

TRANS-LEX **PRINCIPLES** PRINTOUT VERSION



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Preface

This is a print out-version of the Center for Transnational Law's (CENTRAL) TransLex-Principles. It contains the text of more than one hundred principles of transnational commercial law, the new *lex mercatoria*.

The CENTRAL Research Team has collected thousands of full-text references for each principle from legal doctrine, arbitral case law, domestic statutes and international uniform law. For online-access to these references and to more background information on the underlying concept of the “creeping codification of transnational law” please refer to the “Principles” Section of www.trans-lex.org.

For access to the largest bibliography on transnational law please refer to the TransLex-Bibliography at www.trans-lex.org.

If you want more information on the Center for Transnational Law, please refer to www.central-koeln.de.

Please do not hesitate to contact us at info@trans-lex.org if you have any questions or suggestions.

Professor Dr. Klaus Peter Berger, LL.M.

Chapter I: General Provisions

Section 1: Good Faith and Fair Dealing

No. I.1.1 - Good faith and fair dealing in international trade

(a) Parties to international business transactions must act in accordance with good faith and fair dealing in international trade. This standard applies to the negotiation, formation, performance and interpretation of international contracts.

(b) The standards and requirements imposed on the parties by this Principle vary depending on the individual circumstances involved, such as the trade sector in which the parties are operating, their size and degree of professional sophistication, and the nature and duration of the contract.

(c) The parties may not exclude or limit the application of this Principle to their legal relationship.

Cite principle as: www.Trans-Lex.org/901000

Commentary:

1 Subsection (a) clarifies that the scope of the principle of good faith is not limited to the interpretation of contracts but provides a behavioural standard for the parties from the beginning to the end of their (pre-)contractual relationship. This means that each party has the obligation to display a behaviour towards the other party which cannot harm the latter and which takes into account the reasonable expectations of the other side. The parties to a contract have to display a normal and usual diligence which is reasonable for the safeguard of their interests, particularly in trying not to make rushed offers, with a potential to surprise the other party.

2 The Principle of good faith is of such pivotal significance not only for transnational contract law but for legal relationships as a whole that the parties may not contractually exclude or limit its application. Subsection (c) makes it clear that the Principle of good faith is not subject to the Principle of freedom of contract. Such an agreement would itself be void because it is against *boni mores*.

3 Subsection (b) makes it clear that the application of the good faith principle is never a purely mechanical process, but always requires a determination of what is deemed to be a proper conduct of a party, taking into account all circumstances of the concrete case. This analysis must include the nature of the contract itself. Thus, the reference to the 'duration of the contract' in subsection (b) is meant to indicate that the time factor may play an important role as an 'amplifier' for the parties' duties imposed on them by the good faith principle. Thus, in long-term, 'relational' contracts, the principle of good faith will almost always impose increased duties of good faith on both parties as compared to 'one off' exchange contracts. These increased duties may concern, e.g., the parties' duty to notify the other side in case of problems in the performance of the contract and the parties' duty to cooperate with the other party when such cooperation can reasonably be expected for the performance of that party's obligations. The reference to the degree of the parties' professional sophistication in subsection (b) must be seen and applied in conjunction with Trans-Lex Principle I.2.3.

4 Also, the fundamental principle of good faith is the source of many other general but more specific principles and rules of transnational commercial law, such as the principle of sanctity of contracts ("*pacta sunt servanda*") as the basis of transnational contract law, the prohibition of inconsistent behaviour, the duty to renegotiate, the duty to notify and cooperate with the other side, the right to set off, the common intentions of the parties as the goal of every contract interpretation, or the existence of implied contractual obligations. Good faith may also set limits to the exercise of the parties' legal rights, e.g. with respect to the prohibition of abuse of rights or the parties' right to withhold performance. Before resorting to the overriding general principle of good faith, one should always seek to apply these more specific and concrete principles and rules.

No. I.1.2 - Prohibition of inconsistent behaviour

(a) A party cannot set itself in contradiction to its previous conduct vis-à-vis another party if that latter party has acted in reasonable reliance on such conduct ("venire contra factum proprium"; "l'interdiction de se contredire au détriment d'autrui").

(b) Violation of this Principle may result in the loss, suspension, or modification of rights otherwise available to the party violating this Principle or in the creation of rights otherwise not available to the aggrieved party.

Cite principle as: www.Trans-Lex.org/907000

Commentary:

1 This Principle follows from the general Principle of good faith and fair dealing. The other party's reliance may be based on a specific act, a statement or on the silence of the party. The conduct must be related to the contractual relationship existing between the parties.

2 Irrespective of the basis for the other party's reliance, the application of the Principle is limited by the standard of reasonableness. The other party must have acted in *reasonable* reliance on the first party's previous behaviour. This means that it must have had justified reasons to base its reliance on the first party's conduct. Whether this is the case, must be determined against the circumstances of each individual case.

No. I.1.3 - Forfeiture of rights

A party that has not raised voluntarily a right to which it is entitled under the law for a certain period of time is precluded from asserting that right against another party that has justifiably relied on such conduct and will suffer injury if the former party is allowed to repudiate its conduct.

Cite principle as: www.Trans-Lex.org/906000

Commentary:

The Principle is derived from the Principle of good faith and the prohibition of inconsistent behaviour. A party may not claim the invalidity of a contract after it has performed its contractual obligations over a period of several months and has impliedly acknowledged the legal validity of the contract, provided the other party had reasons to believe in the fact that the first party would not object to the validity of the contract. The question whether the second party has such reasons must be decided against the background of the standard of reasonableness.

No. I.1.4 - Abuse of rights

A party may not exercise a right merely to damage the other party or to achieve a result which is disproportionate to the result intended by the legal principle out of which the right arises.

Cite principle as: www.Trans-Lex.org/906500

Commentary:

The Principle provides a classical example of a behaviour which is contrary to the general principle of good faith and fair dealing.

No. I.1.5 - No advantage in case of own unlawful acts

A party may not derive an advantage from its own unlawful acts ("nullus commodum capere potest de iniuria sua

propria", "ex iniuria non oritur ius", "clean hands theory").

Cite principle as: www.Trans-Lex.org/904000

Commentary:

The principle is derived from the general principle of good faith. It means that one party may not avail itself of the fact that the other party has not fulfilled a contractual obligation or has not had recourse to some means of redress, if the former party has, by some illegal act, prevented the latter from fulfilling the obligation in question or having recourse to that redress.

No. I.1.6 - No damage claim in case of consent

A party suffering damage or another prejudice may not raise claims arising out of this if it has consented to the act leading to the damage or prejudice ("volenti non fit iniuria").

Cite principle as: www.Trans-Lex.org/908000

Commentary:

The Principle means that where there is consent there is no injury. It is derived from the general principle of good faith and the prohibition of inconsistent behaviour. If one, knowing and comprehending the danger, voluntarily exposes himself to that danger, though not negligent in doing so, he is deemed to have assumed the risk and is precluded from a recovery for an injury resulting therefrom.

Section 2: Reasonableness; Trade Usages; Professional Competence

No. I.2.1 - Standard of reasonableness

The parties always have to act according to what is reasonable in view of the particular nature of their transaction and the circumstances involved, in particular the economic interests and expectations of the parties.

Cite principle as: www.Trans-Lex.org/902000

Commentary:

- 1 The Principle is derived from the general standard of good faith and fair dealing.
- 2 Its application involves an objective test, taking the position of a neutral person (the "reasonable man") who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract. The reasonable man can be described as a fictional businessman possessing and exercising those qualities of attention, knowledge, intelligence, and judgment that international business requires of its members for the protection of its own interests and the interests of others.
- 3 In legal disputes, the court or arbitral tribunal personifies the reasonable man.

No. I.2.2 - Trade usages

The parties are bound by any usages to which they have agreed and by any practice which they have established between themselves. Unless agreed otherwise, they are considered to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned.

Cite principle as: www.Trans-Lex.org/903000

Commentary:

1 The fact that parties to international business are bound by trade usages of the nature defined in the Principle, even if they did not positively know them, as long as they ought to have known them, results from the presumption of professional competence of international businessmen. Because of this presumed professional competence, businessmen must accept that they are bound by trade usages which they knew or ought to have known.

2 The usage is qualified in three ways: 1) it must be a usage which the parties knew or ought to have known; 2) it must be widely known and regularly observed in international trade (thereby excluding domestic or local usages) by parties to contracts of the type involved and 3) the usage must emanate from the particular branch of trade in which the parties are operating.

3 A trade usage may be defined as a general or at least widespread regular observance of a particular line of conduct amongst those engaged in a particular branch of international trade over at least a short period of time (Vogenauer, in: Vogenauer/Kleinheisterkamp (eds.), *Commentary on the UNIDROIT Principles of International Commercial Contracts*, 2009, at 194).

4 The fact that the parties are bound by any practices which they have established between themselves follows from the principle of sanctity of contracts and the prohibition of inconsistent behaviour. Like a usage, a practice is a particular line of conduct, but contrary to a usage, it must not be observed by businessmen of a particular branch of trade, but only by the parties to the contract.

5 When a practice has been "established" between the parties depends on the circumstances of the case. The reference to the principle of sanctity of contracts means that the practice must be based on a common understanding of the parties and that the other party feels bound by it because of this common understanding which has developed between the parties to the contract in the past, e.g. with respect to the performance of previous contracts concluded between them, or - in case of long-term contracts - with respect to previous performances under that contract (see Vogenauer, *id.*, at 195).

No. I.2.3 - Presumption of professional competence and equality of parties

(a) The professional competence and equality of the parties to an international commercial contract is presumed.

(b) Parties to such contracts may not argue that they were not aware of the significance of the contractual provisions and obligations to which they have agreed.

Cite principle as: www.Trans-Lex.org/909000

Commentary:

1 The Principle is based on the understanding known from domestic laws that everybody who is doing business carries an increased responsibility for his or her business activities, especially with respect to the conclusion of contracts with other businessmen and the assumption of legal rights and duties which arise out of these contracts. Commercial parties must be aware of the extent and significance of and the risks associated with the contractual commitments which they have entered into in the course of their business. They must also accept trade usages, even if they did not positively know them, as long as they ought to have known them, which, again, involves the presumption of professional competence of international businessmen.

2 The application of subsection (b) leads to the consequence that a seller bears the supply risk if the contract with his customer does not contain a provision which provides for a different distribution of the supply risk. Also, the force majeure defence is not available to a party who is facing an increased economic burden of performance unless the contract contains a provision which lists or defines such scenarios as force majeure events.

3 Also, international arbitral tribunals are particularly reluctant to accept the hardship defence when there is no gap or lacuna in the contract and when the intent of the parties has been clearly expressed. In these cases, the principle of *pacta sunt servanda* prevails. The reason why arbitral tribunals are particularly cautious in these cases is that it is generally much less likely in international commercial transactions that the parties have been unaware of the risk of a remote contingency or unable to formulate it precisely, given their presumed professional sophistication.

4 Subsections (a) and (b) increase the burden of proof for a professional party that intends to avoid a contract for errors in law or fact. As a result of the presumption of Subsection (a), a professional party must carry the consequences of its own mistakes to a wider extent than private, *i.e.* non-commercial parties.

Section 3: Varia

No. I.3.1 - Limitation of transfer of rights

No one may transfer more rights than he actually has ("nemo plus iuris transferre potest quam ipse habet").

Cite principle as: www.Trans-Lex.org/905000

Commentary:

It follows from this Principle that only the person who holds a legal title to a right (e.g. property, creditor of a contractual claim) may transfer that right or modify it.

No. I.3.2 - Lex specialis-Principle

Specialized laws prevail over general laws ("*lex specialis derogat legi generali*").

Cite principle as: www.Trans-Lex.org/910000

Commentary:

1 The Principle contains a generally recognized rule of interpretation pursuant to which the more specific provision takes precedence over the more general one.

2 The Principle is based on the presumption that, in enacting a law or drafting a contract provision, a lawmaker or contract drafter does not want to create a law or contractual provision that would be devoid of any scope of application. This would be the case if the general rule always prevailed.

Chapter II: Agency

No. II.1 - Prerequisites and effects of agency

Where an agent acts on behalf of a principal within the scope of his authority which has been granted to him expressly or can be implied from the circumstances, his acts bind the principal and the third party unless it follows from the circumstances of the case that the agent undertakes to bind himself only.

Cite principle as: www.Trans-Lex.org/911000

Commentary:

1 If the prerequisites of the Principle are met, the contract is concluded between the third party and the party which has granted the authority to the agent (the "principal").

2 The scope of the agent's authority must be determined through interpretation of the terms of the power of attorney (in case of an express authority) or the principal's conduct or other circumstances from which the principal's intention to confer authority on the agent can be inferred (implied authority). Even absent an express or implied authority, the acts of the agent may bind the principal *vis-à-vis* the third party in a case of apparent authority.

3 The authority of organs or officers of corporations are not governed by the Principle, but by special rules of domestic corporation law.

No. II.2 - Agent acting on behalf of group of companies

A corporate entity acting on behalf of a group of corporate entities binds all entities that belong to the group.

Cite principle as: www.Trans-Lex.org/912000

Commentary:

This Principle has been developed by international arbitral tribunals as the so-called "group of companies doctrine" for cases in which a member of a corporate group, even though not a signature to an arbitration agreement concluded by another member of the corporate group, appeared in economic reality as the real party to the arbitration agreement and was therefore treated as such by these tribunals. While the principle is disputed in the arbitration context because of the form requirement for arbitration agreements, e.g. under Art. 7 of the UNCITRAL Model Law on International Commercial Arbitration, it can be extended to contracts in general for which no such form requirement exists. However, its application must be limited to clear cases in which the involvement of the non-signatory in the performance of the contractual obligations is so evident and strong that the case comes close to one of apparent authority.

No. II.3 - Agent acting without or outside his authority

The principal is not bound if an agent acts without or outside his authority (*falsus procurator*) unless he ratifies, expressly or impliedly through his conduct, the acts of the agent. In the latter case, the act produces the same effects as if it had initially been carried out with authority.

Cite principle as: www.Trans-Lex.org/913000

Commentary:

1 The scope of the agent's authority must be determined through interpretation of the terms of the power of attorney (in case of an express authority) or the principal's conduct or other circumstances from which the principal's intention to confer authority on the agent can be inferred (implied authority).

2 No matter whether the principal's grant of authority to the agent was express or implied, the scope of the authority extends to all acts which are reasonably necessary to achieve the principal's purposes for which he granted the authority to the agent unless there are clear indications for the fact that the agent intended to grant only a limited authority to the agent.

3 Where an agent acts without authority or exceeds his authority, its acts do not bind the principal and the third party to each other unless in a case of apparent authority.

4 Ratification by the principal of acts by an agent who has acted without authority may be addressed to the third party, to the agent, to both or to the public.

No. II.4 - Agency by estoppel / Apparent authority

Where the conduct of the principal causes the third party reasonably and in good faith to believe that the agent has authority to act on behalf of the principal and the agent is acting within the scope of that authority, the principal may not invoke against the third party the lack of authority of the agent ("agency by estoppel", "Anscheinsvollmacht").

Cite principle as: www.Trans-Lex.org/914000

Commentary:

This Principle results from the general Principle of good faith and the prohibition of inconsistent behaviour. The Principle requires reasonable reliance by the third party on the conduct of the principal, e.g. because the latter has made certain statements or has behaved in a way that causes a reasonable person in the same situation as the third party to believe that the agent has authority to act on behalf of the principal and that he is acting within the scope of that authority.

No. II.5 - Attribution of knowledge to principal

Facts which the agent knows or ought to have known are attributable to the principal.

Cite principle as: www.Trans-Lex.org/915000

Commentary:

The principal may not misuse the agency by arguing that he was not aware or did not know certain facts which his agent knew or ought to have known. Because the agent acts for the principal and with authority granted by the latter, his knowledge is attributed to the principal.

No. II.6 - Performance by agent

Unless a contrary intention appears from the language of the parties, or the nature of the transaction, a debtor may perform his part by an agent. Such a contrary intention is presumed, in the case of any duty involving personal confidence between the parties, or the exercise of the debtor's personal skill.

Cite principle as: www.Trans-Lex.org/915500

Commentary:

A debtor may involve a third party in the performance of his obligations *vis-à-vis* the creditor unless that performance is dominated not only by the performance interest of the creditor but by personal aspects such as the special skills of the debtor or the confidence of the creditor in the abilities of the debtor or if the parties have, by express agreement or by implication, excluded the debtor's right to avail himself of the services of a third party in the performance of his obligations.

No. II.7 - General agent

An agent having authority to conduct a particular trade or business, or to act generally for his principal in a particular trade, business, or undertaking, has authority to do every lawful thing necessary or usually incidental thereto.

Cite principle as: www.Trans-Lex.org/915600

Commentary:

1 The Principle relates to a situation in which an agent has received a general instead of a specific authority to act for a principal, typically for a certain business or trade. For those cases, the Principle provides a guideline as to the scope of the agent's authority.

2 There may be intermediary cases in which the authority of the agent is general in nature, but limited to certain types or categories of acts necessary for the conduct of the business.

Chapter III: Set-Off; Assignment

No. III.1 - Set-off

If parties have mature and liquidated claims of an identical nature vis-à-vis each other, each party may declare the set-off of these claims. Set-off is not admissible if the contract contains an explicit or implicit (e.g. a "net cash against..." clause) prohibition of set-off. The parties may also agree on the set-off of these claims by contractual consent.

Cite principle as: www.Trans-Lex.org/916000

Commentary:

1 The right to set-off mutual claims is based on the idea that it would be against good faith if a creditor requires performance of an obligation from his debtor if the creditor would have to return immediately what he has received from the debtor ("*dolo agit, qui petit, quod statim redditurus est*").

2 Set-off based on an agreement of the parties may either have the direct effect of extinguishing the claims to be set-off ("contractual set-off") or may give one party the unilateral right to declare set-off irrespective of the requirements set forth in the rule, *i.e.* maturity, liquidated and identical nature of claims ("contract to allow set-off").

No. III.2 - Assignment of claim

(a) The creditor (assignor) may assign his claim by contract to the assignee. An assignment is not subject to any form requirements. The assignment is valid irrespective of whether the debtor has been notified of the assignment.

(b) A claim for the payment of a sum of money may be assigned in part. A claim for a non-monetary performance may be assigned in part only if the debtor consents to the assignment; or the claim is divisible and the assignment does not render performance significantly more burdensome for the debtor.

(c) An assignment is invalid if the assigned claim does not exist. A future claim may be the subject of an assignment but the transfer of the claim depends on its coming into existence and being identifiable as the claim to which the assignment relates.

(d) In a b2b-context, a contractual prohibition of, or restriction on, the assignment of a claim, agreed upon by the parties to the contract out of which the claim arises, does not affect the assignability of that claim.

(e) A claim is not assignable, if the parties intended that the promisee alone should be entitled thereto. Such an intention is presumed if the nature of the transaction involves personal confidence between the parties, or is otherwise such that personal consideration is of the essence of the contract.

(f) An accessory right securing payment of the assigned claim is transferred to the assignee without a new act of transfer notwithstanding any agreement between the assignor and the debtor or other party granting that right, limiting in any way the assignor's right to assign the receivable or the right securing payment of the assigned claim. If a non-accessory right is, under the law governing it, transferable only with a new act of transfer, the assignor is obliged to transfer such right and any proceeds thereof to the assignee.

(g) As soon as the assignment becomes effective the assignor ceases to be the creditor and the assignee becomes the creditor in relation to the claim assigned.

(h) The debtor may put forward against the assignee any defences which at the date the assignment becomes effective were available to him against the assignor.

Cite principle as: www.Trans-Lex.org/917000

Commentary:

1 Assignment means the transfer of a claim for payment or for other kinds of performance by agreement between the old (assignor) and the new (assignee) creditor. The assignment is effective irrespective of whether the obligor is notified of the assignment.

2 For the assignment to become effective, the claim to be assigned must exist. This is a consequence of the Principle that no one may transfer more rights than he actually has.

3 A non-assignment clause concluded between the obligor and the assignor does not prevent the assignment from becoming effective but may make the assignor liable for breach of contract *vis-à-vis* the obligor.

4 Because the assignment becomes effective even if the obligor is not notified of the assignment (see para. 1), the latter may not be put in a disadvantage by the assignment. His legal position existing at the moment the assignment becomes effective must be preserved. The obligor may therefore put forward against the assignee any defences that were available to him against the assignor, including a right to set-off.

Chapter IV: Contract

Section 1: General Principles

No. IV.1.1 - Freedom of contract

The parties are free to enter into contracts and to determine their contents (principle of party autonomy).

Cite principle as: www.Trans-Lex.org/918000

Commentary:

1 Together with the Principle of sanctity of contracts this Principle of party autonomy constitutes a core pillar of transnational contract law. The parties' freedom relates to both their decision *whether* to enter into a contract and *how* the contents of that contract should be. It is this latter aspect of party autonomy which allows the parties to create, always within the boundaries of *boni mores* and the Principle on unfair standard terms, their own contractual framework, tailor made to the specificities of their commercial transaction.

2 There may also be mandatory provisions of domestic law, which must be applied irrespective of which law governs the contract ("*lois d'application immédiate*", "*lois de police*", "*Eingriffsnormen*") and which may set limits to the party's freedom to determine the contents of their contractual relationship.

3 The Principle of good faith is not subject to the Principle of freedom of contract, *i.e.* the parties may not contractually exclude or limit it. Such an agreement would itself be void because it is against *boni mores*.

No. IV.1.2 - Sanctity of contracts

(a) A valid contract is binding upon the parties. It can only be modified or terminated by consent of the parties or if provided for by the law. The parties to a contract must, unless legally excused from performance, perform their respective duties under the contract ("*pacta sunt servanda*").

(b) A valid unilateral promise or undertaking is binding on the party giving it if that promise or undertaking is intended to be legally binding without acceptance.

Cite principle as: www.Trans-Lex.org/919000

Commentary:

1 The Principle is an expression of the general Principle of good faith which above all signifies the keeping of faith. Without such a rule international contract law would be a mere mockery.

2 The respect for this principle requires parties to execute their contractual undertakings. However, the modalities of this execution are not indicated by this general principle. It is the principle of good faith which provides this precision in a way that one can merge both principles into one when it comes to the performance of a contractual obligation: "*pacta sunt servanda bona fide*".

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In spite of its pivotal importance, the principle of sanctity of contracts is not without exceptions. One such exception is the principle of hardship. However, since the principle of sanctity of contracts is the rule, the hardship defence is available only in exceptional cases.

4 The Principle applies only between the parties to the contract. It does not prejudice any effect which the contract may have *vis-à-vis* third parties.

Section 2: Conclusion of Contract

No. IV.2.1 - Contractual consent

(a) A contract is concluded when one party has communicated to another an offer, and that other party has accepted it, or when the parties have united in a concurrent expression of intention, designed to create a contractual obligation or contractual obligations.

(b) A valid contractual consent requires that the parties intend to be legally bound and that they have sufficiently identified the terms of the contract with respect to the parties and the subject matter.

Cite principle as: www.Trans-Lex.org/920000

Commentary:

1 Subsection (a) mentions two scenarios in which a contract can be concluded. In the first scenario, one party issues an offer and the other party accepts that offer. In this scenario, the contract is concluded once the offer has been accepted, unless that acceptance contains additions, limitations or other modifications which, when compared with the offer, constitute a material alteration of the offer. In that later case, the reply which purports to be an acceptance constitutes a rejection of the offer and a counter-offer. That counter-offer must be accepted by the party who issued the initial offer for the contract to be concluded.

2 Subsection (b) lists the two requirements which every declaration of will must meet in order to be qualified as a binding offer or acceptance, a subjective and an objective one.

3 The subjective one relates to the fact that for offer and acceptance to be legally valid and binding, they must be issued by the parties with an intention to be legally bound. Usually, such intention is not declared expressly and must be inferred from the circumstances of the case. If a statement is made by one party without such intention, that statement must be qualified as a non-binding declaration of interest or an invitation to make an offer ("*invitatio ad offerendum*").

4 The objective requirement relates to the fact that offer and acceptance must identify the essential elements ("*essentialia negotii*") of the contract

which the parties intend to conclude, *i.e.* the identity of the parties, and, in case of a sales contract, the nature of the goods to be delivered by the seller and the price to be paid by the buyer. These elements can be determined by application of the general principles of interpretation. Essentially, the offer must be so specific that the offeree can conclude the contract by simply saying "yes". Put differently, the acceptance must be the mirror image of the offer. However, a contract can be concluded with the price or other essential elements being fixed at a subsequent stage if the parties indicate that they want to be bound even though that essential element has not yet been fixed.

5 There is a connection between both requirements. The more detailed and specific an offer is, the more likely it is that the party wants to be bound by it.

No. IV.2.2 - Silence by offeree

(a) Silence by the offeree does not in and of itself amount to acceptance.

