were inconvenienced by the laws of European states. Those laws were often ill-developed and imperfectly administered; principally served the interests of the noble heads of government and not of commercial interests; were not based on an understanding of then current commercial and trade relations and practices; might change with a royal marriage, change in sovereign, or defeat in war; and often were not adjudicated or enforced in an effective manner. The solution of those merchants was to create their own law, the so-called *lex mercatoria*, and to establish and administer their own private commercial courts. This law and these courts dealt with contracts and parties from all Europe and were not limited by national boundaries.

In our own time, the *droit commun législatif* proposed by French comparative law scholar Edouard Lambert early in the 20th century was intended to achieve the same purpose as the *lex mercatoria* through adoption of "general principles of law" or a *jus commune*. Conferences convened in the 19th and 20th centuries sought, unsuccessfully, to create common commercial law for the Latin American states. More successfully, the Scandinavian countries have created a common system of commercial law which each applies through each country's own national legislation. The Uniform Commercial Code ("UCC") of the United States ("U.S."), which has been adopted (sometimes with modifications) by almost all the U.S. states, and the Restatements of the Law prepared by the American Law Institute, which are scholarly and logically-organized declarations and commentary as to the present or preferred states of particular aspects of the law, are examples in a federal setting of a similar effort to create transjurisdictional uniform commercial law.

WHY "INTERNATIONALIZE" CONTRACTS?

Before we examine the question of how commercial contracts may be "internationalized," we will first explore the question of why such "internationalization" of contracts is even being attempted.

This is not a process that is being pressed on unwilling contracting parties. On the contrary, the process is being created at the urging of such parties. Most "internationalization" is volitional on the part of the contracting parties, *i.e.*, contracting parties may elect to not have their contract be subject to most forms of contract "internationalization" and in some instances they must positively declare their contract to be subject to a form of "internationalization" before it is made subject to it.

National governments, in contrast, are often very dubious about this process of contract "internationalization." Every country has, regarding some types of contracts or particular aspects of all contracts, imposed limitations on the contracting parties removing such contracts from the coverage of some national laws or the jurisdiction of national courts. National restrictions on contract "internationalization" arise largely on the basis of two concerns: (1) a desire by the country to maintain control over the contracts (and the parties) through its own laws and courts and (2) a fear that parties will choose (or a weaker party will be compelled to choose) some legal standard and/or an adjudicatory system that subverts or evades the national policies embodied in national laws which are enforced through national courts.

Contracting parties are generally supporters of contract "internationalization" for a number of reasons. The list which follows does not purport to be exhaustive of them.

"Internationalization" makes contract negotiations and compromises on some ancillary matters (particularly choice of law and venue for dispute resolution under the contract) easier where the contracting parties are of more than one nationality. It has long been a common practice for each contracting party to insist that its own national laws be made the "choice of law" designated in the contract. In most cases, this insistence did not reflect a considered choice following a close examination of the different laws and legal systems of each of the parties. Usually the party insisting that its national laws be chosen is completely ignorant of the nature of the laws and legal systems of the other contracting parties. That party simply knows its own laws and legal system and is comfortable with them. Where more than one party insists on its own national laws being adopted, this often imposes significant delays in negotiations and is not infrequently a "deal killer." Such a negotiating deadlock is self-defeating for all parties concerned. It is dictated by ignorance through an ill-considered insistence on adopting a familiar system of laws no matter how the details of such system and their

application to the contract in question compares with the system of laws proposed by the other party. To avoid such unnecessary contract negotiation impasses, a compromise between each party's insistence on one of two or more competing national legal systems must be found. To be a workable compromise, the legal system ultimately adopted must be one acceptable and familiar to all parties. It has been common practice for the compromise to be the selection as contractual "choice of law" of a third country's legal system and/or courts, such as those of England or the State of New York.

"Internationalization" expedites contract negotiations for a particular aspect of a transaction or regarding transactions in a particular industry. Where a contract must be negotiated *ab ovo* or its terms defined afresh without reference to any one country's national commercial practices or laws, the process is time-consuming. What is more, there is uncertainty about what the contract or the terms mean — or will be defined by the courts to mean — in practice. Consequently, when there are standard contracts, contractual provisions, or contractual terms that have attained general international usage and have been defined clearly in the courts or elsewhere, using these as the basis for negotiations or simply adopting them and filling in the blanks or selecting from among standard optional provisions will greatly speed arrival at an agreement on the contract. In some industries, a quick agreement is an essential element in engaging in transactions and the universal use of standard contracts is of vital importance in those industries.

