

Use of the UNIDROIT Principles to Interpret and Supplement Domestic Law

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Introduction

1. In the present context, where the focus is on the Principles in international commercial arbitration, their role as a means of interpreting and supplementing domestic law shall be understood as covering domestic law only to the extent that it is applied in international commercial arbitration, rather than in all its applications, including by domestic courts in domestic matters.
2. Admittedly, the increasing use of the Principles in international arbitration is likely to have a ripple effect on purely domestic cases in ordinary courts. However, it is assumed that in most countries there is little or no connection between the practice of attorneys and arbitrators mainly active in international arbitration and the practice and experience of domestic courts. The influence of the Principles within national systems of law is more likely to come from commentary and academic teaching, which may lead to the rules they enshrine being incorporated into domestic law.¹

¹ See e.g. H. Wiedemann, 'Anmerkung zum BGH-Urteil von 26. September 1997' [1998] *Juristenzeitung* 1173; J.Ch. Wichard, 'Die Anwendung der UNIDROIT-Prinzipien für internationale Handelsverträge durch Schiedsgerichte und Staatliche Gerichte' (1996) 60 *RebelsZeitschrift* pp. 269, at 299-301, with several examples.

3. Mention should be made of e-commerce, where the UNIDROIT Principles have a potential role. Cases arising from e-commerce are often of limited financial import. However, some U.S. courts have affirmed that commercial arbitration should be open to parties in such cases.² Arbitrators and mediators active in e-commerce dispute settlement organizations need to be informed of the UNIDROIT Principles. There would appear to be no obstacle to applying the UNIDROIT Principles to B2B transactions. As for B2C transactions, although they are not subject to the United Nations Convention on Contracts for the International Sale of Goods (CISG), some of the general notions fundamental to the Principles might still be applicable to them. Of course, it may be that e-arbitrators decide to follow the commentary on the Preamble to the Principles and exclude the application of the Principles to any consumer transaction.

In my view, international e-commerce is so poorly regulated that recourse to a set of globally valid rules such as the Principles should be advocated, with the proviso that if an applicable domestic law better protects the parties to a B2C transaction, such law will prevail.

4. The purpose of this paper is to consider how the Principles can help construe and supplement domestic law within the confines of international commercial arbitration. The question will be dealt with in three parts. We shall first discuss the binding or non binding status of the Principles when they are invoked in a case in which a domestic law has been found to be applicable (**I**). We shall then consider the situation where the Principles diverge from domestic law (**II**). The third and final part will look at the Principles supplementing domestic law (**III**).

² e.g. *Rich Hill & Enza Hill v. Gateway 2000, Inc. & David Prais* (7th Cir. (III) 1997), [1997] Bulletin Swiss Arbitration Association 138. On the arbitrability of consumer cases see E. Gaillard & J. Savage, eds., *Fouchard, Gaillard, Goldman on International Commercial Arbitration* (The Hague: Kluwer, 1999) at 347-348.

I. The binding or non-binding nature of the Principles

A. Opting in and opting out

5. The first question facing an arbitrator who contemplates the application of the Principles to interpret or supplement domestic law in a given case is whether he or she is free not to apply them. The answer is multifaceted.
6. If the parties have agreed upon the application of the Principles prior to their dispute, in the terms of reference or in their pleadings, the arbitrator is bound to apply them. There should be no difficulty in doing so provided that the provisions of the Principles at stake are considered to be compatible with the domestic law that is applicable, if any.³ Nor should there be any difficulty if the provisions in question are contrary only to mandatory domestic law not applicable to international transactions, or what is sometimes called *ordre public interne*, as opposed to the national conception of *ordre public international*. Although it cannot be ruled out, it would be most unexpected for the UNIDROIT Principles to be construed in such a way as to conflict with *ordre public international* as defined under a national system of law or general principles of law.

Therefore, when the parties have agreed upon the application of the Principles, there would appear to be no practical difficulty in applying them.⁴

³ See M. Fontaine, 'Les Principes UNIDROIT, guide de la rédaction des contrats internationaux' in *The UNIDROIT Principles for International Commercial Contracts: A New Lex Mercatoria?*, dossier of the ICC Institute of International Business Law and Practice (Paris: ICC, 1995) [hereinafter *New Lex Mercatoria*], 71 (English summary at 83); M.P. Furmston, 'The UNIDROIT Principles and International Commercial Arbitration' in *New Lex Mercatoria*, 199 (French summary at 209).