(b) Silence by the offeree amounts to acceptance if the offeree begins with the performance of his contractual obligations or is required to reject the offer due to a long-standing business relationship with the offeror or is subject to a practice which the parties have established between themselves or a trade usage requiring rejection of the offer ("qui tacet consentire videtur").

Cite principle as: www.Trans-Lex.org/921000

Commentary:

1 The Principle confirms that, unless the parties agree otherwise or have established a usage or course of dealing between them, mere silence of the party that has received an offer to conclude a contract does not amount to acceptance because that silence does not constitute a binding declaration of will.

2 This situation must be distinguished from scenarios in which, though the party receiving an offer does not issue a statement, an implied acceptance of the offer can be inferred from its conduct, *e.g.* because that party begins to perform the contract. In such a case, acceptance becomes effective once the act indicating the party's implied acceptance is performed, even though the offeror may not have taken note of this act at this point in time.

No. IV.2.3 - No repudiation of contractual consent by state party

A state or state controlled entity may not invoke its sovereignty or internal law to repudiate contractual consent.

Cite principle as: www.Trans-Lex.org/922000

Commentary:

This rule is a special case of the Principles of sanctity of contracts ("*pacta sunt servanda*") and good faith.

No. IV.2.4 - Lapse of an offer

(1) An offer lapses when

i)

the party to whom it is made fails to accept it within the time or in the manner prescribed by the offeror, or, if no time or manner is prescribed, within a time or in a manner reasonable under the circumstances,

ii)
the offeree communicates his refusal of the offer, or makes a counter-offer,

iii)
either party dies or, in case of a corporation, ceases to exist.

(2) An oral offer must be accepted immediately unless the circumstances indicate otherwise.
(3) A late acceptance is effective as an acceptance if without undue delay the offeror informs the offeree that the offeror is treating it as an effective acceptance.

Cite principle as: www.Trans-Lex.org/922500

Commentary:

1 Situations when an offer lapses are determined, first and foremost, by the parties themselves (party-autonomy). The offeror may indicate in his offer the time and/or manner in which his offer must be accepted by the other side. Alternatively, the offeree may indicate to the offeror that he refuses the offer or may make a counter-offer. An acceptance with material alterations, limitations or other modifications constitutes such a counter-offer.

2 Absent such scenarios, the offer must be accepted within the time or manner reasonable under the circumstances. What is reasonable depends on the circumstances of each individual case, and requires to take into account the professional sophistication of the parties, the means of communication used by the offeror and usages and practices of communication established between the parties or in the particular branch of trade in which the parties are operating.

3 If the offer is made orally, it must be accepted immediately, unless the parties have agreed or the circumstances indicate otherwise.

4 The sole purpose of Subsection (1) i) is to protect the offeror. Therefore, the offeror may decide to treat a late acceptance as a valid acceptance pursuant to Subsection (3). In such a case he must inform the offeree without undue delay of this intention. The time limit is necessary because of the need for legal certainty. The parties must know whether a contract was concluded or not. Whether the offeror has reacted without undue delay depends on the circumstances of each case, taking into account the previous practice established between the parties, the significance of the contract for the parties and the standard of reasonableness.

No. IV.2.5 - Holidays and non-business days

If a notice, letter or other communication cannot be delivered at the address of the addressee on the last day of a period set by law or contractual stipulation because that day falls on an official holiday or non-business day at the place of business of the addressee, the period is extended until the first business day which follows.

Cite principle as: www.Trans-Lex.org/934000

Commentary:

The Principle is a natural consequence of the fact that holidays or non-business days are non-working days while time periods set by law or contract

relate to working days because the act required from one party to be performed within that period can only be performed in his or her professional capacity.

No. IV.2.6 - Modified acceptance

(a) A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer.

(b) However, a reply to an offer which purports to be an acceptance but contains additional or different terms which do not materially alter the terms of the offer constitutes an acceptance, unless the offeror without undue delay, objects to the discrepancy. If the offeror does not object, the terms of the contract are the terms of the offer with the modifications contained in the acceptance.

(c) Additional or different terms relating, among other things, to the price, payment, quality and quantity of the goods, place and time of delivery, extent of one party's liability to the other or the settlement of disputes are considered to alter the terms of the offer materially.

Cite principle as: www.Trans-Lex.org/922600

Commentary:

1 This Principle is reflected in Art. 19 CISG and constitutes a modification of Principle IV.2.1. A reply which purports to be an acceptance but which contains material additions, limitations or other modifications of the offer constitutes a rejection of that offer and a counter-offer. That counter-offer must be accepted by the party who issued the initial offer for the contract to be concluded.

2 Subsection (b) is a consequence of the Principle of good faith. The offeror may not refuse to be bound by its offer if the offeree's acceptance does not materially alter, limit or modify the terms of the offer. Subsection (c) provides specific examples of situations in which an acceptance constitutes a material alteration, limitation or modification of the offer. It is obvious that an acceptance becomes a counter-offer if the addition, limitation or modification concerns essential elements of the contract such as the price or other monetary obligation, the goods sold or other kinds of performance etc. The language used in Subsection (c) ("among other things") makes it clear, however, that this list is not exhaustive and that other issues, similar to those listed in Subsection (c), may also be qualified as a material alteration, limitation or modification of the offer. The final judgement depends on the circumstances of each individual case and the usages and practices of the trade sector in which the parties are operating.

3 A modified acceptance must be distinguished from a writing in confirmation that contains material alterations or modifications. A writing in confirmation is not intended to conclude the contract but is sent *after* the contract has been concluded.

No. IV.2.7 - Writings in confirmation

If a writing which is sent within a reasonable time after the conclusion of the contract and which purports to be a confirmation of the contract contains additional or different terms, such terms become part of the contract, unless they materially alter the contract or the recipient objects to the discrepancy without undue delay.

Cite principle as: www.Trans-Lex.org/922700

Commentary:

1 A writing in confirmation must be strictly distinguished from an acceptance (sometimes called "Confirmation of Order" or "Acknowledgment of

Order") with which the offeror concludes the contract. If, in the latter case, the acceptance contains alterations, modifications or limitations, Principle IV.2.6 applies.

2 A writing in confirmation is sent *after* a contract has been concluded. However, Principle IV.2.6 is also relevant here because its Subsection (c) provides a non-exhaustive list of situations in which the terms of an offer are materially altered, limited, or modified. That list can also be used to determine whether the party sending the writing in confirmation has materially altered the terms of the contract concluded between the parties. However, it must be noted that the list in Subsection (c) of Principle IV.2.6 is not exhaustive and that there may be other situations which are not listed there in which the circumstances of the case indicated that the terms of the contract were materially altered by the party sending the writing in confirmation. In these kind of situations, it would be against the Principle of good faith and fair dealing for the party sending the writing to expect that the recipient would accept the alteration because it remained silent.

3 If, however, the writing does not contain a material alteration of the terms of the contract, good faith dictates that the recipient must object to the discrepancy without undue delay. If he does not object without undue delay - a time period that must be determined according to the circumstances of each individual case - the content of the contract is fixed by the writing in confirmation even if that writing in confirmation deviates from the terms of the contract as initially agreed upon by the parties.

Section 3: Contracting under Standard Terms

No. IV.3.1 - Scope of application; Definition

(a) Where one party or both parties use standard terms in concluding a contract, the general rules on formation apply, subject to the following principles.

(b) Standard terms are provisions which are prepared in advance for general and repeated use by the party supplying the term or by a third party and which are actually used without negotiation with the other party.

Cite principle as: www.Trans-Lex.org/922800

Commentary:

1 This Principle takes account of the fact that businessmen tend to conclude contracts by reference to their standard terms in order to save time and costs of long lasting contract negotiations and in order to shape the contract to their benefit.

2 Subsection (a) clarifies that if the parties conclude their contract on the basis of standard terms, the general rules of contract conclusion apply. These rules are merely supplemented or modified by the following rules because of the special nature of standard terms which is defined in Subsection (b). Special rules may apply, however, for the incorporation of an arbitration clause contained in a separate set of standard terms. Such a rule is contained in Art. 7 (2) 3rd sentence of the UNCITRAL Model Law on International Commercial Arbitration.

3 It follows from Subsection (b) that the quality of a contract term as a standard term is determined solely by the user's intention to use that term generally and repeatedly for its contracts to be concluded with other parties and not by the fact that the terms were actually drafted by the party which uses it, or by the nature of the terms as a separate set of standard terms or a standard form or model contract. Therefore, a contract can be a mix of standard and non-standard terms, or can consist only of standard terms.

4 It follows from the last words of Subsection (b) that contract clauses do not qualify as standard terms if they were individually negotiated between the parties to the contract. This does not require that the wording of a clause proposed by one side must have been amended during the contract negotiations as long as that clause was the subject of negotiations between the parties. Very often, the parties consider certain terms in the contract as "package deals", *i.e.* one party requires a change in the wording of one clause because it has accepted another clause which is less favourable to its interests. In such a scenario, both clauses must be considered as individually negotiated. Often, parties have concluded previous contracts with

identical terms. In that case, contract terms which were the subject of the first contract negotiations must be considered individually negotiated in the second negotiations, even if the parties have not discussed that clause again then.

No. IV.3.2 - No surprising standard terms

No term contained in standard terms which is of such a character that the other party could not reasonably have expected it, is effective unless it has been expressly accepted by that party. In determining whether a term is of such a character regard shall be had to its content, language and presentation.

Cite principle as: www.Trans-Lex.org/922810

Commentary:

1 The Principle provides some protection for the party which concludes the contract and accepts the standard forms of its counterparty. Because that party is bound by these terms even if it has not read them, the Principle excludes from the contract those standard terms which are of such a character that the other party could not reasonably have expected them. This is a consequence of the Principle of good faith and fair dealing. While the law accepts that parties may use standard terms to save costs and time, a party may not misuse its standard terms to surprise the other side unless that side expressly accepts these surprising terms.

2 The question whether a standard term is surprising or not depends on the circumstances of each individual case, including the usages of the trade, in which the parties are operating, the practices established between them and their contract negotiations. The second sentence lists three circumstances which can be taken into account when determining whether a standard term is surprising. For example, the "presentation" of a standard term relates to situations in which a specific term is "hidden" in a large number of unclear and confusing standard terms or in which the standard term is printed in extremely small letters so that it is barely legible for the other side. Also, standard forms written in the English language may not contain terms in another language which the other party is not capable of understanding.

No. IV.3.3 - Conflicting terms; battle of forms

(a) In case of conflict between a standard term and a term which is not a standard term the latter prevails.

(b) Where both parties use standard terms and reach agreement except on those terms, a contract is concluded on the basis of the agreed terms and of any standard terms which are common in substance unless one party clearly indicates in advance, or later and without undue delay informs the other party, that it does not intend to be bound by such a contract.
(c) Notwithstanding Subsection (b), no contract is concluded if one party:

i)
has indicated in advance, explicitly or by way of standard contract terms, an intention not to be bound by a contract on the basis of Subsection (b); or

ii)
without undue delay, informs the other party of such an intention.

Cite principle as: www.Trans-Lex.org/922820

Commentary:

1 Subsection (a) requires a two tier test. First, the meaning of the two clauses must be determined through the usual means of interpretation. Secondly, the meaning of the two clauses so determined must be compared in order to decide whether there is a conflict between them. If the answer to that latter question is in the affirmative, the term which is not a standard term prevails. The rationale behind this rule is that terms which are individually negotiated and which, because of these negotiations, have been specifically accepted by both sides, have a stronger contractual force than standard terms which apply even if the party which has not drafted the standard terms has not taken notice of each and every of those standard terms.² Subsection (b) embodies the so-called "knock out-rule". The rule is based on the presumed intentions of the parties. The mere fact that both parties want to conclude the contract on the basis of their own standard terms does not mean that the parties did not want to conclude the contract if some of these terms are contradictory.

3 However, the parties' intention not to conclude the contract under these circumstances may be deduced from specific contract clauses, or their previous and/or subsequent conduct.

4 The "last shot rule", according to which those standard terms prevail in case of conflict with the terms of the other side which have been introduced last, is based on pure coincidence and is therefore not widely accepted in international contract law.

5 A party may always indicate that it does not want to be bound by the contract in case of conflicting standard terms. In that case, the "knock out-rule" of Subsection (b) does not apply and no contract is concluded between the parties. Such a declaration may be made either by way of a provision in its standard terms or by way of a written or oral declaration prior to or, if made without undue delay, after the purported conclusion of the contract. In such a case, no contract is concluded between the parties. Because of this strict consequence which runs counter to the principle that contracts should be upheld as much as possible, a clear and unambiguous declaration by one of the parties is required.

No. IV.3.4 - Unfair standard terms

(a) A standard term that is unfair is not binding on the party who did not supply it.

(b) A standard term in a b2b contract is unfair only if it significantly disadvantages the other party and is of such a nature that its use grossly deviates from good commercial practice, contrary to good faith and fair dealing. When assessing the unfairness of a term for the purposes of this Subsection, regard is to be had to the nature of what is to be provided under the contract, to the circumstances prevailing during the conclusion of the contract, to the other terms of the contract and to the terms of any other contract on which the contract depends.

(c) Contract terms are not subjected to an unfairness test under Subsection (b) if they reflect provisions of the law which would apply if the terms did not regulate the matter. The unfairness test under Subsection (b) does not apply to the definition of the main subject matter of the contract, or to the appropriateness of the price to be paid in so far as the relevant contract terms are presented in an accessible and comprehensible way.

(d) If the contract can reasonably be maintained without the unfair term, the other terms remain binding on the parties.

Cite principle as: www.Trans-Lex.org/922830

Commentary:

1 The Principle provides a special kind of content control for standard terms used in business-to-business (b2b) contracts, *i.e.* contracts concluded

between businessmen. The unfairness test underlying this content control must be distinguished from the one established by the Principle of *boni mores*. While the latter relates to fundamental values of society as a whole, the present Principle merely relates to unfairness as between the parties to a contract. This means that a standard term can be void because it does not pass the unfairness test established by this Principle even though the term does not violate *boni mores* (see Commentary to Principle IV.7.1, Para. 1).

2 Subsection (a) provides that standard terms which have become part of the contract but whose content is unfair are void. The fact that such terms are subject to a special fairness test results from the experience that there is a natural tendency for the drafters and users of standard terms to disadvantage the other side. The fairness test results from the Principle of good faith and fair dealing in international trade. Subsection (b) makes it clear that the liberal fairness test contained therein applies only to b2b contracts. Because of the Principle of the presumption of the professional competence, businessmen must accept standard terms which may be qualified as unfair in contracts concluded with a consumer.

3 The unfairness test in Subsection (b) involves two elements which must both be present for the standard term to be qualified as unfair and void. Both relate to the nature of the standard term under scrutiny: the standard term is unfair and void only if 1) it significantly disadvantages the other side and 2) it is of a nature which results in the fact that its use grossly deviates from good commercial practice, contrary to good faith and fair dealing. The first element must be determined in comparison with the law which would apply absent the standard term. The test requires more than a simple deviation from the law. The deviation must be of such a nature as to constitute a "significant" disadvantage for the other side. The second element requires an examination of the practice in the trade in which the parties are operating. It is not the content of the standard term, but its *use*, *i.e.* its practical effects, which must deviate from good commercial practice. It is important to note that the text does not refer to *any* commercial practice but to "*good*" commercial practice. This means that businessmen may not establish their own practice as a benchmark which would allow them to escape the unfairness test. Rather, the court or arbitral tribunal must always judge that practice against the Principle of good faith and fair dealing. Also, the wording makes it clear that a slight deviation from that good commercial practice is not enough to render the standard term unfair but that a "*gross*", *i.e.* serious and obvious deviation is required. Finally, the good faith and fair dealing criterion allows a very flexible test: the more significant the disadvantage for the other party is, the better the justification for the standard term must be. The Subsection provides that in order to determine the unfairness of a standard term, regard is to be had to the nature of what is to be provided under the contract, to the circumstances prevailing during the conclusion of the contract, to the other terms of the contract, and to the terms of any other contract on which the contract depends.

4 Subsection (c) contains two exceptions from the unfairness test. That test may not be applied to terms which merely reflect provisions of the law which would apply if the terms did not regulate the matter. The purpose of the unfairness test is to determine the unfairness of contract terms but not to determine the fairness of the law. The unfairness test also does not apply to the definition of the main subject matter of the contract, or to the appropriateness of the price to be paid insofar as the relevant contract terms are presented in an accessible and comprehensible way. The reason for that exception is that in a free economy, the main subject of the contract and the price are determined by the parties or by the market and not by the law.

5 Subsection (d) clarifies that the mere fact that a standard term is unfair and void does not affect the validity of the contract itself and of the other standard or individually negotiated terms.

Section 4: Form Requirements; Language

No. IV.4.1 - Principle of informality

(a) Contractual declarations are valid even when they are not made in or evidenced in writing unless mandatory rules of any applicable domestic law provide otherwise.

(b) Parties to international business contracts may not insist on undue formalism without any good reason.

Cite principle as: www.Trans-Lex.org/923000

Commentary:

1 The need for speed and efficiency and the presumed professional competence of businessmen result in the fact that international business contracts or unilateral contractual declarations by the parties to such contracts prior to the conclusion of the contract or during the lifetime of the contract are not subject to any requirement as to form.

2 The parties are of course free to agree on a specific form requirement for declarations to be made by them during the contract or for its termination. In the latter case, the need for legal certainty as to the question whether the contract was in fact terminated may dictate such a contractual form requirement.

No. IV.4.2 - Language

Where the language to be used for communications relating to the contract or the rights or obligations arising from it cannot be otherwise determined, the language to be used is that used for the conclusion of the contract.

Commentary:

Absent any indication to the contrary, the language used for the conclusion of the contract (e.g. in written communications, a contract document or during oral contract negotiations) is the language that must be used by the parties during the performance of their contract and in cases of non-performance, e.g. for notices, declarations of avoidance etc. This rule may also become relevant for the fixing of the language of the arbitration absent an agreement by the parties under Principle XIII.3.4.

Section 5: Interpretation

No. IV.5.1 - Intentions of the parties

The construction of a contract has to determine the common intention of the parties or, if no such intention can be determined, the meaning that reasonable parties of the same kind as the parties would give to it in the same circumstances, taking into account, in particular, the nature and purpose of the contract, the conduct of the parties and the meaning commonly given to contract terms and expressions in the trade concerned.

Cite principle as: www.Trans-Lex.org/924000

Commentary:

1 This principle results from the application of the overriding general Principle of good faith. Contract interpretation must not stop at the literal meaning of the terminology used by the parties in their contract, but must seek to determine their true intentions at the moment of contract conclusion, taking into account the circumstances of the case. This task involves ascertaining what a reasonable person would have understood the parties to have meant. The relevant reasonable person for that purpose is one who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

2 The standard of reasonableness and the presumption of professional competence of the parties must also be observed. The effect of the last two principles mentioned is that in interpreting an international commercial contract, one must assume that the parties intended to establish a reasonable distribution of contractual rights and duties between them, aimed at achieving their common commercial objective.

3 The conduct of a party subsequent to the conclusion of the contract may also be taken into account since such conduct may reflect that party's own understanding of the meaning of certain contractual terms or terminology. Also, previous contracts of the same kind concluded between the parties may provide additional guidance.

No. IV.5.2 - Context-oriented interpretation

Contractual stipulations shall be interpreted taking into account the whole contract in which they appear.

Cite principle as: www.Trans-Lex.org/927000

Commentary:

1 The Principle takes account of the fact that contractual stipulations form an integral part of the contract in which they appear. Very often, there are connections between the various contract clauses in a contract. The contractual agreement may consist of a number of contract documents, which, in their entirety, constitute the contract and which may or may not include indications as to the hierarchy between the various documents which must be observed when interpreting the clauses which make the contract.

2 For all these reasons, any interpretation of a contract clause must not look at that clause in isolation but must take into account the contract as a whole. This includes the Preamble of the contract which may contain important guidelines for the interpretation and understanding of the contract as a whole. A letter of intent concluded prior to the contract itself may also provide helpful guidance for the interpretation of the clauses contained in the contract.

No. IV.5.3 - Interpretation in favour of effectiveness of contract

Where there is doubt about the meaning of a contract term, an interpretation should be preferred that makes the contract lawful or effective ("ut res magis valeat quam pereat"; "effet utile").

Cite principle as: www.Trans-Lex.org/925000

Commentary:

1 This principle follows from the general principle of interpretation pursuant to which contract interpretation must always seek to determine the common intentions of the parties.

2 The assumption behind that Principle is that each contract is aimed at achieving the parties' common commercial objective. Therefore, contract interpretation of terms which convey different meanings and of which one renders the terms redundant or even absurd or the contract invalid, should always focus on that meaning of the contractual terminology which gives a certain effect to the words or validity to the contract as a whole.

No. IV.5.4 - Interpretation against the party that supplied the term

Where, after the interpretation of a contract term that has been supplied by one party, doubts remain as to the meaning of that term, an interpretation against that party is to be preferred ("contra proferentem").

Cite principle as: www.Trans-Lex.org/926000

Commentary:

This rule may be applied if a contractual term is contained in standard terms drafted by one party. However, it may also be used in situations in which one party has drafted a contract which does not have the quality of standard terms. In such scenarios, the party which drafted the ambiguous term may not later rely on a meaning of that term which is to the disadvantage of the other side, unless this ambiguity was discussed between the parties when the contract was concluded.

No. IV.5.5 - Falsa demonstratio rule

In case the parties have used the wrong term but mean the same thing, their common intention prevails ("falsa demonstratio non nocet").

Cite principle as: www.Trans-Lex.org/928000

Commentary:

This Principle is a specific example of Principle IV.5.1. If the common intention of the parties can be determined, that common intention prevails over a different wording of the the contract.

No. IV.5.6 - Rights and duties of the parties under "FOB" and "CIF"

If the parties have agreed on a sale "FOB" or "CIF", the respective rights and duties of the parties under the contract are to be determined according to the latest version of the International Commercial Terms (INCOTERMSspan class="unicode"sup®/sup/span) issued by the International Chamber of Commerce (ICC) unless the parties have indicated that a different meaning is to be attributed to the term used.

Cite principle as: www.Trans-Lex.org/928500

Commentary:

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1 The INCOTERMSspan class="unicode"sup@/supspan(International Commercial Terms) are a universally recognized set of definitions of international trade terms developed, formulated and published by the International Chamber of Commerce (ICC) in Paris, France. The ICC holds the Trademark to the spanINCOTERMSspan class="unicode"sup@/supspan and the Copyright to spanits publications related to spanthe INCOTERMS span class="unicode"sup@/supspan. The INCOTERMSspan class="unicode"sup@/supspan define the responsibilities and liabilities of buyer and seller. While not all of the INCOTERMSspan class="unicode"sup@/supspan have assumed the quality of transnational law, the FOB and CIF terms can be qualified as such due to their worldwide use and recognition in international trade and transport. Even for domestic shipments in the USA, where a different understanding of FOB has prevailed so far, reference is now made to the INCOTERMSspan class="unicode"sup@/sup. The content of each clause of the INCOTERMSspan class="unicode"sup@/sup is determined exclusively by the latest version of the INCOTERMSspan class="unicode"sup@/sup, published by the ICC (see *Incoterms 2010*, ICC Publication 715), unless the parties have indicated that a different meaning is to be attributed to the term used.spanIt must be noted that the following overview is not intended to be used alone, and should always be used in conjunction with the INCOTERMSspan class="unicode"sup@/sup 2010 rule book!span

2 Pursuant to the Guidance Notes published by the ICC in ICC Publication No. 715, the rights and duties of the parties under a FOB ("Free on Board" named port of shipment) contract are as follows:

"This rule is to be used only for sea or inland waterway transport. 'Free on Board' means that the seller delivers the goods on board the vessel nominated by the buyer at the named port of shipment or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel, and the buyer bears all costs from that moment onwards. The seller is required either to deliver the goods on board the vessel or to procure goods already so delivered for shipment. The reference to 'procure' here caters for multiple sales down a chain ('string sales'), particularly common in the commodity trades. FOB may not be appropriate where goods are handed over to the carrier before they are on board the vessel, for example goods in containers, which are typically delivered at a terminal. In such situations, the FCA rule should be used. FOB requires the seller to clear the goods for export, where applicable. However, the seller has no obligation to clear the goods for import, pay any import duty or carry out any import customs formalities."