There are instances in which a nation's laws, legal system, or courts are thought by one or more contracting parties to be so unacceptable as to require some contractual means to remove the contract from the application of one or all of them. Unfortunately, such instances are numerous. It is often the case that these are in lesser developed countries or former socialist countries where the courts are not competent, efficient, independent, or honest and where the laws may be rudimentary, conflicting, untested in the courts, or otherwise inadequate. Nonetheless, developed countries also are sometimes believed by some parties to have laws, legal systems, and courts to which such parties are unwilling to subject their contracts. The process of legal adjudication in the U.S. is widely thought, outside the American legal profession, to be exorbitantly expensive and distressingly slow and to too often render imperfect or unpredictable outcomes. "Internationalization" of contracts may provide the means of escaping the jurisdiction of such unacceptable laws, legal systems, and courts.

It is also the case that parties to contracts may wish to have greater flex-

ibility in their means of resolving contractual disputes, to maintain a degree of confidentiality of information or the progress of dispute resolution, or to refer such disputes to adjudicators with greater knowledge of their industry than would be possible through the use of national courts. It is for this reason, among others, that international arbitration and related alternative dispute resolution means outside any nation's judicial system are increasingly popular and have even become the virtual industry standard in the case of some industries or types of contracts.

In every effort to "internationalize" contracts, there is always an initial problem that must be faced. If national governments refuse to acquiesce to this internationalization, practical implementation may be severely limited — at least in some cases. If national governments formally or informally accede to this internationalization, there is a danger that the process will become mired in all the politics, rigidities, and disregard of commercial interests that created the initial enthusiasm for the internationalization.

HOW TO "INTERNATIONALIZE" CONTRACTS

Having described why parties might wish to "internationalize" their contracts, let us turn our attention to how they might do so.

Assuming that parties are permitted full license to freely arrive at mutually-acceptable contractual terms, they may contract to do whatever they wish under whatever terms they wish. In such a world, the parties could craft their own legal standards applicable to the contract and freely define all terms used in the contract. In reality, however, no contract can establish an entire and entirely independent legal substructure. Even the most detailed self-regulating contracts still require extrinsic legal frameworks as the matrices upon which their contractual terms are constructed. Similarly, language differences and the absence of established international definitions or standard terminology regarding the terms used may create gaps in the contracts' legal standards. Terms devised by the parties and untested in practice or in the courts may be interpreted in ways not initially expected or intended by the parties.

A completely unrestricted right by the contracting parties to mutually agree to whatever contract and contractual terms they chose does not exist in any country, of course. When the purpose of the contract is illegal, such as hiring a killer to illegally slay another, the contract itself is invalid and its cre-

ation may itself constitute a criminal act. When the contract would violate essential public policies, it is commonly the case that the contract, to the extent it violates such policies, is invalid. Frequently, in such cases, violative provisions will be ignored and/or statutorily or judicially dictated provisions will be substituted for them. Under any circumstances where the choice of law by the parties is so limited, the right of choice of law of a contract is generally restricted to domestic laws existing at the time of contract formulation or by the domestic law existing at the time of adjudication. This may permit one or the other party to act with greater familiarity regarding the controlling law than the other and, in the latter case, post-contract-signing changes in the law may invalidate the assumptions made even by a fully-informed party when entering into the contract.

Nonetheless, to the extent there is freedom for the parties to contract according to their own mutual agreements, the contracting parties may essentially create their own, *ad hoc,* legal standards and terms applicable to a particular contract through the drafting of the contract. The extent of the parties' freedom to contract varies greatly from legal system to legal system, with common law legal systems usually providing the greatest latitude to the parties and the civil law legal systems often being quite restrictive. Some legal systems, such as the Islamic legal system, will permit no latitude of choice — at least for those aspects covered by the Islamic or other relevant law.