⁴ For more details see e.g. A. Giardina, 'L'application des Principes UNIDROIT aux contrats internationaux' in *New Lex Mercatoria*, 143 (English summary at 153).

7. An analogous situation is addressed in the Preamble, which allows for the application of the Principles when the parties have agreed that their contract be governed by “general principles of law”, the “*lex mercatoria*” or the like’.⁵
8. On the other hand, the parties are undoubtedly free explicitly to opt out of the Principles, as they can opt out of the CISG for instance.⁶ The question arises as to whether, if the parties have remained silent in their contract or the terms of reference as to the application of the Principles, and a domestic law has been declared applicable or is clearly to be applied pursuant to customary conflict rules, this should be construed as a common intent to opt out of the Principles. The question is particularly relevant when the parties’ pleadings show that they are not of the same mind as to whether the Principles should apply.⁷ To answer this question, let us first examine the applicable law (a), before considering how properly to understand a contract in which there is no mention of the Principles (b).
9. (a) For the implied opting-out choice to be recognized, it has to be congruent with the national law, which is then applicable to the exclusion of the Principles.

In the reverse direction, when opting in, the so-called direct approach leading to the application of the Principles makes it unnecessary to choose between domestic laws, as the parties have agreed upon the Principles as the

⁵ On the more general use of the terms ‘general principles of law’ (followed by ‘*lex mercatoria*’, then ‘UNIDROIT Principles of International Commercial Contracts’) see K.P. Berger, *The Central Enquiry on the Use of Transnational Law in International Contract Law and Arbitration – Selected Results from the First Worldwide Survey on the Practice of Transnational Commercial Law* [2000] ASA Bulletin 654 at 659.

⁶ They are also free to opt out of only some of the Principles, even where the Principles state that no derogation is allowed (as in arts. 1.5, 1.7, 5.7(2), 7.4.13(2) and most of chapter 3). See Giardina, *supra* note 4; J. Huet, ‘Synthesis’ in *New Lex Mercatoria*, 273.

⁷ e.g. final award in ICC case 9029, (1999) 10:2 ICC ICArb. Bull. 88.

applicable law, maybe also with the CISG.⁸ In some awards, this direct approach is also based on the belief that the Principles represent trade practice, or the fact that the Principles represent a common ground between the two or three laws otherwise connected with the case.

As far as opting out goes, however, it would appear to be a contradiction in terms to follow a direct approach, since the parties wish *prima facie* to escape transnational law. Thus, the question for the arbitral tribunal is whether their consent has been validly expressed and which matters are covered by such agreement. For instance, does opting out also cover pre-contractual commitments or alleged tortious conduct in relation to breach of contract?

There would appear to be only two approaches to settling the question of opting-out agreements:

- (1) Either the Principles are validly excluded under the applicable law as determined through the rules of conflict common to the two or more legal systems connected with the case; or
- (2) the choice of opting-out is validated after a single applicable law has been determined through a national rule of conflict or an international treaty where applicable, *e.g.* the Inter-American Convention on the Law Applicable to International Contracts of 17 March 1994.⁹

Then, the arbitral tribunal may have recourse to the international private law of the seat of the arbitration, if the particular issue is deemed to be a procedural one (as is time-limit under English law) or, more likely, to the *lex*

⁸ See Wichard, *supra* note 1 at 275ff., mentioning that the parties may thus perhaps escape the mandatory provisions of the law otherwise applicable, with the exception of *ordre public international* and *lois d'application directe*.