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3 Pursuant to the Guidance Notes published by the ICC in ICC Publication No. 715, the rights and duties of the parties under a CIF ("Cost, Insurance

and Freight", named port of destination) contract are as follows:

"This rule is to be used only for sea or inland waterway transport. 'Cost, Insurance and Freight' means that the seller delivers the goods on board the vessel or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel. The seller must contract for and pay the costs and freight necessary to bring the goods to the named port of destination. the When CPT, CIP, CFR, or CIF are used, the seller fulfils its obligation to deliver when it hands the goods over to the carrier in the manner specified in the chosen rule and not when the goods reach the place of destination. This rule has two critical points, because risk passes and costs are transferred at different places. While the contract will always specify a destination port, it might not specify the port of shipment, which is where risk passes to the buyer. If the shipment port is of particular interest to the buyer, the parties are well advised to identify it as precisely as possible in the contract. The parties are well advised to identify as precisely as possible the point at the agreed port of destination, as the costs to that point are for the account of the seller. The seller is advised to procure contracts of carriage that match this choice precisely. If the seller incurs costs under its contract of carriage related to unloading at the specified point at the port of destination, the seller is not entitled to recover such costs from the buyer unless otherwise agreed between the parties. The seller is required either to deliver the goods on board the vessel or to procure goods already so delivered for shipment to the destination. In addition the seller is required either to make a contract of carriage or to procure such a contract. The reference to 'procure' here caters for multiple sales down a chain ('string sales'), particularly common in the commodity trades. CIF may not be appropriate where goods are handed over to the carrier before they are on board the vessel, for example goods in containers, which are typically delivered at a terminal. In such circumstances, the CIP rule should be used. CIF requires the seller to clear the goods for export, where applicable. However, the seller has no obligation to clear the goods for import, pay any import duty or carry out any import customs formalities."/the

No. IV.5.7 - Merger Clauses

br / (a) Where a contract in writing includes a term stating that the document contains all contract terms ("merger clause"), any prior statements, undertakings or agreements which are not contained in the document do not form part of the contract.

(b) Unless the contract otherwise provides, a merger clause does not prevent the parties' prior statements from being used to interpret the contract.

Cite principle as: www.Trans-Lex.org/928550

Commentary:

1 Merger clauses are also called "integration clauses" or "entire agreement clauses". The typical text of such a clause is as follows:

span class="med1"span class="med1""This writing is understood and intended to be the final expression of the parties' agreement and is a complete and exclusive statement of the terms and conditions with respect thereto, superseding all prior agreements or representations, oral or written, and all other communication between the parties relating to the subject matter of this agreement."

2 The purpose of such a clause is to make sure that only the provisions contained in the written contract constitute the agreement between the parties. The merger clause is intended to provide for legal certainty during the performance of the contract because it prevents either party from going back after the contract is signed and claim that the written agreement is not complete.

3 However, statements or declarations made by the parties prior to the conclusion of their contract are not without significance even if a merger clause is contained in the contract. They may be used to interpret the contract in the light of these prior statements or declarations, which may result in the

modification of the written text of the contract or in the assumption of an implied term.

Section 6: Contractual Obligations

No. IV.6.1 - Express and implied obligations

(a) The contractual obligations of the parties may be express or implied.

(b) Implied obligations stem from

- i)
the nature and the purpose of the contract;

- ii)
practices established between the parties and usages;

- iii)
good faith and fair dealing; or

- iv)
reasonableness.

Cite principle as: www.Trans-Lex.org/928900

Commentary:

Subsection (a) takes account of the fact that the parties may provide for their contractual obligations in their contract expressly or by implication. In the latter case, these obligations must be determined by application of the general principles of contract interpretation, taking into account the aspects listed in Subsection (b). The list itself makes reference to Principles of transnational law, such as good faith, trade usages and the standard of reasonableness.

No. IV.6.2 - Subsequent fixing of contract price

If the contract does not contain a provision fixing the price or a method for determining it, the parties are to be treated, in the absence of any indication to the contrary, as having agreed to the price generally charged at the time of the

conclusion of the contract for such performance in comparable circumstances in the trade concerned, or, if no such price is available, to a reasonable price.

Cite principle as: www.Trans-Lex.org/929000

Commentary:

- 1** The Principle is based on the assumption that a contract can be concluded between the parties even though the price for one party's performance has not yet been fixed.
- 2** If it is clear in such a scenario that the parties wanted to conclude the contract even absent the price stipulation, they are treated as having agreed to the price generally charged at the time of the conclusion of the contract for such performance in comparable circumstances in the trade concerned unless the circumstances indicate otherwise.
- 3** If the contract is unique or there are other reasons why no such market price is available, then the parties are treated as having agreed to a reasonable price.

No. IV.6.3 - Fixing of price by one of the parties

If the contract provides that the price is to be fixed or determined by one of parties, and this determination is manifestly unreasonable, the other party may apply to a court or arbitral tribunal to have a reasonable price fixed, notwithstanding any agreements to the contrary.

Cite principle as: www.Trans-Lex.org/930000

Commentary:

- 1** This Principle takes account of the fact that the parties may leave the determination of the price to one of them. If in such a scenario the price fixed by one party is manifestly unreasonable, the other party may apply to a court or arbitral tribunal to have a reasonable price fixed.
- 2** The party which fixes the price enjoys a certain discretion. The other party may only apply to the court or arbitral tribunal if the price fixed is "manifestly", *i.e.* obviously unreasonable.
- 3** The parties may not derogate from that provision which is intended to protect the party which does not possess the right to fix the price.

No. IV.6.4 - No contract to detriment of third party

Contracts may not be concluded to the detriment of a third party ("res inter alios acta alteri non nocet").

Cite principle as: www.Trans-Lex.org/931000

Commentary:

This Principle takes account of the fact that a contract has legal effects only between its parties ("*inter partes*"). While the parties may conclude a contract for the benefit of a third party, they may never, however, provide for contractual stipulations to the detriment of a third party which is not a party to the contract. In order for such stipulations to be binding on that third party, that party must become a party to the contract which contains these stipulations.

No. IV.6.5 - Best efforts undertakings

If a party promises its "best efforts" in the performance of its contractual duties, that party owes to the promisee all

efforts which can be expected from a reasonable party of the same kind in the same circumstances, taking into account the particular nature of the contract and the interests of the parties.

Cite principle as: www.Trans-Lex.org/932000

Commentary:

1 Best endeavours or best efforts clauses are frequently used in international contracts either to determine the degree of performance owed by one side for the fulfillment of an ancillary duty such as the procurement of a clearance from antitrust or other official authorities or even to weaken the standard of duty for the debtor's main obligation due to the uncertainties existing at the moment of contract conclusion with respect to the success or performance owed by that party. The best efforts principle is a borderline case which one may be tempted to categorize as a legal rule rather than as a general principle of law. However, like the principle of good faith and fair dealing, the best efforts principle comes close to a behavioural standard for the performance of any contract, provided that parties have included a best efforts clause into their contract.

2 Due to its generic nature, the principle of best efforts reflects the fact that general principles of law constitute 'rules of optimal application' which means that they may be complied with in varying degrees, depending on the circumstances of the individual case. "Best efforts" or "best endeavours" clauses have their origin in English and US common law. English courts have made it very clear that a debtor under a best efforts or best endeavours clause does not owe a low but a reasonable standard of care and diligence in the performance of his duties. Thus, an English court has held that a best endeavours undertaking in a contract does "not mean that the limits of reason must be overstepped" but that the words mean that [the debtor] must, "broadly speaking, leave no stone unturned" (*Sheffield District Railway Company v. Great Central Railway Company*, [1911] 27 T.L.R. 451, 452). In *Midland Land Reclamation Limited and Leicestershire County Council v. Warren Energy Limited* of 1997, the court held that the debtor's obligation under such a clause is "to do what can reasonably be done in the circumstances".

3 It follows from these considerations of the English courts that if a party promises its "best efforts" or "best endeavours" in the performance of its contractual duties, that party owes to the promisee all efforts which can be expected from a reasonable party of the same kind in the same circumstances, taking into account the particular nature of the contract and the intentions and interests of the parties. If the party is a professional, he or she will have to live up to the standards of his or her profession or trade.

No. IV.6.6 - Time is of the essence

Unless otherwise agreed by the parties or contrary to the intrinsic nature of the contract, time limits and other contractual stipulations as to the timely performance of the parties' obligations have to be strictly complied with ("time is of the essence").

Cite principle as: www.Trans-Lex.org/933000

Commentary:

The Principle takes account of the fact that time and costs are essential elements in the dealings of international businessmen. The time factor dominates contractual performances by international traders. For that reason, stipulations as to the timely performance of the parties' contractual obligations must be strictly complied with. Thus, a provision that stipulates that performance must be rendered "on" May 2 does not mean that performance may be rendered "around" May 2. Also, businessmen acting on a global scale must take the effect of the different time zones on the timely performance of their contractual obligations into account.

No. IV.6.7 - Duty to renegotiate

Each party has a good faith obligation to renegotiate the contract if there is a need to adapt the contract to changed circumstances and the continuation of performance can reasonably be expected from the parties.

Cite principle as: *www.Trans-Lex.org/935000*

Commentary:

1 The Principle is derived from the fundamental Principle of good faith. Renegotiation may involve the revision of existing contractual terms or the filling of gaps.

2 In long term contracts, such duties are imposed in revision or renegotiation clauses. Absent such contractual stipulations, good faith may dictate that the parties get together and try to renegotiate their contract. The hardship scenario provides a specific example of such a duty to renegotiate. The duty to renegotiate is one of best efforts. The party must do its best to pursue successful negotiations, but there is no obligation to agree or to achieve certain results.

3 In renegotiating their contract, the parties must always seek to maintain the commercial equivalence of their respective contractual obligations. The idea that the performance obligations of the parties should be commercially equivalent is a general principle of international commercial contract law and must therefore be observed in the renegotiation context. Apart from that, there are a number of guidelines which must be observed by the parties in a renegotiation process: 1. Respecting the remaining provisions of the contract, 2. Having regard to the prior contractual practice between the parties, 3. Making a serious effort to reach agreement, 4. Paying attention to the interests of the other side, 5. Producing information relevant to the adaptation, 6. Showing a sincere willingness to reach a compromise, 7. Maintaining flexibility in the conduct of negotiations, 8. Searching for reasonable and appropriate adjustment solutions, 9. Making concrete and reasonable suggestions for adjustment instead of mere general declarations of willingness, 10. Avoiding rushed adjustment suggestions, 11. Giving appropriate reasons for one's own adjustment suggestions, 12. Obtaining expert advice in difficult and complex consensus proceedings, 13. Responding promptly to adjustment offers from the other side, 14. Making an effort to maintain the price-performance relationship taking into consideration the parameters regarded as relevant by the parties, 15. Avoiding an unfair advantage or detriment to the other side ("no profit - no loss" principle), 16. Prohibition on creating established facts during negotiations except in emergency situations (ban on "escalation" strategies), 17. Maintaining efforts to reach agreement over an appropriate length of time, 18. Avoiding unnecessary delays in the consensus proceedings.

4 Within a given renegotiation process, none of these obligations claims sole validity. Rather, they are starting points for determining what is required of the parties in each individual case, by examining the nature of the contract and the combined effect of its provisions, and the type of risks realised.

5 The weighing-up of various factors will be subject to the principle of good faith and in particular the notions of fairness and reasonableness derived from this. Thus, a party will be subject to fewer requirements if the opposite side also makes no moves to support the negotiation process. This follows from the idea of cooperation as a distributor of legal duties, on which most of the above mentioned obligations are based. The idea of an asymmetrical distribution of information also needs to be considered when weighing-up. According to this, the obligation of one party to make its own suggestions during the renegotiation process is proportionately smaller in so far as the other party is in a better position to make progress towards a solution due to technical conditions or the distribution of risks in the contract. Timing also has a role to play in determining the negotiation obligations of the parties. So the obligation to provide concrete suggestions for a solution needs to be fulfilled to an increasingly higher standard the more the negotiations proceed.

6 A party's liability for damages arising from a breach of the duty to renegotiate can be assumed only in exceptional cases. Here too, the special legal nature of this duty should be taken into account. Merely not reaching agreement will not in itself constitute a breach of obligation. Instead, this is assumed where the non-agreement is proven to be caused by a gross breach of obligation in bad faith by the other side. This could be the case for example where proceedings are unjustifiably delayed or negotiations are intentionally obstructed or where proposals by one side are obviously rejected for other reasons than normal business judgement. Only under these circumstances can it be assumed that a reasonable person in a comparable situation would have made greater efforts.

No. IV.6.8 - (Re-) Negotiation Agreement / Clause(Pactum de negotiando)

(a) Under an agreement or contract clause requiring the parties to (re-) negotiate in applies accordingly.

(b) Such agreements/clauses impose an obligation on the parties to make to reach an agreement within the framework of (a) above. They do not, however, require the parties to actually reach an agreement unless otherwise provided for in the agreement/clause.
(c) If the renegotiation of the contract relates to the adaptation of the price to be paid by one party for the performance of the other party, then - unless otherwise agreed by the parties - the result of the renegotiation process must reflect the initial economic equilibrium between the price and the value of the other party's performance at the time of conclusion of the contract or at the time of the conclusion of the price agreement resulting from the last renegotiation process.

Commentary:

1 See for a list of guidelines which must be respected by the parties in a contractual renegotiation process Trans-Lex Commentary to Principle IV.6.7, Para. 3.

2 Subsection (c) relates to situations in which the parties have agreed to adapt the price to changed circumstances by bilateral negotiations. In such scenarios the parties' agreement on the adapted price which results from these negotiations must reflect the initial economic equilibrium between the price and the value of the other party's performance at the time of conclusion of the contract or at the time of the conclusion of the price agreement resulting from the last renegotiation process. However, the parties are free to agree in their renegotiation clause or in a subsequent agreement that the new price shall be fixed solely according to the market conditions prevailing at the moment of the price fixing, *i.e.* without regard to the initial equilibrium between the price and the value of the other party's performance. If the parties have not provided a clear indication as to whether they intended to agree on price adaptation (in which case the initial equilibrium must be observed) or price fixing (in which case the initial equilibrium must not be observed), their will must be determined by application of the general Principles of contract interpretation.

No. IV.6.9 - Duty to notify / to cooperate

(a) Each party is under a good faith obligation to notify in a timely fashion the other party of any problems that occur in the performance of the contract and of any other facts or circumstances on whose knowledge the other party is discernibly dependent, provided that such information can reasonably be expected from that party.

(b) Each party is under a good faith obligation to cooperate with the other party when such cooperation can reasonably be expected for the performance of that party's obligations.

Cite principle as: www.Trans-Lex.org/936000

Commentary:

1 This Principle is a direct consequence of the general Principle of good faith. The parties must accept that a contract is not merely a meeting point of conflicting interests, but also, to a certain and varying extent, a common project in which each party must cooperate with the other side. The intensity of the duty to notify and, in particular, the duty to cooperate, depends on the nature of the contract, the professional sophistication of the parties and, in particular, on whether one is dealing with a long-term or one-off contract.

2 The goal of the duty to cooperate in international contracts is to promote and advance contractual performance, to show sincere efforts to further the contractual relationship and to achieve its goals and to refrain from any conduct that would obstruct the contract's implementation, even if these

actions are contrary to a party's immediate short term interests. This duty is not without limits. It exists only within the confines of the legitimate expectations of the parties and the standard of reasonableness.

No. IV.6.10 - Conditions

(a) A condition is a term in a contract, to the effect that on the occurrence, or non-occurrence of an uncertain event, act, or forbearance, a right shall arise, or cease to exist.

(b) A condition, on the occurrence of which a right is to arise, is called a "condition precedent" (or "suspensive"); a condition on the occurrence of which a right is to cease to exist, is called a "condition subsequent" (or "resolutive").

Cite principle as: www.Trans-Lex.org/936500

Commentary:

The Principle deals with the two kinds of contractual conditions. While a condition precedent is agreed upon by the parties as a condition on the occurrence of which a contractual right is to *arise*, a condition subsequent is a condition on the occurrence of which a right is to *cease to exist*.

No. IV.6.11 - Plurality of debtors

Two or more parties who are liable for one and the same performance are (a) joint, or (b) partial debtors. Parties are liable as joint or partial debtors when they unite in making one and the same promise under the same contract or when they are liable for the same damage unless the contract or the law provides otherwise.

(a) Joint debtors

(aa) The creditor may claim performance from any one of the joint debtors until full performance has been reached.

(bb) If one joint debtor has performed, in kind or by way of set off, the liability to the creditor of the other joint debtor(s) is discharged to the extent of such performance or set-off. The same applies if one joint debtor concludes a settlement with the creditor.

(cc) As between themselves, joint debtors are liable in equal shares unless the contract or the law provides otherwise. If a joint debtor has performed more than his share, he may claim the excess from any of the other joint debtors to the extent of each debtor's unperformed share.

(dd) A joint debtor may invoke against the creditor any defence which another joint debtor can invoke, other than a defence personal to that other debtor. Invoking the defence has no effect with regard to the other joint debtors.

(b) Partial debtors

(aa) The creditor may claim from any partial debtor only that part of the performance for which he is liable and the partial debtor is bound to perform only to that extent.

(bb) Partial debtors are liable in equal shares unless the contract or the law provides otherwise.

Cite principle as: www.Trans-Lex.org/936600

Commentary:

1 The Principle deals with two types of plural obligations, those incurred by joint debtors and those incurred by partial debtors. Whether a case of joint or partial debtorship is present depends on the terms regulating the obligation. Absent such terms, the obligation of two or more debtors to perform the same obligation or to pay the same damage is a joint obligation.

2 Subsection (a) stipulates that in case of joint debtors, which are frequently encountered in practice, the creditor may claim *whole* performance from any of the debtors without having to involve all the debtors. The joint debtor that is approached by the creditor may invoke any defence which another joint debtor can invoke, unless such defence is linked to the person of that other debtor and may therefore not be invoked by another debtor. Performance by one debtor, either in kind or by way of set-off, discharges the other debtors to the extent of such performance or set-off. As to the internal liability among themselves, Subsection (a) (cc) provides a default rule of equal sharing, unless the parties, expressly or by implication, have provided otherwise. A rule of unequal sharing may also be provided for by the law, for example in cases of damage claims in which one debtor carries a greater degree of fault or responsibility as compared to the other debtors. If one debtor has performed more than its internal share, he may recover the excess portion of this performance from any of the other joint debtors, but only to the extent of each debtor's unperformed share.

3 Subsection (b) stipulates that in case of partial debtors, the creditor may claim from each partial debtor *only that part of the performance* for which the debtor is liable. This means that the partial debtors carry separate liabilities *vis-à-vis* the creditor for their own shares. Non-performance by one debtor does not affect the obligations of the other partial debtors. The partial debtor may not invoke defences which are available only to other partial debtors. Absent a contrary indication in the contract or in the law, partial debtors are liable *vis-à-vis* the creditor in equal shares.

No. IV.6.12 - Plurality of creditors

Two or more persons who may claim one and the same performance from the debtor are (a) joint, or (b) partial creditors.

(a) Joint Creditors

(aa) A joint creditor may claim full performance from the debtor and the debtor may render full performance to any of those joint creditors.

(bb) If one joint creditor has received performance, in kind or by way of set-off, the liability of the debtor to the other joint creditors is discharged to the extent of such performance or set-off. The same applies if one joint creditor concludes a settlement with the debtor.

(cc) As between themselves, joint creditors are entitled to performance in equal shares. If a joint creditor has received more than that creditor's share, that creditor must transfer the excess to the other creditors to the extent of their respective shares.

(dd) A release granted to the debtor by one of the joint creditors has no effect on the other joint creditors.

(ee) A debtor may invoke against a joint creditor any defence which he can invoke against another joint creditor, other than a defence personal to that other creditor. Invoking the defence has no effect with regard to the other joint creditors.

(b) Partial Creditors

(aa) A partial creditor may claim from the debtor only his share of the claim and the debtor owes to that partial creditor only that creditor's share of the claim.

(bb) Partial creditors are entitled to performance in equal shares unless the contract or the law provides otherwise.

Cite principle as: www.Trans-Lex.org/936700

Commentary:

1 This Principle is the mirror image of Principle IV.6.11 as it deals with two types of plurality of creditors, joint creditors and partial creditors.

Consequently, the two Subsections are mirror images of the two Subsections of Principle IV.6.11.

2 Subsection (a) stipulates that in case of joint creditors, which are frequently encountered in practice, every creditor may claim *whole* performance from the debtor without having to involve all the joint creditors. The debtor may invoke against the creditor any defence which he can invoke against another joint creditor, unless such defence is linked to the person of that other creditor and may therefore not be invoked by the debtor *vis-à-vis* another joint creditor. Performance by the debtor, either in kind or by way of set-off, discharges the debtor also *vis-à-vis* the other joint creditors to the extent of such performance or set-off. As to the internal right to performance, Subsection (a) (cc) provides a default rule of equal sharing. If one joint creditor has received more than his internal share, he must transfer the excess to the other joint creditors, but only to the extent of their respective shares.

3 Subsection (b) stipulates that in case of partial creditors, one creditor may claim from the debtor *only his share of the claim*. This means that the debtor carries separate liabilities *vis-à-vis* every partial creditor. Non-performance by the debtor *vis-à-vis* one partial creditor does not affect his obligations *vis-à-vis* the other partial creditors. Absent a contrary indication in the contract or in the law, partial creditors are entitled to performance *vis-à-vis* the debtor in equal shares.

No. IV.6.13 - Duty of confidentiality

Where information is given as confidential by one party in the course of negotiations, the other party is under a duty not to disclose that information or to use it improperly for its own purposes, whether or not a contract is subsequently concluded. Where appropriate, the remedy for breach of that duty may include compensation based on the benefit received by the other party.

Cite principle as: www.Trans-Lex.org/936800

Commentary:

1 For the Principle to apply, one party must make it clear to the other side that information given shall remain confidential. Absent such a clear indication, a duty of confidentiality may exist if, in light of the circumstances of the case, it would be contrary to the general principle of good faith and fair dealing to disclose information which one party has received from the other or to use it for own purposes once the negotiations are terminated or broken off.

2 It follows from this Principle that information concerning confidential (settlement) negotiations between the parties are generally considered inadmissible as evidence in subsequent arbitration or court proceedings. The same applies to oral or written declarations or statements by the parties in mediation ("mediation privilege").

Section 7: Invalidity of Contract

No. IV.7.1 - Invalidity of contract that violates good morals (boni mores)

A contract that violates good morals (boni mores) is void.

Cite principle as: www.Trans-Lex.org/937000

Commentary:

1 The Principle that a contract violating '*boni mores*' or 'good morals' is void provides the moral underpinning of transnational commercial law. Violation of good morals means much more than that the contract is unreasonable as between the parties or unfair. Rather, the concept of good morals relates to fundamental values of society and is not of a purely legal nature. It includes basic legal, as well as economic, ethical, moral, and social values that the individuals of the relevant community generally consider binding and crucial for their peaceful coexistence in that community. Such fundamental values of morality and justice arise from and are based on a broad social consensus and thus shape the morality of a community. Good morals, therefore, involve a broad and objective standard. They relate to the social morality of a community, not to the individual morality of the judge or arbitrator who decides a given case.

2 The Principle that a contract that violates '*boni mores*' is void serves as a limit of the parties' freedom of contract in order to protect and preserve the aforementioned basic values of the international community. The conflict with good morals may be caused by the conclusion of the contract, by the performance to be rendered under the contract by one of the parties or by both of them or by the purpose for which the contract was concluded. Often, the violation of good morals results from a combination of the contents of the contract and surrounding circumstances. The broadness of the concept entails that it has numerous aspects, such as protection of the economic independence of the weaker contracting party, prohibition of malicious exploitation of a position of power, prohibition of entering a contract out of indecent or mischievous consideration, or the prohibition of creating illegal obligations that give an incentive to crime.

3 In international business, these fundamental transnational values are part of transnational public policy. They include the prohibition of crimes against humanity, racial discrimination, child labour, slavery, torture, terrorism, money laundering and drug trafficking. Also, contracts which are concluded in violation of an embargo that results from a resolution of the United Nations and is thus based on a broad consensus of the international community of nation states, is void because it violates transnational *boni mores* expressed in that embargo resolution. The Principle that a contract involving the payment of bribes is void is another specific example of this general Principle.

4 If the contract violates good morals, the judge or arbitrator has no discretion. He *must* regard the contract as void irrespective of the intention and the knowledge of the parties. This follows from the fundamental nature of the values involved and from the fact that the judge or arbitrator serves as a guardian of these fundamental values.

No. IV.7.2 - Invalidity of contract due to bribery

(a) Contracts based on or involving the payment or transfer of bribes ("corruption money", "secret commissions", "pots-de-vin", "kickbacks") are void.

(b) Any intentional offer, promise or transfer of any undue pecuniary or other advantage, whether directly or through

intermediaries, to a foreign public official or private party, for the benefit of that official or private party or for a third party, in order that the official or private party acts or refrains from acting in relation to the performance of official or other duties, in order to obtain or retain business or other improper advantages in the conduct of international business constitutes bribery.

Cite principle as: www.Trans-Lex.org/938000

Commentary:

1 The prohibition of bribery is derived from Principle IV.7.1. Bribery as defined in subsection (b) means any intentional offer, promise or transfer of money or of other advantages such as goods, property, privileges, objects of value, shares/stock options, promotion, sponsorship, donations etc. to a public official or the employee of a private party or for the benefit of a third party with the expectation that this official or employee favours the offering party or its principal, e.g. with respect to the awarding of a contract.