An extension of private initiatives to "internationalize" contracts occurs when particular industries or private commercial associations create their own effective legal systems for specific contracts through the standard usages of their industries or the formal crafting of standard contracts and model clauses, establishment of defined terms or applicable legal rules, or empanelment of non-governmental dispute resolution bodies. These may be of universal applicability or may apply only to transactions within an industry or of a special type. Governments may chose to or not to formally recognize these privately-established legal standards and procedures. They may also chose to permit their operation with respect to contracts subject to the governments' possible jurisdiction or to proscribe in part or in whole the operation of such a system with regard to those contracts.

Examples are numerous where industries, trade associations, and commercial organizations have created such legal and procedural contract standards that have become almost universally adopted and accepted. Among them are the International Chamber of Commerce ("ICC") and its

International Contract Terms ("INCOTERMS") for commercial contracts and Uniform Customs and Practice for Documentary Credits 500 ("UCP 500") rules for letters of credit.

Nonetheless, the adoption of contractual terms, rules, procedures, or dispute resolution methods by any individual or the contractual incorporation of industry measures risks practical invalidation if the courts of a country will not recognize that adoption or incorporation as being legally binding or if a legal decision or award based on such adoption or incorporation is not recognized or enforceable in a country where execution of the decision or award must be carried out. For that reason, governmental participation in or acquiescence to any measures adopted or taken provides greater reassurance of the practical effectiveness of such measures. If national governments take a role in the internationalization of contracts, that role may be one for individual governments acting alone, for many governments acting informally but in harmony, or for governments acting multilaterally through legally enforceable conventions and other obligations.

Individual national governments may harmonize particular aspects of their laws with one another. This may take place through formal procedures, such as under treaty or by participation in international fora intended to draft model laws for adoption by individual states or to establish common standards and practices. It may take place informally where the national laws and practices of one country for a particular matter are so pioneering, so demonstrably efficacious, or have become such international standards through their wide-spread use by parties and adoption into the law of other states that a country is induced to model its laws on those of the other state. When this is sufficiently universal, the legal standard becomes an effective and nearly uniform global one even though enacted only through national legislation.

A major contribution to uncertainty regarding the law applicable to a contract, even when some national law is to be applied, is the varying application of national conflicts of law standards to international contracts. Many national (or even state/provincial) governments have sought to reduce uncertainties for international contracting parties, principally regarding conflicts of law rules but sometimes extending coverage to many other and more peripheral subjects, by enacting what are known as "Private International Law Statutes." These will be of importance to contracting parties considering selecting such a country's laws and courts under a contractual "choice of

law" provision or which are compelled to accept the applicability of the country's legal system as a condition of entering into the contract.

Finally, national governments may jointly act through treaty/convention or in multilateral organizations to establish compulsory multinational standards for the operative legal and adjudicatory rules and measures applicable to prescribed international contracts and other commercial transactions. Often these acts do not provide enough flexibility or the ability to change the standards with new developments or practical experience in their application. The establishment of such multilateral measures may take place through international conventions that establish legal standards which are imposed on, or which may be voluntarily adopted by, private contracting parties. Such standards, when made applicable, will be recognized by all the governments and national courts of the signatories to the convention as being legally valid and enforceable. This may also take place through conventions, treaties, and multilateral agreements which establish mandatory practices and standards pertaining only to the actions of individual national governments but which will have great consequences for some private international contracting parties with regards to how their contracts will be interpreted, administered, and adjudicated. Unfortunately, such instruments when enacted or adopted tend to sometimes be interpreted differently in different countries.

Among those multilateral organizations and institutions which may create model laws, conventions, and suggested standards and rules are the Organization for Economic Cooperation and Development ("OECD"); the Organization of American States ("OAS"); the Council of Europe; and the U.N. and many of its agencies, including the U.N. Commission on International Trade Law ("UNCITRAL"), the U.N. Conference on Trade and Development ("UNCTAD"), the U.N. International Maritime Organization ("IMO"), the World Intellectual Property Organization ("WIPO"), the Economic Commission for Europe, the International Labor Organization ("ILO"), and the U.N. Industrial Development Organization ("UNIDO"). Among the quasi-multilateral organizations performing similar functions are the ICC, the Hague Conference on Private International Law, the International Organization for Standardization ("ISO"), and the International Institute for the Unification of Private Law ("UNIDROIT").

For a comprehensive and regularly updated source of information regarding work in progress by the main international organizations, refer to