2 Subsection (a) makes it clear that the Principle applies both to contracts which have as their subject matter the payment or transfer of bribes (see *infra* para. 5) and to contracts which, even though their subject matter does not involve the payment or transfer of bribes, were concluded because of bribery.

3 In view of the detrimental effect of bribery to companies and national economies, this rule applies irrespective of the fact that corruption was and still is endemic in many countries. Like the prohibition of racial discrimination, child labour, money laundering, anti-competitive practices, terrorism or drug trafficking, the prohibition of bribery belongs to those fundamental values of morality and justice which are widely recognized by civilized nations around the globe. The Principle is therefore part of transnational public policy. The values and standards of transnational public policy reflect a minimum standard of conduct and behaviour in international commercial relations. The fact that the prohibition of bribery belongs to these fundamental values is reflected by the increasing criminalization of bribery and the increasing number of anti-bribery laws and international anti-bribery recommendations and conventions. As a result of this dual significance of the prohibition of bribery, a violation of this rule not only leads to the invalidation of a contract which is based on or involves the payment or transfer of bribes. Arbitral awards involving such contracts can be set aside and their enforcement can be refused based on the public policy defence contained in, e.g. Art. 34 (2) (b) (ii) UNCITRAL Model Law on International Commercial Arbitration of 1986 and Art. V (2) (b) New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958. Also, because of its very strong public policy nature, arbitral tribunals which are faced with an issue of bribery must examine this issue *ex officio*, even if it is not argued by either side.

4 In arbitration proceedings where a case of corruption is alleged, the crucial issue typically is whether corruption has been demonstrated and proven by the party who is alleging it. Usually, direct evidence of corruption, such as contemporaneous documents or witness testimony, is available only in rare cases. Because arbitral tribunals are devoid of any power to compel third party witnesses or to open a criminal investigation, they must rely on circumstantial evidence in order to decide whether a case of corruption has occurred. Such circumstantial evidence may include the nature of the contractual obligation to be performed by the party that claims the payment of the money, the amount of the fee agreed upon by the parties and its relation to the value of the performance owed by the other party, the way in which this fee is to be calculated (lump sum or percentage fee), the payment terms (cash payments, payments to unrelated third parties) or the fact that the party claiming the money refuses to disclose information about its nature, organizational or personal structure. Sometimes payments under the contract are to be made to payment agents which are not identical with the receiving party or banks in off-shore jurisdictions which are known to have no or only very weak financial supervisory or legal enforcement authorities or the involvement of foundations of a non-commercial nature as payment-agents for the party which is to receive the money under the contract. Such factors may be taken into account by the arbitral tribunal in determining whether a contract is based on or involves the payment or transfer of bribes.

5 Often, the payment of bribes is disguised by the conclusion of a "consultancy" or "agency" agreement which contains the obligation of one party to pay a sum of money ("commission") for the performance of certain consultancy services by the other side. Such contracts are concluded, e.g. in the area of public procurement. In some cases, such agreements do not contain specific contractual obligations for the party which is to receive payment

under the contract by the other party, but rather very vague "best efforts" undertakings. In such a case, a claim for payment based on the contract fails if the party claiming the payment is not in a position to prove the performance of the contract (*i.e.* his activities owed to the other side) as a contractual prerequisite for the payment. In such a case, the arbitral tribunal can dismiss the claim without having to rule on the invalidity of the contract under the present Principle. If the arbitral tribunal decides to rule on the invalidity of the contract, the vagueness of the contractual obligations of the party which is claiming the money under the contract is another factor (*see supra* para. 4) to be taken into account by the tribunal.

No. IV.7.3 - Right to avoid the contract for mistake in fact or law

(a) A party may avoid a contract retrospectively based on a mistake of fact or law existing at the moment the contract was concluded if:

- i)
the mistake was caused by information given by the other party, or

- ii)
the other party knew or ought to have known of the mistake and it was contrary to good faith and fair dealing to leave the mistaken party in error

- iii)
the other party made the same mistake

provided that the other party knew or ought to have known that a reasonable party in the same situation as the party in error would not have entered into the contract or would have concluded the contract on materially different terms.

(b) A party's right to avoid the contract for mistake is excluded if

- i)
the risk was assumed, or, under the particular circumstances, should be borne by it,

- ii)
it was grossly negligent in committing the mistake, or if

- iii)
the party, being aware of and reasonably capable of enforcing such a right, manifests an intention to confirm the transaction.

br / (c) Avoidance is effected by notice to the other party.

(d) Where the party who has the right to avoid a contract under this Principle confirms it, expressly or impliedly, after becoming aware of the relevant circumstances, or becoming capable of acting freely, that party may no longer avoid the contract.

Cite principle as: www.Trans-Lex.org/938500

Commentary:

1 The Principle provides the rather strict conditions under which a party may avoid the contract for mistake in fact or law, *i.e.* in cases in which that party erroneously assumed factual or legal circumstances at the moment the contract was concluded. In such a scenario, that party may avoid the contract only if the mistake is one of those listed in Subsection (a) i) to iii) *and* the objective/subjective standard provided for in the second part of Subsection (a) is met, showing that the mistake is of such a serious nature so as to justify the right to avoid as an exception to the general and fundamental Principle of sanctity of contracts.

2 While the three types of mistakes listed in Subsection (a) i) to iii) are rather clear-cut, the objective/subjective test refers to the objective Principle of reasonableness, which allows a flexible approach that takes into account the circumstances of the case in order to determine whether a reasonable person in the same situation as the party would have refused to enter into the contract or would have contracted under materially different terms had it known the correct state of the facts or the law.

3 Subsection (a) makes it clear that the legal consequence of avoidance is that the effects of the contract are eliminated retrospectively, *i.e.* the parties are considered to never have concluded the contract.

4 The incidents listed in Subsection (b) under which a party's right to avoid the contract for mistake in fact or law is excluded are based on the general Principle of good faith. An assumption of risk can happen as a unilateral act or by agreement between the parties. In any case, one has to make sure that it was the assumed risk which has materialized in the party's mistake.

5 Because of the severe consequences of avoidance, it must be declared by a clear and unambiguous notice to the other side. The term "avoidance" must not be used in such a notice as long as it is clear beyond doubt for the addressee of that notice that the party sending the notice does not want to be bound by the contract any longer. Principle IV.4.2 applies to the notice.

6 A party may renounce its right to avoid the contract by express or implied confirmation of the contract, provided that party was aware of the circumstances (but not necessarily of the legal right which follows from these circumstances) which would have justified the avoidance of the contract when it issued such confirmation. Typically, such confirmation is addressed to the other side. However it may also be effected through a public statement or act of confirmation.

No. IV.7.4 - Right to avoid the contract for fraudulent misrepresentation

(a) A party may avoid a contract if the other party has induced the conclusion of the contract by fraudulent misrepresentation, whether by words or conduct, or fraudulent non-disclosure of any information which good faith and

fair dealing, required that party to disclose.

(b) Misrepresentation is fraudulent if it is made with knowledge or belief that the representation is false, or recklessly as to whether it is true or false, and is intended to induce the recipient to make a mistake. Non-disclosure is fraudulent if it is intended to induce the person from whom the information is withheld to make a mistake.

(c) In determining whether good faith and fair dealing require a party to disclose particular information, regard should be had to all the circumstances, including good commercial practice in the situation concerned.
(d) Subsections (c) and (d) of apply.

Cite principle as: www.Trans-Lex.org/938550

Commentary:

1 This Principles provides for a right to avoid the contract in scenarios in which a party's consent to a contract was induced by fraudulent misrepresentation or fraudulent non-disclosure of any information by the other side. Whether disclosure was required must be determined by taking into account all the circumstances in the individual case, including good commercial practice in the situation concerned and the Principle of good faith and fair dealing.

2 Subsection (b) defines situations in which misrepresentation or non-disclosure is fraudulent. It requires a determination of the intentions and state of mind of the party making the misrepresentation or non-disclosure.

3 Avoidance is effected by clear and unambiguous notice to the other side. Principle IV.4.2 applies to that notice.

Section 8: Precontractual Liability

No. IV.8.1 - Principle of pre-contractual liability

(a) A party is free to negotiate a contract and is not liable for failure to reach agreement with the other side.

(b) A party who breaks off contract-negotiations in bad faith is liable for the losses caused to the other party ("culpa in contrahendo").

(c) It is bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party while leaving the other party under the justified assumption that a contract would be concluded. The same applies if a party insists on contract terms so clearly unreasonable that they could not have been advanced with any expectation of acceptance, provided that there is some demonstrable advantage to be gained for that party by avoiding the contemplated transaction.

Cite principle as: www.Trans-Lex.org/939000

Commentary:

1 Unless the parties have agreed otherwise, e.g. in a renegotiation clause, the fundamental Principle of freedom of contract includes a party's right to say "no", i.e. to reject a party's offer or to break off negotiations at any time. However, even the Principle of party autonomy must be balanced with the overriding Principle of good faith. Subsection (c) lists two cases in which breaking off of negotiations is against good faith and may make that party liable for losses incurred by the other side because of the breaking off of the negotiations.

2 In the first scenario, the party breaking off the negotiations has signalled to the other side before or during the negotiations that the contract will be concluded. The text requires that the assumption of the other side is "justified". This requires an objective test, applying the standard of reasonableness. The question must be asked whether it was reasonable for the one party under the circumstances of the case and taking into account the conduct and statements of the other side to assume that the contract will be concluded.

3 In the second scenario, one party played a game with the other side, misusing the negotiations in order to gain some advantage other than the advantage expected from the potential contract, without revealing that intention to the other side. There are two important qualifications for this test to be met. First, the contract terms suggested by that party must be "clearly" unreasonable. This means much more than that the suggested contract terms favour the party who suggests them. Rather, they must be obviously unreasonable from an objective perspective. Secondly, the advantage that the party wants to gain by breaking off the negotiations must be "demonstrable", *i.e.* can be easily proven.

Chapter V: Performance

Section 1: General Principles

No. V.1.1 - Place of performance

(a) If the place of performance is neither fixed by, nor determinable from, the contract, a party has to perform:

i)
a monetary obligation, at the obligee's place of business;

ii)
any other obligation, at its own place of business.

(b) If a party has more than one place of business, the place of business for the purpose of the preceding paragraph is that which has the closest relationship to the contract, having regard to the circumstances known to or contemplated by the parties at the time of conclusion of the contract.

(c) A party must bear any increase in the expenses incidental to performance which is caused by a change in its place of business subsequent to the conclusion of the contract.

Cite principle as: www.Trans-Lex.org/940100

Commentary:

1 The Principle provides a default rule for those infrequent cases in which the parties have not fixed the place of performance in their contract. In that case, the place of performance depends on whether the debtor is to perform a monetary or non-monetary obligation. In the first case, the debtor must perform at the creditor's place of business. In the second case, the debtor can perform at its own place of business.

2 Subsection (b) provides a rule for cases in which a party has more than one place of business, Subsection (c) contains a rule related to the carrying

of costs caused by a party's change of business which occurs *after* the contract was concluded.

No. V.1.2 - Time of performance

A party must perform its obligations:

- i)
if a time is fixed by or determinable from the contract, at that time;

- ii)
if a period of time is fixed by or determinable from the contract, at any time within that period unless circumstances indicate that the other party is to choose a time;

- iii)
in any other case, within a reasonable time after the conclusion of the contract.

Cite principle as: www.Trans-Lex.org/940200

Commentary:

1 The Principle makes it clear that the time of performance is governed first and foremost, by the Principle of party autonomy. The agreement of the parties can be express or implied in which case it must be determined by application of the general principles of contract interpretation. The agreement may relate to a fixed time of performance ("on June 1", "on the last day of next month") or to a period of time ("within the next three months"). In the first case, the debtor must perform at the time fixed, there is no room for taking into account special circumstances. In the second scenario, the rule is more flexible for the very reasons that the parties have agreed not on a precise moment but on a period of time. That flexibility works in both directions, though. On the one hand, the debtor may perform at any time within that period. On the other hand, circumstances may dictate that the other party is to choose a time.

2 Absent an express or implied agreement by the parties, the time of performance is determined under the general Principle of reasonableness.

No. V.1.3 - Early performance

(a) A party may decline a tender of performance made before it is due except where acceptance of the tender would not unreasonably prejudice its interests.

(b) A party's acceptance of early performance does not affect the time fixed for the performance of its own obligation.

Cite principle as: www.Trans-Lex.org/940300

Commentary:

1 If the parties have agreed on a specific time or period of time of performance or if that time is determined pursuant to Principle IV.1.2, the creditor is entitled to reject earlier performance by the debtor, because that earlier performance would violate the agreement of the parties or the law.

2 However, as any other right, the creditor's right of rejection is subject to the general Principle of good faith. The creditor may therefore not reject earlier performance by the debtor if that rejection must be qualified as the exercise of a mere formal legal position, because the creditor's interests would not unreasonably prejudice by the debtor's premature performance.

3 Subsection (b) provides that if the creditor accepts a debtor's premature performance voluntarily or under Subsection (a), the time for the performance of its own obligation is not affected by that acceptance.

No. V.1.4 - Principle of simultaneous performance; right to withhold performance

(a) The parties to a bilateral contract are required to render their respective performances simultaneously, unless they have agreed on or circumstances indicate a different order of performance.

(b) If performance of an obligation by one party is dependent upon performance of another obligation arising out of the same contract by the other party, each party may withhold performance until tender of performance by the other party. Where one party has performed in part, the other party cannot refuse to perform if to do so would be contrary to good faith, having regard in particular to the relatively slight or trivial nature of the default ("exceptio non adimpleti contractus", "inadimplenti non est adimplendum").

Cite principle as: www.Trans-Lex.org/941000

Commentary:

1 A scenario in which the parties are not under a duty to perform simultaneously as provided for in Subsection (a) would be a contract which provides for delivery and deferred payment or delivery on credit or, *vice-versa*, for payment in advance of delivery.

2 The question as to whether the performance of an obligation is dependent upon performance of another obligation by the other party as provided for in Subsection (b) is a matter of contract interpretation. This always applies to those core obligations of a contract which constitute a direct exchange of promises and which are characterized in some jurisdictions as "synallagmatic" or "reciprocal" ("*do ut des*"), *i.e.* the duty of the seller to deliver the goods sold and the duty of the buyer to pay the sales price. There may be contracts in which two obligations are so closely connected by the will of the parties as expressed in the contract that they may be qualified as "dependent" even though they would not be characterized as "synallagmatic" or "reciprocal" in those jurisdictions.

3 Subsection (b) makes it clear that the exercise of the right to withhold performance is always subject to the principle of good faith (Trans-Lex Principle I.1.1). The principle of proportionality mentioned in Subsection (b) is derived from the principle of good faith. It would be contrary to good faith (and amount to an abuse of right) to rely on the non-performance of a relatively minor obligation by the other side in an attempt to avoid performance of an essential obligation of the party invoking the right to withhold performance, see Fouchard Gaillard Goldman On International Commercial Arbitration, 1999, No. 1486.

4 The relative triviality of non-performance by one party, however, is but one illustration of a more general restriction of the scope of subsection (b) by the requirement of good faith. The overriding principle of good faith may restrict a party's right to invoke a right to withhold performance also in other scenarios outside the ambit of Subsection (b).

No. V.1.5 - Costs of performance

Each party shall bear the costs of performance of its obligations, unless the parties have agreed otherwise.

Cite principle as: www.Trans-Lex.org/940400

Commentary:

The Principle provides a clear-cut rule for the carrying of the costs of performance. These costs must be carried by the party who performs, unless the parties have agreed otherwise, expressly or by implication. These costs may involve the transport of the goods sold, fees to be paid for the export of goods, bank charges for money transfers etc.

Section 2: Payment of Money Debts

No. V.2.1 - Payment in currency of place of payment

Unless otherwise agreed by the parties, payment of a money debt may always be made in the currency of the place for payment.

Cite principle as: www.Trans-Lex.org/952000

Commentary:

The Principle provides a default rule for those rare cases in which the parties have not made an agreement on the currency of the contract price to be paid by one side. In such a case, the money debt must be paid by the debtor in the currency of the place of payment.

No. V.2.2 - Conversion of money debts

Conversion of the currency of account into a different currency of payment has to be made according to the exchange rate prevailing at the time when payment is due. If the debtor is in arrear, the creditor may require payment either at the rate when payment is due or at the rate of the time of actual payment.

Cite principle as: www.Trans-Lex.org/953000

Commentary:

The rule contained in this Principle applies only if the parties to the contract have not agreed on a different distribution of the currency conversion risk. Please see Commentary No. 3 to Principle V.2.4.

No. V.2.3 - Nominalistic principle

Unless otherwise agreed by the parties, a claim for payment in a certain currency entitles the creditor only to the contractually specified amount of that currency (nominal value), irrespective of any fluctuations of the currency in which the debt is expressed between the date of concluding the contract out of which the claim arises and the date of payment.

Cite principle as: www.Trans-Lex.org/954000

Commentary:

1 This Principle means that every debtor has to pay a monetary debt at its nominal value. Therefore, without any special agreement of the parties in their contract, each party carries the risk of currency depreciation if he is to receive under a contract a payment in a currency other than the currency

of his home country.

2 Commentary No. 4 to Principle V.2.4 explains how the parties may cope with the exchange rate risk by inserting an exchange rate adjustment clause ("value-stabilization clause" or "index-linking clause") into their contract.

No. V.2.4 - Distribution of currency transferrisk

The currency transfer risk concerning a payment to be made by one party under a contract follows from Art. VIII (2)(b) IMF-Agreement.

Cite principle as: www.Trans-Lex.org/955000

Commentary:

1 Art. VIII (2) (b) IMF-Agreement of July 1944 provides that exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with the IMF-Agreement shall be unenforceable in the territory of any member. The Article serves to protect and implement the currency transfer restrictions of the IMF Member States as long as these restrictions are consistent with the IMF-Agreement. The Article therefore requires courts, international arbitral tribunals and domestic administrative authorities to accept and enforce the extra-territorial effect of such exchange control regulations in order to ensure a uniform treatment of these provisions throughout the Member States of the IMF. At the same time, the second sentence of Art. VIII (2) (b) shows that this provision reflects notions of reciprocity and inter-state cooperation (*comitas*) in the common struggle of the IMF Member States to enforce exchange control regulations which are consistent with the objectives and policies of the IMF-Agreement. For that reason, contracts have to be treated as unenforceable under Art. VIII (2) (b) IMF-Agreement notwithstanding that the law under which the foreign exchange regulation is maintained or imposed is not the law which governs the contract. Due to the fundamental nature of these policy considerations underlying Art. VIII (2) (b) IMF-Agreement and its significance for the global currency system, its content must be regarded as part of transnational law.

2 Only those measures fall within the ambit of Art. VIII (2) (b) IMF-Agreement which have been issued by an IMF Member State for the sole purpose of protecting the balance of payment and currency reserves of that particular country. Thus, measures which are not based on such purely economic motives but which appear to be foreign policy related or based on concerns for the national security of that country fall outside the scope of Art. VIII (2) (b) IMF-Agreement. This view is supported by the fact that the Fund has established a special notification procedure for "restrictions on payments and transfers of current international transactions that are solely related to the preservation of national or international security". In this procedure, the Fund does not examine the contents and substance of the regulation but merely indicates to the member state that "it has no objection to the imposition of the restrictions". This refusal to scrutinize such "measures for nonbalance of payments reasons" reveals that they fall outside the scope of the IMF Agreement and the general competence of the Fund. It would be inconsistent with this general policy underlying the IMF-Agreement if Art. VIII (2) (b) would require courts and arbitral tribunals to enforce such measures of member states for which the Fund refuses to take over any substantive responsibility. An exception applies only in those cases where an exchange control regulation that is issued solely for the purpose of protecting the national security of the country that has enacted it is sanctioned by UN Security Council Resolutions. This follows from Art. VI of the Agreement between the IMF and the United Nations of 1947 and the rights and duties of the UN Member States under Artt. 41, 42 and 48 of the UN-Charter. It should be noted that this approach to the practical application of Art. VIII (2) (b) IMF-Agreement is not achieved by reference to the rather vague notion of public policy, but by a narrow and policy-oriented interpretation of that Article itself.

3 The currency *transfer* risk must be distinguished from the currency *conversion* risk. That risk stems from the fact that the price or any other sum to be paid by one contract party is fixed in the contract in a certain currency, e.g. the currency of the payee, but the payor pays it in a different currency. In such a scenario, Principle V.2.2 applies unless the parties include a clause in their contract to deal with the currency conversion risk. Such currency conversion clauses avoid problems of payment by one party in currencies other than the one agreed upon in the contract and caused by exchange rate changes by fixing in advance the exchange rate for the price or other payment to be made under the contract.

4 The currency transfer risk must also be distinguished from scenarios in which a contracting party which is to receive a payment under the contract bears an exchange rate risk in the transaction, e.g. if the contract price or any other payment to be made under the contract is to be effected in a currency other than the currency of the country in which that party is located. In such situations, that party may either enter into hedging arrangements with its bank or, if the other party agrees, include an exchange rate adjustment clause ("value-stabilization clause" or "index-linking clause") into the contract. Such a clause provides for an identified fixed exchange rate between the currency of the payee and the currency in which payment is to be made and for an adjustment of the contract price if the exchange rate differs by more than x% on the date the payment is to be made or on another date fixed by the parties. The effect of such a clause is to provide for an exception to the Principle of nominalism pursuant to which a claim for payment in a certain currency entitles the creditor only to its nominal value, *i.e.* the contractually specified amount of that currency, irrespective of any fluctuations of the currency in which the debt is expressed between the date of concluding the contract out of which the claim arises and the date of payment.

No. V.2.5 - Payment of contract price through documentary credit

An agreement by the parties to payment through Documentary Credit (Letter of Credit, L/C) means any arrangement, however named or described, whereby a bank (the "Issuing Bank") acting at the request and on the instructions of a customer (the "Applicant") or on its own behalf,

- i)
is to make a payment to or to the order of a third party (the "Beneficiary"), or is to accept and pay bills of exchange (Draft(s)) drawn by the Beneficiary, or

- ii)
authorises another Bank to effect such payment, or to accept and pay such bills of exchange (Draft(s)), or

- iii)
authorises another Bank to negotiate,

against stipulated document(s), provided they appear, on their face, to be in compliance with the terms and condition of the credit, to be determined according to international standard banking practices as reflected in the UCP issued by the International Chamber of Commerce.

Cite principle as: www.Trans-Lex.org/958500

Commentary:

1 Opening a documentary credit (letter of credit, L/C) has become a usual way of payment by buyers/importers in international trade. The abstract and

binding undertaking of the issuing bank, often confirmed by a bank in the country of the seller/exporter, to pay the contract price if the documents provided for in the L/C agreement between the parties are presented to the bank by the seller/exporter and are considered to be "clean on their face", is almost as good as a cash payment by the buyer and provides security for the seller/exporter who can be sure to receive his money while the goods are still in transit to the buyer/importer.

2 Almost all documentary credit transactions are governed today by the Uniform Customs and Practices for Documentary Credits (UCP) which are formulated and published exclusively by the International Chamber of Commerce (ICC) in Paris, France. Because of their global and longstanding use and recognition, the UCP must be considered as part of transnational law.

Chapter VI: Non-Performance

No. VI.1 - Termination of contract in case of fundamental non-performance

(a) If a party's failure to perform its obligation amounts to a fundamental non-performance, the other party may terminate the contract.

(b) The right of a party to terminate the contract is exercised by notice to the other party.

(c) If performance has been offered late or otherwise does not conform to the contract the aggrieved party will lose its right to terminate the contract unless it gives notice to the other party within a reasonable time after it has or ought to have become aware of the offer or of the non-conforming performance.

(d) Termination of the contract releases both parties from their obligation to effect and to receive future performance.

(e) Upon termination of the contract either party may claim restitution of whatever it has supplied, provided that such party concurrently makes restitution of whatever it has received. If restitution in kind is not possible or appropriate allowance should be made in money whenever reasonable. However, if performance of the contract has extended over a period of time and the contract is divisible, such restitution can only be claimed for the period after termination has taken effect.

(f) Termination does not preclude a claim for damages for non-performance.

(g) Termination does not affect any provision in the contract for the settlement of disputes or any other term of the contract which is to operate even after termination.

Cite principle as: www.Trans-Lex.org/942000

Commentary:

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1 The right to terminate the contract requires that the other party's non-performance is fundamental. The type of non-performance is irrelevant, it relates to any failure by a party to perform any of its obligations under the contract. This wide scope includes defective and late performance.

2 A party's non-performance is fundamental if the requirements of Art. 25 CISG are met, *i.e.* if the non-performance substantially deprives the other party of what it was entitled to expect under the contract unless the non-performing party did not foresee and could not reasonably have foreseen such result. The nature of the obligation which one party is not performing may also be relevant in determining whether that party's non-performance is fundamental, *e.g.* when strict performance in compliance with the letters of the contract is of the essence. The time factor may also be relevant in that

a non-performance that, in and of itself, is not fundamental, may be qualified as fundamental because the non-performance is of such a nature that the other party has reasonable grounds to believe that the non-performing party will not or cannot perform in the future.

No. VI.2 - Notification of Lack of Conformity of Goods

(a) The buyer may not rely on a lack of conformity if the buyer does not give notice to the seller within a reasonable time specifying the nature of the lack of conformity. The time starts to run when the goods are supplied or when the buyer discovers or could be expected to discover the lack of conformity, whichever is later.
(b) The buyer loses the right to rely on a lack of conformity if the buyer does not give the seller notice of the lack of conformity within two years from the time at which the goods were actually handed over to the buyer in accordance with the contract.
(c) Where the parties have agreed that the goods must remain fit for a particular purpose or for their ordinary purpose during a fixed period of time, the period for giving notice under subsection (b) does not expire before the end of the agreed period.
(d) The buyer does not have to notify the seller that not all the goods have been delivered if the buyer has reason to believe that the remaining goods will be delivered.
(e) The seller is not entitled to rely on this Principle if the lack of conformity relates to facts of which the seller knew or could be expected to have known and which the seller did not disclose to the buyer.

Cite principle as: www.Trans-Lex.org/943000

Commentary:

1 This Principle follows from the presumption of professional competence of international businessmen. In the interest of legal certainty and speed, the buyer must notify the seller of a lack of conformity of the goods delivered to him by the seller and the nature of such lack if he wants to preserve his legal right arising out of such non-conformity.

2 The timeframe within which such notice must be given by the buyer must be determined against the Principle of reasonableness, taking into account all circumstances of the case, including the nature of the transaction and of the goods sold, practices established between the parties and relevant trade usages. Principle IV.4.2 applies to the notice.

3 Subsection (b) is derived from Art. 39 (2) CISG which provides that the buyer loses his right to rely on a lack of conformity of the goods if he does not give the seller notice thereof at the latest within a period of two years from the date on which the goods were actually handed over to the buyer, unless this time-limit is inconsistent with a contractual period of guarantee.

4 Given that the Principle is intended to protect the seller against unexpected claims of non-conformity by the buyer, the seller is not protected by the Principle in situations in which such protection would be contrary to the overriding Principle of good faith. Subsection (e) clarifies that such a situation exists if the lack of conformity relates to facts of which the seller knew or could be expected to have known and which the seller did not disclose to the buyer

No. VI.3 - Force majeure

(a) If non-performance of a party is

i)

due to an impediment which is beyond the reasonable control of that party and

- ii) could not have reasonably been foreseen by that party at the time of conclusion of the contract, and

- iii) neither the impediment nor its consequences could have been avoided or overcome by the non-performing party ("Acts of God", "Force Majeure", "höhere Gewalt"), and

- iv) the non-performing party did not assume, explicitly or implicitly, the risk of the occurrence of the impediment

that party's non-performance is excused.

(b) If non-performance is temporary, performance of the contract is suspended during that time and that party is not liable for damages to the other party. If the period of non-performance becomes unreasonable and amounts to a fundamental non-performance, the other party may claim damages and terminate the contract.

(c) Unless otherwise agreed by the parties expressly or impliedly, Force Majeure events under subsection (a) above are impediments such as

- i) war, whether declared or not, civil war or any other armed conflict, military or non-military interference by any third party state or states, acts of terrorism or serious threats of terrorist attacks, sabotage or piracy, strike or boycott, acts of governments or any other acts of authority whether lawful or unlawful, blockade, siege or sanctions, or

- ii) accidents, fires, explosions, plagues, or

iii)
natural disasters such as but not limited to storm, cyclone, hurricane, earthquake, landslide, flood, drought etc.,
or

iv)
any event of a similar nature.

(d) The party who fails to perform must give notice to the other party of the impediment and its effect on its ability to perform. If such notice is not received by the other party within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, it is liable for damages resulting from such non-receipt.

(e) Where the obligee has been prevented by a Force Majeure event as defined in (a) above from causing a limitation period to cease to run, the limitation period is suspended so as not to expire before one year after the relevant impediment has ceased to exist.

Cite principle as: www.Trans-Lex.org/944000

Commentary:

1 The parties may have, voluntarily or by accident, modified the prerequisites of the force majeure defence, e.g. with respect to the events which may constitute force majeure or with respect to the requirement of foreseeability in subsection (a) ii). In such a case, the Trans-Lex Principle can only be applied as modified by the agreement of the parties, typically in a force majeure clause.

2 The reference to 'piracy' in subsection (c) i) takes account of the increasing threat of piracy (for a definition see Article 101 UNCLOS*) to global sea transports, e.g. in the Gulf of Aden, offshore Lagos in Nigeria and in other places of the world. The events 'acts of terrorism or serious threats of terrorist attacks' contained in subsection (c) i) are a reaction to a change in the force majeure drafting practice of many companies after 9/11. The wording of the introductory phrase of that subsection ('such as') and of subsection (iv) ('any event of a similar nature') makes it clear that the list of force majeure events contained therein is non-exhaustive unless the parties provide otherwise in their contract. Thus, it may be considered a force majeure event if a mandatory export control law in force in the country of one of the parties prohibits the export of goods from that country under the conditions set forth in the contract.

3 Force majeure requires that performance under the contract becomes physically or legally impossible for the party invoking the force majeure defence. The mere fact *alone* that performance of a contract becomes economically more onerous or commercially less attractive for one party does not constitute a force majeure event even though the lack of funds may have been caused by a force majeure event listed in subsection (c). A change in economic or market conditions, affecting the profitability of a contract or the ease with which a party's obligations can be performed, does not constitute a force majeure event under subsection (c). Such scenarios may be considered Hardship events under Trans-Lex Principle VIII.1. Lack of funds may be considered a force majeure event, however, if the economic onerousness of performance comes close to a physical impossibility to perform or if the parties have extended the scope of force majeure to such scenarios in their contract, e.g. in the force majeure clause.

4 If a seller of generic goods has problems with his supplier, that situation does not in and of itself constitute a force majeure event. The seller's responsibility for its supplier is part of its general procurement risk, unless the seller has included a "delivery-against-supply clause" into the contract,

which limits its procurement risk to the supply received, or the other party has assumed the supply risk (e.g. by insisting on a certain supplier or by otherwise identifying the seller's source of performance more or less narrowly in the contract) or the seller is obliged to deliver specific or identified goods or the seller's duty to deliver is limited to a fixed stock. 5 The seller is likewise responsible (and may not invoke the force majeure defence absent an external impediment beyond his control) for its employees, subcontractors or other parties in his sphere of control. If the seller engages other independent third parties for the performance of the contract, the force majeure defence is available to him only if that party is exempt under the force majeure Principle *and* the person whom he has engaged would be so exempt if the provisions of the force majeure Principle were applied to him. The situation may be different if the other party has insisted on the involvement of the third party, thereby assuming the risk associated with the involvement of that third party.⁶ No party may derive an advantage from the force majeure event. This "no profit-no loss" rule is expression of an international standard of fairness, which has its roots in the principle of good faith.

7 The notification requirement in Subsection d) results from the application of Principle IV.6.9 in the force majeure context. Because the non-performing party's duty to notify the other side of the impediment is a contractual duty, the other party may claim damages pursuant to Principle VII.1 if the non-performing party violates this duty.

Footnotes:

* United Nations Convention on the Law of the Sea.

No. VI.4 - Promise to pay in case of non-performance

When the contract contains a clause providing that a party who fails to perform is to pay a specified sum to the aggrieved party for such non-performance, the aggrieved party is entitled to that sum irrespective of its actual loss. If the amount is grossly excessive in relation to the loss resulting from non-performance, and the other circumstances, the specified sum may be reduced by an arbitral tribunal or court to a reasonable amount notwithstanding any agreements of the parties to the contrary.

Cite principle as: www.Trans-Lex.org/945000

Commentary:

1 The Principle covers a broad range of clauses which can be categorized as penalty clauses ("*clause pénale*"; "*Vertragsstrafeversprechen*") and liquidated damages clauses ("*Schadenspauschalierung*") under many domestic laws. Under common law, penalty clauses are considered invalid due to their *interrorem* effect, intended to put pressure on the debtor as an incentive for timely performance. Some civil law systems, such as German law, contain provisions which invalidate penalty clauses when they are contained in standard terms.

2 In international business, these clauses are extremely often used because time is of the essence for the seller or the ordering party who has resold the goods before he has received them from his seller or is under some other type of time pressure which makes timely performance essential. For that reason, these types of clauses are not regarded as invalid *per se* in transnational law.

3 In line with the very purpose of such clauses, the agreed sum is forfeited, irrespective of the actual loss suffered by the aggrieved party. This means that the non-performing party cannot escape its obligation to pay the agreed sum by arguing that the aggrieved party has sustained a smaller loss than the sum agreed upon in the clause or no loss at all.

4 If, however, the agreed sum is *grossly*, *i.e.* clearly and obviously, excessive in relation to the loss caused by the non-performance and also in relation to the other circumstances of the case, the non-performing party may apply to the court or arbitral tribunal to have the sum reduced to a reasonable amount, even if the parties have excluded that right by agreement. In determining whether the sum is grossly excessive, the court or arbitral tribunal necessarily enjoys a certain degree of discretion. The power of the court or arbitral tribunal is limited to a "reduction" of the sum, which excludes both a total elimination (a "reduction to 0") and an increase of the agreed sum.

No. VI.5 - Anticipatory breach

When a party to a contract absolutely and unequivocally expresses an intention - expressly or tacitly - not to perform, or when it becomes otherwise clear, after the conclusion of the contract, that there will be a fundamental non-performance, the other party may terminate the contract. Principle VI.1 applies.

Cite principle as: www.Trans-Lex.org/945500

Commentary:

- 1** This Principle equates a fundamental non-performance that can be expected with actual non-performance. In order to be equated with actual non-performance, however, the future non-performance must meet one of the two tests provided for in the Principle.
- 2** The first test relates to a declaration of the party that it will not perform. This declaration, whether express or tacit, however, must be more than a mere general statement or indication of intent. Rather, the party must express this intention "absolutely and unequivocally". This means 1) that the declaration has left no alternative to non-performance and 2) that there must be no doubt left as to the party's intention not to perform.
- 3** Absent such an express or tacit declaration of the party, future non-performance is equated with actual non-performance only if the circumstances make it reasonably clear that there will be a fundamental non-performance. Contrary to the first test, this is an objective, rather than a subjective test.
- 4** If a future non-performance can be equated with actual non-performance under one of the two tests, the other party has the right to terminate the contract pursuant to Principle VI.1.

Chapter VII: Damages

No. VII.1 - Damages in case of non-performance

The aggrieved party is entitled to damages for loss caused by the other party's non-performance of its contractual obligations. It is entitled, subject to the provisions of , to receive such a sum of money by way of damages as will, so far as possible, put him in the same position as if the contract had been performed.

Cite principle as: www.Trans-Lex.org/946000

Commentary:

The Principle, together with the Principle VII.3.1 establishes the principle of full compensation as the corner stone of the law on damages. The party suffering the damage is entitled to full compensation for the harm it has sustained as a consequence of the other party's non-performance. At the same time, the damages claimed and received must not enrich the party suffering the damage.

No. VII.2 - Principle of foreseeability of loss

Claims for damages are limited to the loss which the non-performing party foresaw or could reasonably have foreseen at the time of the conclusion of the contract as being the likely result of its non-performance.

Cite principle as: www.Trans-Lex.org/947000

Commentary:

- 1** The purpose of the Principle of foreseeability, which is modelled after Art. 74 CISG, is to ensure that the damages to be paid by the non-performing party are linked to the contract and do not fall outside the scope of that contract and are therefore totally unexpected by the other party.

2 This purpose makes it clear that the foreseeability test does not relate to the amount of damages, but to the type and nature of damages which must be seen in relation with the purpose and nature of the contract. The perspective to be taken in performing the foreseeability test is that of the non-performing party at the moment of the conclusion of the contract and, in cases in which that party is unable to foresee the damage for whatever reasons, the perspective of a reasonable person in the situation of that party.

No. VII.3.1 - Limits to claims for damages

Damages may not exceed the actual loss and are available only for loss which is proven by the aggrieved party, or where the amount of damages cannot be established with a sufficient degree of certainty, assessed by the court or tribunal.

Cite principle as: www.Trans-Lex.org/948000

Commentary:

1 The Principle confirms the essential function of damages as a compensation for the loss suffered by the aggrieved party. There are no punitive damages in transnational law. Rather, the damages may not exceed the actual loss suffered, which may include lost profits or further damages such as lost business chances.

2 Immaterial of the nature of the damage, any damage claim is subject to the general rules of burden of proof. This means that the aggrieved party must always prove the damages which it claims.

3 In special cases in which that party finds it impossible to quantify its damages, those damages may be quantified by the court or arbitral tribunal which enjoy a certain degree of discretion.

No. VII.3.2 - Lost profits/Further damages

(a) The party who suffers a loss from the failure of the other party to deliver is entitled to calculate his loss

i)
based on the difference between the contract price and the price of a replacement transaction (e.g. substitute sale or substitute purchase) concluded within a reasonable time and in a reasonable manner or,

ii)
based on the difference between the price in the unexecuted contract and the market price current at the date of default and at the place where the contract should have been performed, or, if there is no current price at that place, the current price at such other place that appears reasonable to take as a reference.

(b) The aggrieved party may only recover lost net profits. This requires that the benefits of avoiding performance - the operating or other costs avoided by the absence of performance - must be deducted from the value to be received

through performance.

(c) A claim for compensation of further harm is not excluded by a claim raised under (a) above, provided that such harm was foreseeable under Principle VII.2 and is established with a reasonable degree of certainty.

Cite principle as: www.Trans-Lex.org/948500

Commentary:

1 The Principle is based on the idea of damages as full compensation of the losses sustained by the aggrieved party and specifies the ways in which the aggrieved party may calculate the losses to be compensated by the damages.

2 Pursuant to Subsection (a), which is modelled after Art. 75 CISG, the aggrieved party may calculate its loss with reference to a replacement transaction actually concluded by it, provided that this transaction is concluded, for the protection of the non-performing party, within a reasonable time and in a reasonable manner, or with reference to the market price at the date of default and at the place where the contract should have been performed, or, if there is no current price at that place, the current price at such other place that appears reasonable to take as a reference.

3 Subsection (b) makes it clear that damages include lost profit, but that the aggrieved party may claim compensation only for net lost profits in order to ensure that the aggrieved party is not enriched by the damages.

4 Subsection (c) makes it clear that Subsection (a) provides a means for the calculation of minimum damages and that the aggrieved party may always obtain damages for additional harm which it may have sustained, provided that such harm was foreseeable and is established with a reasonable degree of certainty.

No. VII.4 - Duty to mitigate

A party who relies on a breach of contract by the other party must take such measures as are reasonable in the circumstances to mitigate its loss, including loss of profit, resulting from the breach. If it fails to take such measures, the party in breach may claim a reduction in the damages in the amount at which the loss should have been mitigated.

Cite principle as: www.Trans-Lex.org/949000

Commentary:

1 This Principle is one of the most firmly established rules of transnational commercial law. A party suffering damages from a breach of contract by the other party cannot simply lean back and let the damages mount up. In fact, it often happens that a party wants to shift all the responsibility for certain damages on its counterpart while the evidence reveals that it would have been possible for that party to minimize that damage had it acted without delay at the moment it received knowledge of the damage.

2 Which measures a party relying on a breach by the other party is required to take in order to mitigate its damages, e.g. with respect to the amount of time and financial resources to be invested in or the nature of such measures, must be determined by application of the standard of reasonableness.

3 Depending on the circumstances and on what is to be considered reasonable in a given case, the party relying on a breach of contract by the other side may be under an obligation to accept alternative performance or to agree to a renegotiation of the contract in order to mitigate its damages. However, the duty to mitigate its damages does not require that party to accept unreasonable risks or burdens.

No. VII.5 - Liability for damages for legal opinions

A party is liable for damages if it solicits a legal opinion in the case according to the agreement of the parties and the

other party, who has reasonably believed in the verity of the legal opinion, suffers damages because it has performed its obligation or has made other financial dispositions.

Cite principle as: www.Trans-Lex.org/950000

Commentary:

1 Several legal relationships must be distinguished in the context of liability for legal opinions. If a party solicits a legal opinion from his attorney, and the legal opinion contains mistakes or errors, the attorney is liable to his client under the applicable law. If third parties have relied on the legal opinion, these third parties may have a claim for damages against the attorney even though they have no contract with him if it was obvious or foreseeable for the attorney at the time he produced the legal opinion that these third parties would rely on the advice contained in the legal opinion.

2 The Principle relates to the situation in which two parties agree that one of them solicits a legal opinion and the other party suffers damages because it has performed its obligation or has made other financial dispositions in reliance in the correctness of the legal opinion. Because there is a contract related to the soliciting of the legal opinion between the parties, the party whose reliance in the correctness of the legal opinion is disappointed has a claim for damages against the other party.

No. VII.6 - Duty to pay interest

(a) If the parties have not agreed otherwise, the debtor, who does not pay a sum of money when it falls due has to pay to the creditor interest on that sum from the time when payment was due.

(b) The rate of interest is to be determined on the basis of the average bank short-term lending rate to commercial borrowers prevailing for the currency of payment at the place of payment.

Cite principle as: www.Trans-Lex.org/956000

Commentary:

1 A claim for interest on a sum of money can be qualified either as a damage claim, because the creditor has to borrow the money he does not receive from his debtor elsewhere and has to pay interest for this money, which constitutes his damage. Alternatively, a claim for interest can be characterized as a claim for restitution because the debtor, while withholding the money and investing it, is unjustifiably enriched because it would have been the right of the creditor to invest the sum or use it for other purposes. From a functional perspective, the first approach is to be preferred because in business life, there is a general presumption that businesses work with bank credit for money they do not have or have not yet received.

2 Consequently, interest for sums in arrears are awarded by international arbitral tribunals to compensate for the damage resulting from the fact that the creditor is deprived for a certain period of time of the use of and disposition over the sums to which he is entitled.

3 The interest rate must be reasonable and must be fixed taking into account all relevant circumstances, in particular all relevant contractual stipulations, the nature of the facts which have caused the damage, the interest rates in force on the markets for the relevant currency and the inflation rate of that currency.

4 In light of this Principle, the parties' agreement not to allow for a claim for interest must be clear and unequivocal.

No. VII.7 - Right to charge compound interest

Compound interest may be charged on interest.

Cite principle as: www.Trans-Lex.org/958000

Commentary:

The Principle provides that compound interest, *i.e.* interest on interest, *may* be charged. Such a case is given, *e.g.*, where compound interest would provide a fair and reasonable element of compensation to the innocent victim of a non-performing party, for example when the aggrieved party must take credit for the money not received from the other side and has to pay compound interest to its bank because banks typically charge compound interest. In such cases, the charging and awarding of compound interest is in line with the reasonable expectations of commercial parties. It is for this reason that compound interest is increasingly awarded by international commercial arbitrators either as trade usage, as a substantive rule of private law reflected in the present Principle or under an expressly agreed provision, *e.g.* Art. 26.6 of the LCIA Arbitration Rules.

Chapter VIII: Hardship

No. VIII.1 - Definition

Any event of legal, economic, technical, political or financial nature

- i)
which occurs or becomes known to the disadvantaged party after the conclusion of the contract,

- ii)
which could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract and

- iii)
which fundamentally alters the equilibrium of the contractual obligations, thereby rendering the performance of the contract excessively onerous for that party provided that party has not, through express stipulation or by the nature of the contract, assumed the risk of that event

constitutes hardship ("Wegfall der Geschäftsgrundlage", "clausula rebus sic stantibus", "frustration of purpose").

Cite principle as: www.Trans-Lex.org/951000

Commentary:

1 The principle constitutes an exception to the fundamental principle of sanctity of contracts ("*pacta sunt servanda*"). In spite of its pivotal importance, that principle of sanctity of contracts is not without exceptions. However, since the principle of sanctity of contracts is the rule, the hardship defence is available only in exceptional circumstances. It is for this reason that subsection iii) requires a "fundamental" alteration of the economic equilibrium of the parties' contractual obligations. Such a fundamental, *i.e.* truly exorbitant alteration may result from an increase of the costs of performance of the

party invoking the hardship defence or from a decrease in value of the performance to be rendered by the other party.

2 This hierarchy also follows from the principle of the presumption of professional competence. In international contracts, which are usually comprehensive, detailed and all-embracing contractual frameworks, there is a presumption that absent an adaptation clause in the contract, the principle of sanctity of contracts prevails since it cannot be assumed that the parties were unaware of possible risks related to a change in the value of the parties' performance.

3 The question whether a fundamental alteration of the economic equilibrium of the contractual obligations of the parties has occurred, must be determined against the circumstances of each individual case. In a highly volatile market with sharp price fluctuations, a substantial increase in the cost of performance will be more acceptable than in markets with relatively stable price structures.

4 The hardship defence is not available if the party invoking the defence has, unilaterally or by agreement with the other side, assumed the risk for the events on which the hardship defence is based.

No. VIII.2 - Legal consequences

(a) In case of hardship, the aggrieved party may claim renegotiation of the contract with a view to reach agreement on alternative contractual terms which reasonably allow for the consequences of the event.

(b) If the parties fail to reach agreement on these alternative terms within reasonable time, either party may apply to a court or arbitral tribunal in order to have the contract

i)
adapted to the changed circumstances (provided the applicable procedural law allows for such adaptation), or

ii)
terminated at a date and on terms to be determined by the court or arbitral tribunal.

Cite principle as: www.Trans-Lex.org/951500

Commentary:

1 See for the guidelines which must be observed by parties in a contractual renegotiation process Trans-Lex Commentary to Principle IV.6.7, Para 3.

2 If an arbitral tribunal is called upon to adapt the contract under Subsection (b) i), the question arises whether in these cases a "dispute" or "legal dispute" exists as a prerequisite for arbitral decision making. The reason for this is to be found in the special nature of the renegotiation process. Because the possible negotiation outcome is so open, a difference of opinion between the parties as to the way to adjust the contract is not suited to classical arbitral adjudication in the sense of a clear "yes or no" decision. Rather an agreement between the parties on changing individual contractual obligations or adapting them to the changed economic conditions should be replaced by a ruling by the arbitral tribunal. With regard to the openness of the possible decision, however, the arbitrators are no longer being called upon to make a legal decision but rather, to shape the contractual relationship for the parties.

3 A multitude of modern developments supports the assumption of a more extensive jurisdiction for arbitral tribunals, including the authorisation to

adjust and adapt contracts. Factors in support of this view are the significantly greater arbitration-friendliness of national arbitration acts in recent years combined with increasingly equal treatment of adjudication by arbitral tribunals and by national courts, and the comprehensive recognition of party-autonomy as the leading maxim of arbitration. Even under English law, which has traditionally rejected every interference with the contract by the arbitral tribunal, arbitrators today are authorised to undertake such legal creativity to quite a broad extent. Apart from the extremely arbitration-friendly attitude of the English Arbitration Act 1996, this flows above all from the broad term "dispute", which forms the basis of the English arbitration law. As well as genuine legal disputes ("disputes") it includes mere differences of opinion ("differences") and hence permits the express transfer of the completion and adjustment jurisdiction to an arbitral tribunal. Even without an express transfer of jurisdiction under English law, in the case of contracts where performance has already begun a so-called "implied term" can be assumed, according to which the contract should be amended by a subsequent agreement.

Chapter IX: Unjust Enrichment/Restitution

No. IX.1 - Basic rule

(a) If a party is unjustifiably enriched (enriched party) without any legal ground,

i)
through performance by another, or

ii)
in any other manner,

at the expense of another party (disadvantaged party), the enriched party is bound to render restitution to the disadvantaged party.

(b) Enrichments which are transferable must be restored in natura. Enrichments which are non-transferable must be restored by paying the sum of money equal to the value of the enrichment to be determined according to the contractually agreed price or market price, including full compensation for the use (usufruct) of the subject matter of the enrichment.

enrichment as: www.Trans-Lex.org/959000

Commentary:

1 The Principle provides the basic rule for the restoration of an unjustified enrichment. Such enrichment may arise out of performance by one party, e.g. under an invalid contract (Subsection (a) i)), or the taking or using of an item or value without the consent of the party who is entitled to the taking or using of that item (Subsection (a) ii)). In both cases, the enrichment is unjustified if there is no legal ground which justifies the performance (e.g. a valid contract which obliges the party to perform) or the taking or using (e.g. a legal right to take or use).

2 The enrichment may constitute any kind of benefit by the enriched party. The enrichment of the party against whom the claim is raised must correspond to the disadvantage of the party who claims the restitution of the unjust enrichment. In the scenario envisaged in Subsection (a) i) this will

be the parties to the contract. In the scenario envisaged in Subsection (a) ii) the parties need not have a prior legal relationship with each other.

3 Subsection (b) provides for the consequence of an unjust enrichment which meets the requirements established by Subsection (a). These consequences depend on whether the item which constitutes the enrichment is transferable or not. In the first case, the enriched party must re-transfer the item to the disadvantaged party. In the second case, the enriched party must pay to the disadvantaged party the objective value of the item to be calculated according to the criteria listed in Subsection (b).

4 The enriched party is not liable to restore the enrichment if it has a defence or disenrichment.

No. IX.2 - Circumstances in which an enrichment is unjustified

An enrichment is unjustified in case of transfers of money, goods or services made

i)
on the basis of a contract or obligation or gratuitous disposition which is void or retrospectively avoided pursuant to Principle IV.7.3, or

ii)
without legal capacity to make them, or

paragraph/paragraph

iii)
under an express or implied reservation of a right of recovery, or

paragraph/paragraph

iv)
for a purpose which is not realized or does not materialize.

paragraph/paragraph www.trans-lex.org/959100

Commentary:

1 The Principle provides a list of scenarios in which an enrichment must be considered as unjustified under the basic rule of unjust enrichment. The classical scenario is provided for by No. i) which relates to a contractual relationship that is void *ab initio* or has been rendered void retrospectively, e.g. through the exercise of a party's right to avoid the contract for mistake in fact or law, so that all transfers made by and between the parties under such

contract are devoid of any legal ground and must be restored under the basic rule. A similar scenario is mentioned in No. ii). If a party has no legal capacity to render performance, the other party is unjustifiably enriched with respect to that performance.

2 Even if there is a legal basis for the enrichment under No. i) or ii), e.g. a contract, the enrichment is unjustified and must be restored under the basic rule in case where the party rendering the performance has made an express or implied reservation of a right of recovery or if that party's purpose which it has pursued with its performance has failed or its expectations connected with that performance have been disappointed (No. iv)).

No. IX.3 - Enrichment

(a) A party is enriched by:

i)
an increase in assets or a decrease in liabilities;

ii)
receiving a service or having work done; or

iii)
use of another's assets.

(b) In determining whether and to what extent a party obtains an enrichment, no regard is to be had to any disadvantage which that party sustains in exchange for or after the enrichment.

Cite principle as: www.Trans-Lex.org/959200

Commentary:

1 The Principle contains a broad definition of enrichment for purposes of application of the basic rule. The question whether a party is enriched or not is determined under a purely objective test. Enrichment does not necessarily require a positive act of acquisition by the enriched party. It is also immaterial whether the enrichment is wrongful or not, *i.e.* whether the enriched party has committed a wrongful act in obtaining the enrichment or whether it was aware or unaware of the enrichment, e.g. of the increase of its assets under Subsection (a) i). These aspects may be relevant for restitution claims under other legal grounds which are not excluded by a claim under the basic rule.

2 The most obvious case of enrichment is the increase in assets or decrease in liabilities of a person. This means that the enriched party must have received a new asset or that one of its existing debts must have been partially or fully discharged. A value may also be rendered to a person by rendering a service or performing a work for that party because the market considers that service or work as something valuable. Finally, a party may also be enriched simply by using another party's assets. This latter alternative covers a broad range of transferable and non-transferable assets, such as property in assets, intellectual property, contractual rights, rights of personality etc.

No. IX.4 - Disadvantage

(a) A party is disadvantaged by:

- i)
a decrease in assets or an increase in liabilities;

- ii)
rendering a service or doing work; or

- iii)
another's use of that party's assets.

(b) In determining whether and to what extent a party sustains a disadvantage, no regard is to be had to any enrichment which that party obtains in exchange for or after the disadvantage.

Cite principle as: www.Trans-Lex.org/959300

Commentary:

This Principle is a mere mirror image of Principle IX.3 which defines the enrichment for purposes of application of the basic rule. This shows that the types of benefits and detriments which may constitute the enrichment of the enriched party and the disadvantage to the disadvantaged party are basically the same. Thus, clarifying where the enrichment and disadvantage lies in a given case also serves to determine who is debtor and creditor of the obligation to restore the unjust enrichment under the basic rule.

No. IX.5 - Disenrichment

The enriched party is not liable to reverse the enrichment to the extent that the enriched party has sustained a disadvantage by disposing of the enrichment or otherwise (disenrichment), unless the enriched party would have had the same disadvantage even if the enrichment had not been obtained. This defence is not available when the enriched party did not act in good faith at the time of the disenrichment.

Commentary:

1 This Principle provides a defence of disenrichment to the enriched party. Such disenrichment may be caused either by the disposal of the enrichment by the enriched party (e.g. by spending the money or giving away the goods received) or, as a more general defence, by sustaining some other disadvantage. The underlying rationale of this Principle is that the enriched party must be allowed not to restore the enrichment in order to

prevent it from being worse off as a result of the restitution of the enrichment as compared to its situation without the enrichment. It is for this reason that the defence is not available if the enriched party would have had the same disadvantage if the enrichment had not been obtained.

2 The Principle is subject to good faith and the defence under it is not available to the enriched party if that party did not act in good faith at the time of the disenrichment.

No. IX.6 - No restitution in case of knowledge of illegality of performance

No one may claim restitution of what he has rendered to the other party while knowing the illegality of his performance ("nemo auditur turpitudinem suam allegans").

Cite principle as: www.Trans-Lex.org/960000

Commentary:

This Principle follows from the general Principle of good faith. A party who positively knows that its performance is illegal may not later claim restitution of that performance. Doubts as to the illegality of the performance do not suffice unless the party who performs makes it clear that it assumes all risks arising out of that performance.

No. IX.7 - Relation to other remedies

This Principle does not affect any other right of recovery of the disadvantaged party arising under contractual or other rules.

Cite principle as: www.Trans-Lex.org/960100

Commentary:

The Principle makes it clear that the right to restore an unjust enrichment under the basic rule does not constitute an exclusive remedy for the reversal of the unjust enrichment.

Chapter X: Corporations

No. X.1 - Foreign corporate entities

The existence of foreign corporate entities is acknowledged.

Cite principle as: www.Trans-Lex.org/961000

Commentary:

The Principle reflects the universal application of the juridical concept of corporateness, *i.e.* the existence of corporations as separate legal entities.

No. X.2 - Piercing the corporate veil

(a) The separate legal personality of a corporation ("corporate veil") may be disregarded in appropriate cases in order to hold a shareholder liable for the corporation's debts.

(b) Appropriate cases are cases of:

- i)
clear under-capitalization,

- ii)
mingling of corporate and financial spheres, especially in case of total control of the parent company over the business and financial affairs of its subsidiary, or

- iii)
fraud.

Cite principle as: www.Trans-Lex.org/962000

Commentary:

1 The Principle reflects situations in which the idea of the nature of corporations which constitute entities that are separate and distinct from its members, who are liable only to the extent that they have contributed to the company's capital, must be disregarded due to the application of the Principle of good faith.

2 In all three scenarios listed in the Principle, the concept of the corporation as a separate legal entity is misused by its founders or initiators. In these cases, the corporation is a mere "façade", used by its founders to shield themselves from claims raised against them by their creditors by hiding behind the corporate entity which they have established but which does not possess any assets necessary to satisfy the claims of these creditors.

3 It must be noted that the Principle is an exception to the basic rule that corporations as separate legal entities are acknowledged. The application of the Principle therefore requires a very strict test, *i.e.* clear evidence of under-capitalization, mingling of spheres or fraud, so as to ensure that the Principle remains the exception.

No. X.3 - Liability of corporate founders

The founders are liable for debts incurred in the pre-incorporation phase.

Cite principle as: www.Trans-Lex.org/964000

Commentary:

The Principle is based on the understanding that prior to the coming into existence of the corporation as a separate legal entity, the founders of that corporation, who have a direct interest in the establishment of the corporation, must be held liable for the debts incurred in the context of the incorporation prior to the coming into existence of the corporation as a separate legal entity.

Chapter XI: Expropriation

No. XI.1 - Compensation for expropriation

(a) A state may not, directly or indirectly, nationalize or expropriate foreign private property except for a purpose which is in the public interest, not discriminatory, and against fair compensation.

(b) Fair compensation must be based on the fair market value of the expropriated assets to be determined immediately before the time at which the taking occurred or the decision to take the asset became publicly known.

(c) Absent an agreement of the parties, if a going concern is expropriated, the amount of compensation is to be determined according to the "going concern"-value, based on the discounted cash flow value of the enterprise ("discounted cash flow method", "DCF").

(d) Absent an agreement of the parties, if a non-profitable enterprise is expropriated, the amount of compensation is to be determined according to the value of the original investment with appropriate adjustments.

(e) Payment of compensation shall include interest and has to be made effectively, i.e. in freely convertible currency on the basis of the market rate of exchange existing for that currency on the valuation date or in any other currency accepted by the investor, and prompt, i.e. without undue delay.

Cite principle as: www.Trans-Lex.org/965000

Commentary:

1 Whether a transnational standard of expropriation exists has been debated for a long time, both in legal doctrine and within the United Nations. This is mainly due to the fact that this issue is closely linked to the sovereignty of states, so that any attempt to shape and formulate the law in this area has severe political implications. The Principle reflects a minimum consensus of the majority of legal doctrine, arbitral case law and states which has evolved over the past decades.

2 Expropriation or "wealth deprivation" means any action by a state in taking or modifying the property rights of an individual in the exercise of its sovereignty. The broad language in Subsection (a) makes it clear that expropriation may take many different forms.

3 Expropriation may be direct, e.g. in the form of transfer of title or outright physical seizure, freezing or blocking of assets or funds, compulsory sales etc. However, it is generally acknowledged that states can interfere with property rights of private parties to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the state does not purport to have expropriated them and the legal title to the property formally remains with the original owner.

4 Expropriation may also be indirect ("*de facto*"), e.g. in the form of excessive tax laws applicable only to foreign investors. The concepts of indirect expropriation raises intricate problems, because there is no generally accepted and clear definition of the concept of indirect expropriation ("regulatory expropriation") and what distinguishes it from non-compensable regulation. It may be applicable to regulatory measures aimed at protecting the environment, health and other welfare interests of society. This raises the question as to what extent a government may affect the value of property by regulation, either general in nature or by specific actions in the context of general regulations, for a legitimate public purpose without effecting a "taking" and having to compensate for this act. The expropriating effect may also be caused not by a single measure, but by a series of acts that, over time, have an expropriatory effect ("creeping expropriation").

5 In general, it is the effect of the measure or measures rather than the form which determines whether one is faced with an unlawful expropriation. The mere refusal to pay a debt under a contract concluded by the state with a foreign party is, in and of itself, not a taking as referred to by this Principle. Such issues must be dealt with under the Principle of contractual non-performance. The Multilateral Investment Guarantee Agency (MIGA) of the World Bank offers insurance coverage against losses arising from a government's breach or repudiation of a contract, typically concluded by a

state-owned enterprise with the investor (e.g., a concession or a power purchase agreement) or from the government's non-payment of an award rendered against it. However, this insurance coverage goes beyond the protection standard afforded by the transnational law of expropriation.

6 Some of the requirements spelled out in the Principle are rather broad in nature. This applies to the public purpose requirement in Subsection (a), given that it is very easy for an expropriating state to couch any direct or indirect taking in some "public purpose". Also, states are afforded a wide margin of appreciation in determining whether a taking serves a public purpose. A taking is discriminatory, e.g., if the state has singled out the nationals of a certain country or certain countries and has applied the direct or indirect taking only to this limited group. The taking is not discriminatory if both citizens of the state and aliens are treated in the same manner.

7 It is sometimes argued that an expropriation must also be "according to due process of law" in order to be lawful but it remains unclear whether that requirement is in fact part of transnational law.

8 The standard of compensation dealt with in Subsections (b) to (e) is the most controversial aspect of the transnational Principle of expropriation. It follows from the general principle spelled out in Subsection (a) that an expropriation is lawful only if fair compensation is provided for by the state. The state's duty to compensate for the taking of private property is a result of the respect for property rights as "acquired rights". The Principle reflects the notion of "fair" ("just") compensation, meaning that the party who suffers the expropriation must receive a compensation equal to the fair market value of the expropriated property. There are a number of valuation methods that can be applied to determine the fair market value, depending on the type of expropriated asset. Methods used to value tangible assets are the book value, i.e. the value at which an asset is carried on a balance sheet, and the replacement value, i.e. the amount required to obtain an asset of the same kind as the expropriated asset. The valuation of income-producing property, e.g. a company as a going concern, can be done on the basis of the DCF method referred to in Subsection (c). That method calculates the value at a specified time of cash flows that are to be received in the future by discounting the yearly net cash flows to present value. The discount rate uses the weighted average cost of capital and includes, *inter alia*, cost of capital and risk components. The sum of all future cash flows, both incoming and outgoing, is the net present value, which is taken as the value or price of the cash flows in question. Pursuant to the Principle of party autonomy the parties may always agree on a different method of valuation.

9 The fact that the payment of compensation shall include interest is itself a general Principle of transnational law.

Chapter XII: Proof, Means of Evidence

No. XII.1 - Distribution of burden of proof

The burden of proof rests on the party who advances a proposition affirmatively ("actori incumbit onus probandi").

Cite principle as: www.Trans-Lex.org/966000

Commentary:

This Principle means that a claimant bears the burden of proof for the facts which support his claim, e.g. the facts supporting a claim for damages, while the respondent bears the burden of proof for the facts supporting his defences, e.g. the defence of disenrichment against a claim for restoration of an unjust enrichment.

No. XII.2 - Proof of written contract

A written contract may be proven through any means of modern telecommunication (Telex, Telefax, btx, EDI etc.), if it provides a record of the information contained therein and can be reproduced in written form.

Cite principle as: www.Trans-Lex.org/967000

Commentary:

This Principle takes account of modern means of telecommunication which are used in international business and trade. It must be noted that this

Principle does not impose a form requirement for international contracts but merely establishes a rule of evidence. Pursuant to Principle IV.4.1 contractual declarations are valid even when they are not made in or evidenced in writing unless mandatory rules of any applicable domestic law provide otherwise.

No. XII.3 - Circumstantial evidence

Principal facts may be proven by evidence of facts and/or circumstances from which the existence of those principal facts usually and reasonably follow according to the general experience of life.

Cite principle as: www.Trans-Lex.org/968000

Commentary:

In application of this Principle, the approval of invoices over the amount claimed may serve as circumstantial evidence for the existence of the claim.

No. XII.4 - Prima facie evidence

Prima facie evidence, which is based on a typical set of facts that, according to the general experience of life, justifies the assumption of a certain cause or consequence, is admissible (*res ipsa loquitur*).

Cite principle as: www.Trans-Lex.org/968700

Commentary:

1 The Principle means an alleviation of the general Principle of burden of proof in cases which relate to a set of facts which, according to the general experience of life, typically lead to a certain cause or consequence. Such result or cause can then be inferred from the very nature of that set of facts, even without direct evidence for such cause or consequence. The party must prove only the set of facts, but not the cause or consequence that can be inferred from that set of facts. "Typically" does not mean that the set of facts must be the reason for the cause or consequence in all conceivable circumstances, but that this connection is so frequent that it is highly probable that this connection between the set of facts and the cause or consequence which the party intends to prove exists in the given case.

2 If the other party proves facts which support the assumption of an atypical set of facts which does not allow the inference of the cause or consequence which the first party intends to prove with *prima facie* evidence, the first party must meet the full burden of proof for establishing the facts underlying its claim or defence because the *prima facie* evidence rule is no longer available.

No. XII.5 - Settlement Privilege

(a) Privileged information is inadmissible as evidence in subsequent arbitration or court proceedings between the same parties, provided that the privilege objection

- i)
 - is raised in the arbitration or court proceedings in good faith, and

- ii) does not relate to facts which one side would have been able to prove had there been no settlement negotiations between the parties.

(b) Privileged information relates to

- i) statements, views, admissions, proposals, suggestions, indications of readiness to accept a certain proposal for settlement, whether written or oral, submitted by a party during settlement negotiations, mediation/ conciliation or any other ADR proceedings, or

- ii) statements made or views expressed by a third neutral involved in such proceedings, or

- iii) any document, witness statement or expert report submitted in or prepared by a party solely for these negotiations, mediation/conciliation or any other ADR process between the parties.

Cite principle as: www.Trans-Lex.org/968500

Commentary:

1 The transnational settlement privilege established by this Principle relates not only to oral or written statements submitted to the other side during the negotiations but also to internal documents prepared specifically for these negotiations. Given that the purpose of the privilege is to protect the parties and to ensure efficient settlement talks between them it can make no difference whether such "views" or "suggestions" are formulated by the parties or their experts prior to the settlement negotiations in order to be presented in these settlement talks or whether these pre-formulated views, suggestions or proposals are actually read or otherwise presented or communicated to the other side during these negotiations. To decide otherwise would lead to the strange and unacceptable result that the parties are protected during their settlement talks but would not enjoy the same degree of privilege protection when they prepare for these talks and draft the arguments, views, suggestions and proposals which they want to present in these negotiations. Without a safe and privilege-protected preparation phase, the key policy goal of the settlement privilege - to ensure free and uninhibited settlement talks between the parties, and to allow for careful and deliberate preparation involving both internal and external counsel - would be perverted into a mere farce. Therefore, Art. 10 (1) (f) UNCITRAL Model Law on International Conciliation provides that a party to the conciliation proceedings shall not in arbitral, judicial or similar proceedings rely on, or introduce as evidence "A document prepared solely for purposes of the conciliation proceedings."

2 The privilege objection, like any other legal right, is subject to limitations derived from the Principle of good faith. The good faith requirement is violated and the settlement privilege cannot be invoked if a party has introduced a statement or document during settlement negotiations *solely* for the sake of being able to shield this information from the other side based on the settlement privilege in a subsequent arbitration. The settlement privilege may not be misused to pervert the mediation or negotiations into a "grave of facts".

3 It follows from this good faith limitation that the settlement privilege does not extend to facts which one side would have been able to prove if there had been no settlement negotiations between the parties. It is for this reason that the third sentence of Rule 408 of the US Federal Rules of Evidence provides that "[t]his rule does not require the exclusion of any evidence otherwise discoverable merely because it is presented in the course of compromise negotiations". Likewise, some statutes on the mediation privilege in the US provide that the privilege applies to admissions, representations, or statements made in mediation, provided that they are "not otherwise discoverable or obtainable". In the same vein, Art 7 (2) (a) ICC ADR Rules provides that the privilege applies "unless [the information] can be obtained independently by the party seeking to produce them in the judicial, arbitration or similar proceedings".

4 In addition, evidence stemming from settlement negotiations between the parties must be admitted if they do not relate to statements, views or admissions made by the parties but to objective facts. For example, a report introduced into the settlement negotiations about the inspection of goods which no longer exist at the time of the other proceedings should be admissible in these proceedings.

No. XII.6 - Attorney-Client Privilege

Any communication between a client and his attorney which is made in the course of or in anticipation of legal proceedings or which relates to the giving of legal advice, i.e. the seeking of advice as to legal rights and obligations as opposed to general business matters, and which originates in a confidence that it will not be disclosed, is privileged and may not be introduced as evidence in court or arbitration proceedings.

Cite principle as: www.Trans-Lex.org/968600

Commentary:

1 This Principle is based on the idea that privileges are substantive in nature. A comparative qualification of evidentiary privileges will almost certainly lead to the conclusion that these issues have a substantive nature. This follows from the public policy judgements underlying these privileges. Very often, these judgements relate to the value of certain kinds of information or communication. Such judgements are substantive in nature, even if they are manifested in procedural law in certain jurisdictions because they relate to the taking of evidence.

2 The Principle may be referred to by international arbitral tribunals in lieu of applying complicated conflict-of-laws concepts related to the question of which domestic law applies to a privilege. Also, the tribunal's procedural discretion extends to the treatment of evidentiary privileges. Thus, privileges share the fate of arbitral decision making in this area. It is a general problem that, in the absence of clear evidentiary standards for international arbitration, the tribunal's rulings on evidence can appear unfair and arbitrary in certain cases.

3 By referring to the "confidence" of one side, the Principle makes reference to the reliance interest of the party which expects to be protected by the attorney-client privilege at the time when it makes the communication to his attorney. It is this reliance interest which must be protected by arbitral tribunals that deal with the issue of privileges.

4 The Principle does not answer the question whether the attorney-client privilege extends to communications with in-house counsel, a question that is

treated differently in domestic legal systems around the world.

No. XII.7 - Most favoured nation treatment in case of unequal privilege protection

If the standard of privilege protection granted to one party under the applicable law is different from the standard granted to the other party under the applicable law, the arbitral tribunal - in the interest of procedural fairness and equal treatment of the parties - shall grant to both parties the privilege standard of the law of that party which accords the broadest privilege protection.

Cite principle as: www.Trans-Lex.org/968650

Commentary:

1 The Principle is based on the understanding that the potential for arbitrary treatment of the parties in the application of evidentiary privileges of domestic law runs counter to a fundamental principle of arbitral due process: the tribunal's duty to treat the parties fairly and equally. In fact, it is one of the principal functions of an arbitral tribunal to act as a guarantor and guardian of the parties' fundamental procedural right for equal treatment and their right to be heard as the *Magna Charta* of arbitral procedure. A party may be treated unequally and unfairly when the tribunal applies different privilege standards to the parties resulting in different standards for the production of evidence. In exercising its discretionary powers in the taking and evaluation of evidence, the tribunal must therefore vary or modify the result reached when applying the conflict rule explained above in order to ensure fairness and equality in the taking of evidence and to avoid due process imbalances between the parties. It is for this reason that *both* "flexibility and equality" are regarded as the two fundamental principles of arbitral procedure.

2 Based on the above considerations, an international arbitral tribunal that is faced with conflicting privilege standards and sees "compelling" reasons to (re-)establish equality and fairness between the parties with respect to a concrete privilege issue can apply the "most favoured nation rule" established by the Principle by applying to a given privilege issue only the law of that party that accords the broadest protection to privileged information. This means that a party is entitled to rely on the protection standard of its home jurisdiction as long as this standard is also granted to the other side and the privilege is not invoked *mala fides*. Such an approach does justice to the reliance interests of the parties because they could be confident that they would never be required to produce information that is considered privileged under their own laws. This is the concept underlying Art. 9 (2) (g) IBA Rules which allows the tribunal to "exclude" evidence based on considerations of equality and fairness between the parties. Such approach does not invite forum shopping by the parties, *i.e.* the search for counsel from countries with more favourable privilege rules. As shown above, it is not the law of the jurisdiction where counsel is admitted to the bar but the law of the country where the party has its residence or place of business that applies to the privilege.

Chapter XIII: International Arbitration

Section 1: Arbitration Agreement

No. XIII.1.1 - Arbitration agreement

(a) An arbitration agreement is an agreement by the parties to submit to arbitration - whether administered (institutional arbitration) or not (ad hoc arbitration) - all or certain disputes or disagreements which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.

(b) An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate

agreement (submission agreement).

(c) An arbitration agreement shall be in writing. An agreement is in writing if it is contained in a document signed by the parties or in an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement, or in an exchange of statements of claim and defence in which the existence of an agreement is alleged by one party and not denied by another.

(d) The law applicable to the arbitration agreement is to be determined according to .

Cite principle as: www.Trans-Lex.org/968900

Commentary:

1 The question whether and which disputes are covered by an arbitration agreement must be determined by interpreting the agreement pursuant to their *favorem* rule of construction.

2 The fact that arbitration agreements cover not only "disputes" but also "disagreements" relates to the fact that arbitral tribunals may also adapt contracts to changed circumstances or fill gaps in contracts, see Trans-Lex-Commentary to Principle VIII.2, Para 3.

No. XIII.1.2 - Interpretation of Arbitration agreements

An international arbitration agreement must be construed with a view to preserve its validity and to uphold the will of the parties expressed therein to have their dispute decided by international arbitrators and not by domestic courts (*in favorem validitatis*).

Cite principle as: www.Trans-Lex.org/968902

Commentary:

1 In most modern jurisdictions it is generally acknowledged that the principle of "*in favorem validitatis*" must be applied to the interpretation of an international arbitration agreement. According to this principle, an arbitration agreement should be construed in good faith and in a way that upholds its validity. "[D]oubts about the intended scope of an agreement to arbitrate are [to be] resolved in favor of arbitration" (*Kaplan v. First Options of Chicago, Inc.*, 19 F.3d 1503, 1512 (3rd Cir. 1994)). This pro-arbitration approach or "*in favorem presumption*" to the construction of arbitration agreements serves to enforce the common intention of the parties to have their dispute decided before an international arbitral tribunal.

2 The *in favorem* approach is also a consequence of today's arbitration-friendly climate which is based on the understanding that dispute settlement by international arbitral tribunals has the same value and standing as adjudication before domestic courts. This means that a liberal way of construing arbitration agreements has to be pursued even in those cases where in general contract law the ambiguity could not be resolved through the application of traditional means of interpretation.

No. XIII.1.3 - Arbitration agreement and substantive claim before court

(a) A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.

(b) Where an action referred to in paragraph (a) of this Principle has been brought, arbitral proceedings may

nevertheless be commenced or continued, and an award may be made, while the issue is pending before the court.

Cite principle as: www.Trans-Lex.org/968905

Commentary:

Subsection (b) serves to avoid delays in the arbitration but is not mandatory ("...may..."). If the arbitral tribunal has serious doubts as to its jurisdiction (*i.e.* as to the validity of the arbitration agreement), it can always suspend the proceedings and await the decision of the court before proceeding with the arbitration.

No. XIII.1.4 - Arbitration agreement and interim measures by court

It is not incompatible with an arbitration agreement for a party to request, before or during arbitral proceedings, from a court an interim measure of protection and for a court to grant such measure.

Cite principle as: www.Trans-Lex.org/968910

Commentary:

1 The Principle does not answer the questions which measures may be requested from the domestic court. This issue must be decided pursuant to the procedural law of the courts which may contain an exhaustive list of possible interim measures that can be obtained from the courts in that jurisdiction.

2 The Principle is mandatory which means that the parties may not agree to exclude resort to courts for all or certain interim measures.

Section 2: Arbitral Tribunal

No. XIII.2.1 - Number of arbitrators

(a) The number of arbitrators shall be one or three. The parties are free to determine the number of arbitrators.

(b) Failing such determination, the number of arbitrators shall be determined by the applicable arbitration law.

Cite principle as: www.Trans-Lex.org/968915

Commentary:

1 The parties can always select the number of arbitrators. Typically, the number is one or three, which avoids a deadlock in the voting of the arbitral tribunal.

2 If the arbitration clause does not contain an agreement on the number of arbitrators, Art. 10 (2) UNCITRAL Model Law provides that the tribunal shall consist of three arbitrators. The same numerical preference is contained in Art. 5 UNCITRAL Arbitration Rules and Art. 6 (1) Swiss Rules. Art. 5.4 LCIA Arbitration Rules, however, follows Sec. 15 (3) 1996 English Arbitration Act and provides, for reasons of cost effectiveness, for the appointment of a sole arbitrator unless the parties have agreed otherwise. Sec. 8 (2) ICC Arbitration Rules provides that absent an agreement of the parties, the ICC Court of Arbitration shall appoint a sole arbitrator, save where it appears to the Court that the dispute is such as to warrant the appointment of three arbitrators. A similar rule is contained in Art. 5 ICDR International Arbitration Rules. This flexible rule makes sense in revealing that the number of arbitrators is not a matter of principle, but depends on the complexity of the dispute and other particularities of the case.

No. XIII.2.2 - Arbitrator's duty to disclose

- (a) When a person is approached in connection with his possible appointment as an arbitrator, he shall disclose any circumstances likely to give rise, in the eyes of the parties, to justifiable doubts as to his impartiality or independence.
- (b) An arbitrator, from the time of his appointment and throughout the arbitral proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him.
- (c) An arbitrator who has made a disclosure considers himself or herself to be impartial and independent of the parties despite the disclosed facts and therefore capable of performing his or her duties as arbitrator. Therefore, disclosure does not, in and of itself, demonstrate grounds sufficient to disqualify the arbitrator.
- (d) Non-disclosure by an arbitrator of certain facts or circumstances alone does not constitute a ground for challenge. Only the facts or circumstances that he did not disclose can do so.

Cite principle as: www.Trans-Lex.org/968925

Commentary:

1 Art. 3.2 IBA Rules of Ethics for International Arbitrators provides that 'the appearance of bias is best overcome by full disclosure'. For this reason, Art. 12 (1) UNCITRAL Model Law provides that an arbitrator shall, prior to his appointment, from the time of his appointment and throughout the arbitral proceedings, disclose without delay any circumstances likely to give rise to justifiable doubts as to his impartiality or independence. The ICC's Statement of Independence, which every arbitrator has to sign prior to appointment by the ICC Court of Arbitration, notes that '[a]ny doubt [as to the arbitrator's impartiality or independence] should be resolved in favor of disclosure'. The same rule is contained in General Standard 3 (c) IBA Guidelines.

2 It must be emphasized that if the arbitrator discloses certain circumstances, they should not be equated with a ground for challenge. The IBA Working Group, which drafted the IBA Guidelines on Conflicts of Interest, repeatedly emphasized that the rules contained therein are intended to 'eliminate the misunderstanding that disclosure demonstrates doubts sufficient to disqualify the arbitrator'. The reason for this misunderstanding is rooted in the fact that, in contrast to the determination of a ground for challenge, where the Working Group adopted a narrow, objective 'reasonable third person test', it adopted a wider subjective test to determine whether an arbitrator is under a duty to disclose vis-à-vis the parties. General Standard 3 (a) IBA Guidelines, in adapting the language of Art. 7 (2) ICC Rules of Arbitration, provides that the arbitrator shall disclose such facts and circumstances which, 'in the eyes of the parties' give rise to doubts as to the arbitrator's impartiality or independence. A fact or circumstance which gives rise to doubt in the eyes of a party may be considered totally appropriate from an informed third person's point of view.

No. XIII.2.3 - Grounds for challenge of an arbitrator

- (a) An arbitrator may be challenged only if circumstances exist that, from the perspective of a reasonable third person having knowledge of the relevant facts, give rise to justifiable doubts as to his impartiality or independence, or if he does not possess qualifications agreed to by the parties.
- (b) An arbitrator shall decline to accept an appointment or, if the arbitration has already been commenced, refuse to continue to act as an arbitrator if he or she has any doubts as to his or her ability to be impartial or independent.
- (c) Justifiable doubts necessarily exist as to the arbitrator's impartiality or independence if there is an identity between a party and the arbitrator, if the arbitrator is a legal representative of a legal entity that is a party in the arbitration, or if the

arbitrator has a significant financial or personal interest in the matter at stake.

(d) A party may challenge an arbitrator appointed by him, or in whose appointment he has participated, only for reasons of which he becomes aware after the appointment has been made.

(e) The parties are free to agree on a procedure for challenging an arbitrator, subject to mandatory court control of the challenge as provided for by the arbitration law in force at the seat of the arbitration.

Cite principle as: www.Trans-Lex.org/968935

Commentary:

1 Because arbitrators exercise genuine judicial functions the concepts of 'impartiality' and 'independence' of international arbitrators are of paramount importance to ensuring and safeguarding the integrity of the international arbitral process. It is generally accepted that a lack of impartiality and independence on the part of an arbitrator is a ground for setting aside the award and refusing enforcement because the composition of the tribunal was not in accordance with the provisions of the arbitration law at the seat of the arbitration and the award thus violates international public policy. Together with the basic procedural rights of the parties to be heard and to be treated equally laid down in Art. 18 UNCITRAL Model Law, these principles serve to ensure that dispute settlement through arbitration enjoys the same degree of legitimacy and worldwide acceptance as adjudication before domestic courts. In fact, the preservation and safeguarding of these principles is the very reason why arbitration has the same standing as dispute resolution before domestic courts.

2 While it is perfectly legitimate for a party to select an arbitrator who is generally predisposed to it personally or to its legal position, the arbitrator must be and remain impartial and independent meaning that he or she can decide the dispute - without partiality - in favor of the party with the better case. The arbitrator can be favorably disposed towards one of the parties but must have an open mind and must be and remain in a position to decide the dispute against the party that appointed him.

3 The concepts of 'impartiality' and 'independence' are intentionally formulated rather broadly in order to cover all possible circumstances, which might justify a challenge from a party of the arbitration. Sometimes, a strict distinction between both concepts is advocated. 'Independence' is seen to refer to the relationship between the parties and the arbitrators while the arbitrator's 'impartiality' is said to require a judgment that relates more to the arbitrator's relationship with the substance of the dispute.

4 In reality, the differences in this field are more a matter of how these grounds can be detected than a matter of substance. In general, these concepts must be interpreted so as to cover all biased behavior of the arbitrators during the arbitral proceedings. Sec. 1 (a) and 24 (1) (a) 1996 English Arbitration Act therefore make reference only to the tribunal's or the arbitrator's 'impartiality'. It is the indirect or direct dependence of the arbitrator on one of the parties, a potentially important witness or the arbitral institution administering the proceedings, which provides the decisive evidence indicative of the arbitrator's partiality or impartiality.

5 Always of particular importance are close personal or professional relationships with a co-arbitrator, a party or its counsel, and any direct personal or professional interest in the outcome of the case, as well as secret party communications during the proceedings. The nationality of an arbitrator on its own does not provide a ground for challenge.

No. XIII.2.4 - Kompetenz-Kompetenz; Separability of the arbitration clause

(a) The arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement ("Kompetenz-Kompetenz").

(b) A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than the submission of the statement of defence. A party is not precluded from raising such a plea by the fact that he has appointed, or participated in the appointment of, an arbitrator.

(c) The invalidity of the main contract does not automatically extend to the arbitration clause contained therein unless it is proven that the arbitration agreement itself is vitiated by fraud, or initial lack of consent (Principle of Separability).

Cite principle as: www.Trans-Lex.org/969000

Commentary:

1 It is generally acknowledged today that an international arbitral tribunal, just like any other tribunal, is authorized to decide on its own competence once constituted. This authority is based on the principle of *Kompetenz-Kompetenz*. According to this principle every tribunal which is called upon to decide a dispute, immaterial of whether its authority is based on a statute (domestic court), public international law (International Court of Justice) or an agreement of the parties (arbitral tribunal), is authorized to decide not only on the substantive questions presented to it but also on the preliminary issue of its own competence as the *conditio sine qua non* of its decision-making.

2 The application of the principle of *Kompetenz-Kompetenz* in international arbitration means that the arbitrators must have the authority to rule on the validity of the arbitration agreement from which they derive their authority to decide the dispute. It is neither illogical nor unlawful if a tribunal ultimately decides that the arbitration agreement on which its decision-making power is based is invalid. Rather, this result is a natural consequence of the strict application of the general principle of *Kompetenz-Kompetenz* in international commercial arbitration.

3 If the arbitral tribunal thinks that the contract which contains the arbitration clause is invalid, it can still rule on its own jurisdiction and has the authority to confirm or reject its competence to decide the dispute under the invalid contract. This follows from the notion of the 'separability' of the arbitration agreement from the main contract. Art. 16 (1) UNCITRAL Model Law expresses this principle in clear words and provides that 'an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. The decision by the arbitral tribunal that the contract is null and void shall not entail ipso iure the invalidity of the arbitration clause'. This principle is also manifested in Sec. 1040 (1) German Arbitration Act, which is based on Art. 16 (1) UNCITRAL Model Law. Any challenge to the main agreement does not affect the arbitration agreement: the tribunal can still decide on the validity of the main contract. The doctrine of separability thus further strengthens the jurisdiction of the arbitrators

4 An exception to subsection (c) applies when the main contract is void *ab initio*, e.g. due to missing public permission, exertion of coercive powers or lack of authority to represent. It must be clear in such cases that there has never existed a valid contract between the parties.

No. XIII.2.5 - Power of arbitral tribunal to order interim measures

Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, order any party to take such interim measure of protection as the arbitral tribunal may consider necessary in respect of the subject matter of the dispute. The arbitral tribunal may require any party to provide appropriate security in connection with such measure.

Cite principle as: www.Trans-Lex.org/969010

Commentary:

It is generally acknowledged today that the legal basis for the arbitral tribunal's competence to issue 'interim orders of protection' or 'conservatory measures' lies in its competence to decide on the merits of the dispute. In authorizing a private tribunal to decide existing or future disputes between them, the parties have vested in the arbitrators the inherent power to issue measures of provisional relief connected to the subject matter of the dispute, which serve to safeguard the efficiency of the tribunal's decision-making. One is dealing here with an 'accessory' competence of the arbitrators. Thus, provisions in modern arbitration laws such as Art. 17UNCITRAL Model Law, which authorize the tribunal, at the request of a party, to order any interim measures of protection it considers necessary in respect of the subject-matter of the dispute, do not establish the tribunal's power to issue interim relief, but merely confirm a general principle of international procedural law.

No. XIII.2.6 - Decision making by panel of arbitrators

(a) In arbitral proceedings with more than one arbitrator, any decision of the arbitral tribunal shall be made, unless otherwise agreed by the parties, by a majority of all its members.

(b) Questions of procedure may be decided by a presiding arbitrator, if so authorized by the parties or all members of the arbitral tribunal.

Cite principle as: www.Trans-Lex.org/970030

Commentary:

1 The voting rules contained in Subsection (a) result from the fact that international arbitral tribunals typically consist of one or three arbitrators. In a three member tribunal the rule helps to avoid a deadlock in the voting of the arbitrators on the legal issues relevant for the decision of the dispute. A deadlock may still happen in scenarios where there are three different views on a legal issue.

2 Because questions of procedure may be decided by the chairman alone if so authorized by his co-arbitrators (which typically happens in an international arbitration) pursuant to Subsection (b), procedural orders, in contrast to arbitral awards, may be signed by the chairman alone.

3 The French Court of Appeal of Paris (*Société Braspetro Oil Services (Brasoil) v. GMRA*, Rev. d'Arb. (1999), 834, 836 et seq.) has made it clear that if the arbitrators have dealt with the merits of the parties' presentations and have put an end to the disputed issue by deciding, in a definitive manner, that part of the dispute in their reasoned decision, they have exercised the jurisdictional powers conferred on them by the arbitration agreement. In that case, they have rendered an award, even if they have called their decision "procedural order".

No. XIII.2.7 - Immunity of arbitrator

An arbitrator enjoys immunity from liability for all acts or omissions performed in the exercise of his judicial decision-making unless he has acted intentionally, or arbitrarily, or has committed a fraudulent act.

Commentary:

This Principles follows from the fact that arbitrators are private judges and enjoy the same liability privilege than state court judges. This liability privilege, however, is limited in two ways. First, it covers only the decision-making of the arbitrator. If the arbitrator causes damages to one of the parties to the arbitration and the act which has caused the damage is outside his decision-making task, he has incurred liability *vis-a-vis* that party under the arbitrator's contract which is concluded between the arbitrator and the parties as soon as the arbitrator is appointed. Secondly, the liability privilege does not apply if the arbitrator has acted intentionally, or arbitrarily, or has committed a fraudulent act. In these cases, he does not deserve protection from liability, even though he has acted within the limits of his decision-making duty.

Section 3: Arbitral Procedure

No. XIII.3.1 - Arbitral due process

- (a) Throughout the proceedings, the parties shall be treated with equality.
- (b) Each party shall be given a full opportunity to present his case at all stages of the proceedings ("audiatur et altera pars").
- (c) The parties shall be given sufficient advance notice of any hearing and of any meeting of the arbitral tribunal for the purpose of taking evidence.
- (d) All written pleadings, documents or other communications supplied to the arbitral tribunal by one party shall be communicated to the other party. Likewise, expert reports and other evidentiary documents on which the arbitral tribunal may rely in making its decision are to be communicated to both parties.
- (e) The parties are entitled to be legally represented.

Cite principle as: www.Trans-Lex.org/969020

Commentary:

1 As a consequence of the genuinely judicial nature of arbitration, Art. 18 UNCITRAL Model Law and all other modern arbitration laws safeguard the parties' basic procedural right of equal treatment and their right to be heard as the essential principles of arbitral due process. These basic procedural rights constitute the 'Magna Carta' of any arbitration. They comprise some of the very few mandatory rules of arbitration laws which prevail over any agreement of the parties.

2 The parties' due process rights are also essential elements of public policy. Therefore, the violation of these rules by the arbitrators may lead to the setting aside of the award or to the refusal of enforcement. These rules therefore constitute the principal guidelines for the arbitrators' exercise of their procedural discretion over the conduct of the proceedings.

No. XIII.3.2 - Determination of rules of procedure

- (a) Subject to the mandatory provisions of the arbitration law in force at the seat of the arbitration, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings, either by reference to a set of arbitration rules or by agreeing on specific rules for the conduct of the proceedings prior to or during the arbitration.
- (b) Failing such agreement, the arbitral tribunal may conduct the arbitration in such manner as it considers appropriate, taking into account the parties' due process rights under . The power conferred upon the arbitral tribunal includes the power to determine the admissibility, relevance, materiality and weight of any evidence.

Cite principle as: www.Trans-Lex.org/969030

Commentary:

1 It is a particular characteristic of modern arbitration laws that they leave ample room for party autonomy and contain only very few mandatory

provisions, such as the parties' fundamental right to be heard and to be treated equally as the basis of arbitral due process and provision dealing with the competence of domestic courts. Thus, the provisions contained in the arbitration rules take precedence over the arbitration law in force at the seat of the arbitration all those cases where the arbitration law is not mandatory. Furthermore, the principle of party autonomy, as the hallmark of the arbitral process, always allows the parties to conclude *ad hoc* agreements on procedural issues during the arbitration. It is only absent party agreements concluded prior to or during the arbitration that the arbitrators may develop their own procedural rules.

2 This means that the hierarchy of rules in international arbitration, which forms the fundamental basis for the regulatory framework of the arbitral process, is:

- 1 Mandatory provisions of the arbitration law at the seat (*lex loci arbitri*);
- 2 Party agreements during the arbitration;
- 3 Arbitration rules (*ad hoc* or institutional) agreed upon by the parties;
- 4 Non-mandatory provisions of the arbitration law; and
- 5 Procedural discretion of the arbitral tribunal.

No. XIII.3.3 - Seat of arbitration

(a) The parties are free to agree on the seat of arbitration. Failing such agreement, the seat of arbitration shall be determined by the arbitral tribunal having regard to the circumstances of the case, including the convenience of the parties.

(b) Notwithstanding the provisions of paragraph a) of this Principle, the arbitral tribunal may, unless otherwise agreed by the parties, meet at any place it considers appropriate for consultation among its members, for hearing witnesses, experts or the parties, or for inspection of goods, other property or documents.

(c) The provisions of an arbitration law apply only if the seat of arbitration is in the territory of the state which has enacted that law, unless otherwise provided by that law (*lex loci arbitri*).

Cite principle as: www.Trans-Lex.org/969040

Commentary:

1 The most important effect of the seat of the arbitration is that it determines the applicability of the arbitration law. The arbitration law of a certain jurisdiction, the *spanlex loci spanarbitri*, applies to an arbitration as soon as the seat of that arbitration has been fixed in that jurisdiction. Fixing the seat in a certain country, therefore, establishes a legal relationship between the arbitration on the one hand, and the arbitration law and the courts of that country on the other ("territorial theory").

2 It follows from its limited function that the seat of an arbitration must not be understood in a naturalistic, empirical fashion. Rather, it is a term of art and provides the 'formal legal domicile' (*formales Legaldomizil*) or 'juridical home' of the arbitration. One may also speak of the 'juridical seat' of the arbitration as opposed to the place where the hearings are actually conducted and evidence is taken.

3 This function of the seat means that there is no de-localized arbitration. Every arbitration is subject to a legal and regulatory regime. This regime is the law at the seat of the arbitration, the *lex loci arbitri*. The parties cannot escape this consequence. The 'juridical seat' of an arbitration functions as a connecting factor in conflict of laws. In arbitral practice, the connection of the arbitration to the arbitration law of its seat is rarely felt because most provisions of modern arbitration laws are non-mandatory and may thus be modified by agreement of the parties, e.g. by reference to a set of institutional arbitration rules.

4 The seat of the arbitration must not be confused with the physical location of the hearing(s). Subsection (b) makes it clear that the hearing(s) must not be conducted at the legal seat of the arbitration. It is not even necessary that the award is signed at the seat of the arbitration. Pursuant to Principle

XIII.4.2 (c) the award is deemed to have been made at the place which is indicated in the award as the seat of the arbitration even if, in reality, the award was physically signed at another place or even in another country or on another continent.

No. XIII.3.4 - Language of the arbitration

(a) The parties are free to agree on the language or languages to be used in the arbitral proceedings. Failing such agreement, the arbitral tribunal shall determine the language or languages to be used in the proceedings, taking into account the parties' due process rights under Principle XIII.3.1.

(b) This agreement or determination, unless otherwise specified therein, shall apply to any written statement by a party, any hearing and any award, decision or other communication by the arbitral tribunal.

(c) The arbitral tribunal may order that any documentary evidence shall be accompanied by a translation into the language or languages agreed upon by the parties or determined by the arbitral tribunal.

Cite principle as: www.Trans-Lex.org/969050

Commentary:

1 The language or languages of the arbitration can be agreed upon by the parties. Party autonomy is particularly important here since the choice of the language affects the parties' position in the proceedings and the expediency and costs of the arbitration. If the parties have reached an agreement on the language to be used in the arbitration, due to the principle of the priority of party autonomy, the tribunal has to accept the determination by the parties. Since the arbitral tribunal has no *lex fori*, the parties are not bound by mandatory provisions in force at the seat of the arbitration which provide that proceedings before domestic courts must be conducted in the language of that country.

2 In view of the extreme significance of the language issue in international commercial arbitration, where the parties usually come from different countries and speak different languages, Art. 17 (1) UNCITRAL Arbitration Rules provides that the arbitral tribunal shall determine the language of the arbitration 'promptly after its appointment'. This rule should generally be followed in international arbitration, even if, as in our case, the proceedings are not conducted under the UNCITRAL Arbitration Rules.

3 The tribunal is not completely free in determining the language. There are both practical and legal issues which the tribunal has to take into account in making its decision.

4 Firstly, the arbitrators have to take practical aspects into account, such as the language of contract documents (which is usually the language in which the arbitration clause was drafted) or correspondence between the parties, the parties' own language capabilities and the costs involved in extensive translations of oral proceedings and written submissions. In this context, Principle IV.4.2 may become relevant.

5 Secondly, the arbitrators have to be aware of the fact that the determination of the language in which the factual background of the case and the relevant legal arguments are to be presented to the tribunal affects the position of the parties in the arbitration and may touch upon their fundamental right to procedural due process (right to be heard and to be treated equally).

No. XIII.3.5 - Early legal guidance by the tribunal

(a) The arbitral tribunal shall identify to the parties, as soon as it considers it to be appropriate, the issues that it may regard as relevant and material to the outcome of the case, including issues where a preliminary determination may be appropriate.

(b) An arbitrator may assist the parties in reaching a settlement of the dispute at any appropriate stage of the proceedings. However, before doing so, the arbitrator shall receive an express agreement by the parties that acting in such a manner shall not disqualify the arbitrator from continuing to serve as arbitrator ("informed consent"). Such express agreement shall be considered to be an effective waiver of any potential conflict of interest that may arise from the arbitrator's participation in such process or from information that the arbitrator may learn in the process. If the assistance by the arbitrator does not lead to final settlement of the case, the parties remain bound by their waiver. Notwithstanding such agreement, the arbitrator shall resign if, as a consequence of his involvement in the settlement process, the arbitrator develops doubts as to his ability to remain impartial or independent in the future course of the arbitration proceedings.

Cite principle as: www.Trans-Lex.org/969060

Commentary:

1 Subsection (a) reflects the international consensus enshrined in Art. 2 (3) IBA Rules on the Taking of Evidence in International Arbitration of May 2010.

2 Subsection (b) reflects the approach contained in the CEDR Rules for the Facilitation of Settlement in International Arbitration of November 2009.

No. XIII.3.6 - Hearings and written proceedings

(a) Subject to any contrary agreement by the parties, the arbitral tribunal shall decide whether to hold oral hearings for the presentation of evidence or for oral argument, or whether the proceedings shall be conducted only on the basis of documents and other materials ("documents-only"). However, unless the parties have agreed that no hearings shall be held, the arbitral tribunal shall hold such hearings at an appropriate stage of the proceedings, if so requested by a party.

(b) The parties shall be given sufficient advance notice of any hearing and any meeting of the arbitral tribunal for the purposes of inspection of goods, other property or documents.

Cite principle as: www.Trans-Lex.org/969070

Commentary:

1 Due to the primacy of party autonomy in international arbitration, an agreement by the parties that oral hearings are to be held is binding on the arbitral tribunal. If the parties have agreed not to hold a hearing, such agreement is binding on the parties and the arbitral tribunal. In exceptional cases, the parties' fundamental due process right to be heard may provide a compelling reason for holding an oral hearing even though the parties have agreed not to hold one. Here, the mandatory due process rules prevail over the parties' autonomy. In any event, parties which have agreed not to hold a hearing are not precluded from later modifying their agreement, and thus to allow a party to request oral hearings.

2 In the vast majority of cases, there is no agreement of the parties on the mode of the proceedings (oral or written). In that case, the arbitral tribunal is free to decide whether to hold a hearing or whether to conduct the arbitration on the basis of documents and other materials (even though the latter

approach is not recommended). If one of the parties requests a hearing, the arbitral tribunal must hold a hearing in order to ensure that that party's due process rights are preserved.

3 The question *whether* a hearing will be conducted must be distinguished from the question *how* such a hearing will be conducted. This issue falls within the procedural discretion of the arbitral tribunal pursuant to Principle XIII.3.2. (b), but the parties must be heard before the arbitral tribunal makes a decision on the structure of the hearing.

No. XIII.3.7 - No suspension in case of bankruptcy of a party

Arbitration proceedings are not suspended if one of the parties goes bankrupt.

Cite principle as: www.Trans-Lex.org/970000

Commentary:

The Principle is based on the fact that the insolvency administrator is bound by the arbitration agreement concluded by the debtor prior to the insolvency and that the arbitration proceedings which are pending at the moment the insolvency occurs under the applicable insolvency law may continue despite the insolvency.

No. XIII.3.8 - Default of a party

Unless otherwise agreed by the parties, if, without showing sufficient cause,

- i)
the claimant fails to communicate his statement of claim, the arbitral tribunal shall terminate the proceedings;

- ii)
the respondent fails to communicate his statement of defence, the arbitral tribunal shall continue the proceedings without treating such failure in itself as an admission of the claimant's allegations;

- iii)
any party fails to appear at a hearing or to produce documentary evidence, the arbitral tribunal may continue the proceedings and make the award on the evidence before it.

Cite principle as: www.Trans-Lex.org/970010

Commentary:

1 Typically, it is the Respondent who does not participate in the arbitration, for example, because he thinks that the arbitral tribunal lacks jurisdiction

for want of a valid arbitration agreement. However, there are three reasons why a respondent in an international commercial arbitration, who thinks that the arbitration is inadmissible for lack of a valid arbitration agreement, should never remain passive.

2 Firstly, an unconditional appearance before the tribunal, *i.e.* an appearance without contesting the tribunal's competence would confer jurisdiction upon the tribunal irrespective of the existence of a valid arbitration agreement pursuant to Principle XIII.1.1 (c).

3 Secondly, Subsection (ii) reflects a general principle of international arbitration law, according to which the arbitral tribunal may continue the proceedings if the respondent fails to communicate its statement of defence. This is one of their basic differences to negotiation and mediation, where each party has the right to walk away at any time, resulting in the termination of the process.

4 Thirdly, silence of the respondent on the nomination of a party-appointed arbitrator could not prevent the constitution of the arbitral tribunal as a basic prerequisite for the commencement of the arbitration. Most arbitration laws and institutional arbitration rules provide that, if a party does not nominate its arbitrator within a certain time limit, the other party may request nomination of the second party appointed arbitrator by the arbitral institution or the court. Silence on this issue would thus mean that the party in question loses its right to appoint 'its' arbitrator, which is one of the fundamental benefits of arbitration over adjudication before domestic courts.

No. XIII.3.9 - Waiver of right to object

A party who knows that any provision of the applicable arbitration law from which the parties may derogate or any requirement under the arbitration agreement has not been complied with and yet proceeds with the arbitration without stating his objection to such non-compliance without undue delay or, if a time-limit is provided therefore, within such period of time, shall be deemed to have waived his right to object.

Commentary:

1 This Principle is a direct consequence of the prohibition of inconsistent behaviour which in turn is derived from the Principle of good faith and fair dealing. A party who has knowledge that any non-mandatory provision of the applicable arbitration law or any requirement under the arbitration agreement has not been complied with must raise an objection without undue delay before it proceeds with the arbitration. Any objection which is raised at a later stage of the proceedings is regarded as inconsistent with its previous behaviour because, given that party's knowledge of the non-compliance, its silence is regarded as a waiver of his right to object. A party proceeds with the arbitration if it appears at a hearing or submits a brief or any other communication to the arbitral tribunal and/or to the other party. A party would not be deemed to have waived its right to object, if, for example, a postal strike or a similar impediment prevents it for an extended period of time from sending communications.

2 Whether an objection is raised without undue delay must be considered taking into account the circumstances of the case, including the nature of the provision which the arbitral tribunal did not comply with. When a time limit is provided for, such time limit must be examined first because such time limit, whether provided for in the applicable arbitration law or in the arbitration agreement, has priority over the general formula of "undue delay".

3 If a party is deemed to have waived its right to object under this Principle, it is precluded from raising such objection later during the course of the arbitral proceedings. It also loses its right to invoke such non-compliance in subsequent setting-aside or enforcement proceedings before domestic courts. However, where an arbitral tribunal has ruled that a party was deemed to have waived his right to object, the court can come to a different

conclusion in its review of the arbitral proceedings.

4 Objections against the violation of mandatory provisions of the applicable arbitration law cannot be waived. Such legal consequence would be too rigid given the significance of the rule which is reflected in its mandatory character.

Section 4: Award; Termination of Proceedings

No. XIII.4.1 - Rules applicable to merits; decision ex aequo et bono

(a) The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Any designation of the law or legal system of a given State shall be construed, unless otherwise expressed, as directly referring to the substantive law of that State and not to its conflict of laws rules.

(b) Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

(c) The arbitral tribunal shall decide ex aequo et bono or as amiable compositeur only if the parties have expressly authorized it to do so.

(d) In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction.

Cite principle as: www.Trans-Lex.org/970020

Commentary:

1 Subsection (a) provides that the arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. This conflict rule reflects the principle of party autonomy as the hallmark of international contract law. Due to the paramount importance of this Principle, the award may be set aside if the tribunal ignores the parties' choice of law. The text refers to 'rules of law' (Rechtsvorschriften, règles du droit) instead of 'law'. This terminology indicates that the parties' choice is not limited to domestic law. They may also choose transnational law ('lex mercatoria', 'general principles of law'). Transnational contract law is 'codified' in these Principles or in the UNIDROIT Principles of International Commercial Contracts. Their Preamble provides that '[t]hey may be applied when the parties have agreed that their contract be governed by general principles of law, the lex mercatoria or the like'.

2 In the absence of an express or implied choice of law by the parties, Subsection (b), like Act. Art. 28 (2) UNCITRAL Model Law, provides that the arbitrators may determine the applicable substantive law by reference to the conflict-of-law rules, which they consider applicable. In contrast to this 'indirect' ('voie indirecte') approach to the determination of the applicable substantive law, the French and Dutch arbitration laws adopt the 'direct' ('voie directe') approach and provide that the tribunal may decide the dispute according to the law which it considers appropriate. This allows the arbitrators to adopt a more flexible approach in the determination of the applicable law, be it because all possible conflict-of-laws systems lead to the application of the same law, or simply because the arbitrators consider a certain legal system as particularly appropriate for a 'fair and reasonable' solution of the dispute before them, without having recourse to conflict-of-laws rules.

3 In international arbitral practice, the difference between the different approaches to be applied in the absence of a choice of law by the parties is rarely felt. Irrespective of whether the conflict rule contained in the *lex arbitri* favours the direct or indirect approach, arbitrators will resort to generally accepted conflict-of-laws rules, the closest connection or 'centre of gravity'-test being the most prominent among them.

No. XIII.4.2 - Form and contents of award

(a) The award shall be made in writing and shall be signed by the arbitrator or arbitrators. In arbitral proceedings with more than one arbitrator, the signatures of the majority of all members of the arbitral tribunal shall suffice, provided that the reason for any omitted signature is stated.

(b) The award shall state the reasons upon which it is based, unless the parties have agreed that no reasons are to be given or the award is an award on agreed terms under .

(c) The award shall state its date and the place of arbitration. The award shall be deemed to have been made at that place.

Cite principle as: www.Trans-Lex.org/970050

Commentary:

1 Most arbitration laws and rules contain a number of provisions pertaining to the form in which the award is to be rendered by the tribunal. Typically, an award must contain:

- the complete names and domiciles of the parties and of their legal representatives;-the name(s) of the arbitrator(s);-a recital of the essential milestones of the proceedings (dates of briefs and hearings), demonstrating that the parties had adequate opportunity to present their case;-the tribunal's holding on the merits including costs;-the reasons for the tribunal's decision;-a determination of the monetary or other relief to be accorded, including damages, interest and costs;-the date of the award;-the place of the arbitration;-the signature(s) of the arbitrator(s).

2 The significance of some of the issues listed in Para 1 goes far beyond that of a mere formality. Thus, the place ('seat') of arbitration indicated in the award determines the nationality of the award. The award's nationality, in turn, is important for determining the competent court for setting aside procedures and also for determining whether the award can be enforced under the system of the New York Convention. The indication of the place of arbitration in the award, therefore, serves the purpose of providing legal certainty at the setting aside and enforcement stage. However, the arbitrators are not required to hold the hearings and deliberations at that place. It is also important to note that the arbitrators are under no obligation to actually 'make' (i.e. sign) the award at that place. The tribunal could conduct an arbitration without ever physically meeting or conducting hearings or deliberating or signing the award at the seat of the arbitration. To avoid any uncertainties in this important area, Subsection (c) provides that the award "shall be deemed to have been made" at the place of arbitration, *i.e.* the seat indicated in the award.

3 Together with the tribunal's holding on the merits of the dispute, the reasons given by the arbitrators for their decision constitute the central part of the arbitral award. It is, therefore, very rare for parties to agree that no reasons are to be given by a tribunal for its decision on the merits. The standards to be applied to the reasons of the award are not as high as those which apply to court decisions.

4 International arbitrators sometimes render 'procedural orders' in which they decide on substantive legal issues which are in dispute between the

parties. In such a case, the term given to the decision by the arbitrators does not prejudice a court's right to look behind the terminology and formalities chosen by the arbitrators and to consider the decision as a genuine arbitral award. A court may have to scrutinize the true nature of the decision in setting aside proceedings, which are only available for genuine arbitral awards. The French Court of Appeal of Paris (*Société Braspetro Oil Services (Brasoil) v. GMRA*, Rev. d'Arb. (1999), 834, 836 et seq.) has made it clear that if the arbitrators have dealt with the merits of the parties' presentations and have put an end to the disputed issue by deciding, in a definitive manner, that part of the dispute in their reasoned decision, they have exercised the jurisdictional powers conferred on them by the arbitration agreement. In that case, they have rendered an award (which must meet the formal requirements mentioned above in Para 1 and which is final) and not a procedural order (which must not meet for formal requirements mentioned above under Para 1, may be signed by the chairman alone and is not final but may be changed by the tribunal), irrespective of how the decision is called and framed by the arbitral tribunal. Thus, in the context of the qualification of the nature of the arbitrators' decision, the domestic courts always retain the last word. Otherwise, a tribunal could shield its decision from attack by the courts in setting aside and enforcement proceedings, simply by disguising it as a procedural order.

No. XIII.4.3 - Settlement

(a) If, during arbitral proceedings, the parties settle the dispute, the arbitral tribunal shall terminate the proceedings and, if requested by the parties and not objected to by the arbitral tribunal, record the settlement in the form of an arbitral award on agreed terms.

(b) An award on agreed terms shall be made in accordance with the provisions of and shall state that it is an award. Such an award has the same status and effect as any other award on the merits of the case.

Cite principle as: www.Trans-Lex.org/970040

Commentary:

1 When parties have negotiated a settlement of their dispute 'in the shadow of the arbitration', i.e. without the help of the arbitrators outside the arbitral proceedings, the tribunal should issue an order for the termination of the arbitral proceedings pursuant to Subsection (a). Usually, the arbitral tribunal will not issue such an order on its own motion but will wait for a request from both parties. If no such order is issued by the tribunal, the mere fact that the parties have reached a settlement on their substantive claims does not terminate the arbitral procedure. To avoid such a 'sleeping arbitration', experienced arbitrators will always ask parties who have reached a settlement and who have not requested an order for the termination of the proceedings to submit such a joint request to the tribunal. A unilateral request to terminate the proceedings by one party, without the other party having had an opportunity to comment, does not constitute a sufficient basis for the arbitral tribunal to terminate the proceedings. Before issuing a termination order, the tribunal must be completely convinced that the parties have actually reached a settlement which definitely and finally resolves all outstanding issues between the parties. Such an order has no *res iudicata* effect. If the settlement is void, a claimant may re-submit its claim to a newly appointed arbitral tribunal.

2 Not infrequently, parties who have negotiated a settlement agreement, either 'in the shadow of the arbitration' or with the assistance of the arbitrators during the arbitral proceedings seek to have their agreement formalized with the help of the arbitrators. Upon a joint request by the parties, the arbitral tribunal in such a case will record the parties' settlement in the form of an 'arbitral award on agreed terms' or 'consent award' pursuant to Subsection (b). This type of decision is regulated in Art. 30 UNCITRAL Model Law. Contrary to an order for the termination of the proceedings, this decision of the tribunal constitutes a genuine arbitral award. Subsection (b) states that 'such an award has the same status and effect as any other

award on the merits of the case'. It is for this reason that Subsection (b) also provides that an award on agreed terms has to be made in accordance with the provisions concerning the form and content of arbitral awards and shall state that it is an award. This latter statement may be of particular relevance at the enforcement stage. The statement makes it clear for foreign enforcement courts that the award on agreed terms is a genuine award and can be enforced under the 1958 New York Convention.

No. XIII.4.4 - Termination of proceedings

(a) The arbitral proceedings are terminated by the final award or by an order of the arbitral tribunal in accordance with paragraph (b) of this Principle.

(b) The arbitral tribunal shall issue an order for the termination of the arbitral proceedings when:

- i)
the claimant withdraws his claim, unless the respondent objects thereto and the arbitral tribunal recognizes a legitimate interest on his part in obtaining a final settlement of the dispute;

- ii)
the parties agree on the termination of the proceedings;

- iii)
the arbitral tribunal finds that the continuation of the proceedings has for any other reason become unnecessary or impossible.

(c) The mandate of the arbitral tribunal terminates with the termination of the arbitral proceedings, subject to provisions of the applicable arbitration law relating to the correction and interpretation or the setting aside of the award or the rendering of additional awards.

Cite principle as: www.Trans-Lex.org/970060

Commentary:

1 A typical scenario for a termination order arises if the parties have negotiated a settlement 'in the shadow of the arbitration', *i.e.* without the help of the arbitrators outside the arbitral proceedings. The tribunal should then issue an order for the termination of the arbitral proceedings pursuant to Subsection (b) ii). This standard practice is also reflected in Principle XIII.4.3 (a).

2 Usually, the arbitral tribunal will not issue such an order on its own motion but will wait for a request from both parties. If no such order is issued by the tribunal, the mere fact that the parties have reached a settlement on their substantive claims does not terminate the arbitral procedure. To avoid such a 'sleeping arbitration', experienced arbitrators will always ask parties who have reached a settlement and who have not requested an order for the termination of the proceedings to submit such a joint request to the tribunal. A unilateral request to terminate the proceedings by one party, without the other party having had an opportunity to comment, does not constitute a sufficient basis for the arbitral tribunal to terminate the proceedings.

3 Before issuing a termination order, the tribunal must be completely convinced that the parties have actually reached a settlement which definitely and finally resolves all outstanding issues between the parties. Such an order has no res iudicata effect. If the settlement is void, a claimant may re-submit its claim to a newly appointed arbitral tribunal.

Section 5: Confidentiality

No. XIII.5.1 - Confidentiality

(a) The parties to arbitration proceedings, whether institutional or ad hoc, are under an obligation to keep confidential all awards and orders produced by the arbitral tribunal in the arbitration, together with all materials in the proceedings created for the purpose of the arbitration, as well as all materials submitted by another party in the framework of the arbitral proceedings not otherwise in the public domain, save and to the extent that disclosure may be required of a party

- i)
by a legal duty vis-à-vis a third party, especially an official authority of a state ("public interest exception"),

- ii)
to protect or pursue a legal right,

- iii)
to enforce or challenge an award in bona fide legal proceedings before a state court or other judicial authority;
or

- iv)
is justified by an express or implied consent of the party who produced the document during the arbitration.

(b) This undertaking also applies to the arbitrators, the tribunal-appointed experts, the secretary of the arbitral tribunal and, in case of institutional arbitration, the arbitral institution.

Cite principle as: www.Trans-Lex.org/970500

Commentary:

1 Given the significance of the confidentiality issue for international commercial arbitration as a whole, it is surprising that most arbitration laws, including the UNCITRAL Model Law, do not contain provisions on the confidentiality of the proceedings. While some arbitration rules do contain confidentiality undertakings, others, such as the ICC Arbitration Rules, do not. It is therefore of utmost significance to determine whether a general principle related to the confidentiality of the proceedings exists in international arbitration law.

2 The English Court of Appeal in *Emmott v. Michael Wilson & Partners Ltd.* not only emphasized the nature of the confidentiality principle as a substantive rule of arbitration law, but at the same time made it clear that there are intrinsic limits to this principle which are 'still in the process of development on a case-by-case basis'. The Court listed as principal cases in which disclosure will be permissible by one party to the arbitration, i.e. in which an exception to the duty of confidentiality applies:

- express or implied consent of the other party; - order, or leave of the court; - disclosure is 'reasonably necessary' for the protection of the legitimate interests of one of the parties; and - the 'interest of justice' or the 'public interest' requires disclosure.

3 The problem with this list of exceptions is that their precise delineation is far from clear. While the case of an express or implied consent of the other party is undisputed, the Court did not make it clear under what circumstances an order, or leave of the court could or should be granted. Also, the precise scope of the 'interest of justice' and 'public interest' exception remains unclear. It goes without saying that a mere 'general' public interest, e.g. one expressed in the media or the political arena, can never justify an exception to the principle of confidentiality. Only where the public interest is manifested in a statutory duty of disclosure vis-à-vis a third party, e.g. a public authority (tax, antitrust, public prosecutor, etc.) does that public interest prevail over the parties' implied contractual duty of confidentiality. This limit to the parties' duty of confidentiality is to be found in some arbitration rules.

Chapter XIV: Private International Law

No. XIV.1 - Law applicable to an international arbitration agreements

(a) The substantive validity of an international arbitration agreement is to be determined according to the law chosen by the parties of said agreement, or failing any indication thereof, according to the law in force at the place (seat) of the arbitration.

(b) The formal validity of an international arbitration agreement is to be determined according to the formal validity rules of the arbitration law of the country in whose territory the arbitration has its seat.

Cite principle as: www.Trans-Lex.org/973000

Commentary:

1 The validity of the arbitration agreement is primarily governed by the law chosen by the parties. Typically, international business contracts do not contain specific choice of law clauses for the arbitration agreement contained in such contracts. The general choice of law clause contained in the contract and specifying the proper law of the contract does not necessarily extend to the arbitration agreement which is a separate contract.

2 Absent a choice of law by the parties, the law of the seat of the arbitration plays a dominant role in determining the law applicable to the arbitration agreement. It governs the following issues, three of which relate to the validity of the arbitration agreement:

1. The substantive validity of the arbitration agreement absent a choice of law;
2. The formal validity of the arbitration agreement if it is to be determined by the tribunal;
3. The objective arbitrability of the subject matter of the dispute;
4. The arbitral procedure.

3 This significance of the law of the seat has an important harmonizing effect on the determination of the law applicable to the validity of the arbitration agreement. It serves to avoid frictions and contradictions that might arise if different laws apply to these issues. Decisional harmony created by the seat is important because the arbitration agreement constitutes the very basis of the tribunal's jurisdiction. This requires hard, fast, workable and generally accepted conflict rules in order to avoid further complications if the jurisdiction of the tribunal is contested by one side. This is also in line with the notion of party autonomy as one of the principal maxims of international commercial arbitration. The seat is typically chosen by the parties or by the tribunal or by the arbitral institution on their behalf. The choice of the seat thus becomes a direct or indirect choice of law by the parties with respect to the issues listed above.

4 If the issue at stake relates to the personal status of a party or to the protection of the other party, the significance of the seat is overridden by other connecting factors which are better able to do justice to these policy considerations. This applies to:

- The parties' capacity to arbitrate ("subjective arbitrability"), which is governed by the law of the country where the party has its residence, domicile or seat and
- The issue of whether a party was duly represented when concluding the arbitration agreement, which is governed by the law of the state where the agent has concluded the arbitration agreement

5 Thus, there are only three different connecting factors, the seat reigning most prominently among them, with respect to the determination of the law governing all aspects of the validity of international arbitration agreements for six different legal issues.

No. XIV.2 - Law applicable to international contracts

(a) A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract. The parties may at any time agree to subject the contract to a

law other than that which previously governed it.

(b) Absent a choice of law by the parties, a contract is governed by the law with which the contract is most closely connected ("centre of gravity test"; "engster Zusammenhang"; "liens les plus étroits").

(c) Contracts are most closely connected with the law of the country where the party required to effect the characteristic performance has its habitual residence, seat or place of business.

(d) Where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that indicated in paragraphs (b) or (c), the law of that other country shall apply.

(e) The law applicable to a contract by virtue of this Principle shall govern in particular:

- i)
interpretation;

- ii)
performance;

- iii)
the consequences of a total or partial breach of obligations, including the assessment of damages in so far as it is governed by rules of law;

- iv)
the various ways of extinguishing obligations, and prescription and limitation of actions;

- v)
the consequences of nullity of the contract.

Commentary:

1 The closest connection test in Subsection (a) goes back to the famous German law professor and Prussian minister for legislation, *Friedrich Carl von Savigny*. In Vol. 8 of his major treatise "*System des heutigen Römischen Rechts*" published in the 19th century, *Savigny* argued that it is the task of conflict of laws to determine the "seat" of a legal relationship, *i.e.* the legal system with which this legal relationship has the closest territorial connection. Today, the closest connection test has a functional instead of a purely territorial meaning. It is reflected, *e.g.*, in Art 4 of the Rome I Regulation of the EU, Sec. 1051 (2) of the German Arbitration Act and Art. 187 (1) of the Swiss arbitration law contained in the Swiss Federal Law on Private International Law.

2 The rule in Subsection (b) is based on the idea that it is not the party who pays but the party who performs in kind - often in a professional context - that provides the characteristic performance within a contractual relationship. It is this performance which determines the type of contract one is dealing with. This relatively easy and straightforward approach provides legal certainty and ensures a uniform approach to the determination of the law applicable to a contractual relationship, no matter before which court or arbitral tribunal the issue is to be decided.

3 This means that, absent an express or implied choice of law by the parties (which always prevails over any objective connection of the contract to a domestic legal system unless the parties' choice of law agreement is invalid), the determination of the law applicable to a contract is based on a typology of contracts: -a contract for the sale of goods is governed by the law of the country where the seller has his habitual residence, seat or principal place of business (unless the contract is governed by the UN Sales Convention or CISG, but note Art. 4 CISG for the limited scope of the Convention, issues outside the Convention's scope must be determined under the applicable domestic law!), -a contract for the provision of services is governed by the law of the country where the service provider has his habitual residence, seat or principal place of business, a contract of carriage is governed by the law of the country of habitual residence, seat or principal place of business of the carrier, -a franchise contract is governed by the law of the country where the franchisee has his habitual residence, seat or principal place of business, -a contract for the performance of a certain work (e.g. construction contract) is governed by the law of the country where the contractor has his habitual residence, seat or principal place of business, -a consultancy contract is governed by the law of the country where the consultant has his habitual residence, seat or place of business, -a distribution contract is governed by the law of the country where the distributor has his habitual residence, seat or principal place of business, -a licencing contract is governed by the law of the country where the licencer has his habitual residence, seat or place of business, -a research and development contract is governed by the law of the country where the researcher/developer has his habitual residence, seat or principal place of business, -a contract in banking and finance (e.g. a loan agreement) is governed by the law of the country where the bank has its seat, -an employment contract is governed by the law of the country in which or, failing that, from which the employee habitually carries out his work in performance of the contract.

4 A **mixed contract** which combines elements of a number of the types of contracts listed above is governed by the law of the country where the party that does not pay has his habitual residence, seat of place of business.

5 Where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that indicated in para. 3 above, the law of that other country shall apply.

6 If the contract is connected to a number of legal systems but is not most closely connected to either of them, the *lex validitatis* Principle may provide a way to connect the contract to one of those legal systems.

No. XIV.3 - Rule of validation/Lex validitatis

If a contract has contacts to more than one jurisdiction and the parties have not agreed on the applicable law, it is in the presumed interest of the parties to apply the law, both as to form and to substance, that validates the contract ("*favor negotii*"; "*lex validitatis*"; "rule of validation").

Cite principle as: www.Trans-Lex.org/972000

Commentary:

- 1** The rule is based on the presumed common intention of the parties that the validity of their contract should be upheld. If the validity of the contract is maintained by one law but denied by another and the contract has a connection to both legal systems, the law should be applied that does not render the contract illegal or void.
- 2** If, however, the parties have chosen a specific law to be applied to their contract, that choice must be respected, irrespective of whether that law invalidates the contract.