⁹ See A. Boggiano, 'La Convention interaméricaine sur la loi applicable aux contrats internationaux et les Principes UNIDROIT' (1996) I Unif. L. Rev. 219.

contractus if this has already been determined by the parties or is easily determinable by the arbitral tribunal.¹⁰

10. (b) Under the proviso that the applicable national law may dictate otherwise, it should be noted that the possibility of implicitly opting out of the Principles is of course available to parties¹¹, as it is possible for them to opt out of the CISG. However, implied opting out presupposes that the parties were aware of the Principles in the first place.¹² This is not necessarily the case, however. Experience tends to suggest that many parties who did not invoke the Principles before the onset of litigation are favourable to their application when the question is raised. Further, the notion that ‘no one is supposed to be ignorant of the law’ [*nul n’est censé ignorer la loi*], already contested in our national laws, is rejected in articles 3.4 and 3.5 of the Principles themselves, which allow for avoidance for mistake of law. Moreover, one cannot equate the Principles with the law of which everyone should be aware.¹³ The Principles are neither state law nor international law in the usual meaning of ‘interstate law’.

¹⁰ See H. Raeschke-Kessler, ‘Should an Arbitrator in an International Arbitration Procedure apply the UNIDROIT Principles?’ in *New Lex Mercatoria*, 167, suggesting application of the conflict-of-law rules of the party whose failure to perform gave rise to the arbitration; see also Giardina, *supra* note 4, mentioning also the law of third countries and international law such as art. VIII(2)(b) of the Articles of Agreement of the International Monetary Fund. Only where international rules are binding should it be unnecessary to resort to a system of conflict of law.

¹¹ See final award in ICC case 8873, (1999) 10:2 ICC IC Arb. Bull. 78.

¹² Thus we cannot share the opinion of Mr Raeschke-Kessler, *supra* note 10, that when a party comes from a country whose legal doctrine does not accept the *lex mercatoria* approach, opting out is implied by mere silence.

¹³ This is not to say that some of the Principles are not ‘rules of law’ as within the meaning of the UNCITRAL Model Law on International Commercial Arbitration (art. 28(1)) or domestic legislation (e.g. French New Code of Civil Procedure (art. 1496)). See A. Komarov, ‘Remarks on the Applications of the UNIDROIT Principles of International Commercial Contracts in International Commercial Arbitration’ in *New Lex Mercatoria*, 155 at 158-59. For a contrasting view, stressing the difference between ‘principles’ and ‘rules’, see H. van Houtte, ‘The UNIDROIT Principles of International Commercial Contracts and International Commercial Arbitration: Their Reciprocal Relevance’ in *New Lex Mercatoria*, 181 at 184-85. In our view, regard must be had to the specific provision at issue to know whether it qualifies as a ‘rule of law’; H. van Houtte, *ibid.* at 195, considers art. 7.4.9 of the Principles to be a rule, not a principle.

B. Comparison with binding treaties

11. A brief comparison with binding international and domestic law may be in order here. The Principles are not subject to the Vienna Convention on the Law of Treaties of 23 May 1969. Unlike international treaties, which derogate from state sovereignty and are therefore construed mainly on the basis of their wording, with little regard for extra-textual factors, the Principles may be more broadly construed. In their case, consideration may be given to the Preamble, which states their purposes, and the article-by-article comments, which of course do not exist for international treaties, save as agreed upon in a protocol or the like. Indeed, it is explicitly mentioned in the comments that ‘the concept of “international” contracts’ should be given ‘the broadest possible interpretation’.¹⁴

The construction of an instrument and its status in international law are closely interrelated. International conventions are usually to be strictly construed, as they are binding. For instance, the World Trade Organization Appellate Body in Geneva requires all dispute settlement panels adjudicating conflicts between states in the context of GATT agreements to interpret the provisions of those agreements literally, and not to base their findings on principles of international law. The States members wish in effect to be bound only by the words and phrases of the GATT and ancillary conventions (e.g. Agreement on Trade-Related Aspects of Intellectual Property Rights¹⁵). States allow the Dispute Resolution Body to review their commercial policies only within the limits of their obligations as narrowly construed in accordance with the 1969 Vienna Convention.

¹⁴ Preamble, comment § 1.

¹⁵ WTO’s ‘Understanding on Rules and Procedures Governing the Settlement of Disputes’ may be found at www.wto.org/english/docs_e/legal_e/28-dsu.pdf

12. On the other hand, where states are not parties to a binding treaty, there is evidence of flexibility in the application of even basic concepts that might need more careful interpretation.

For example, under ICANN policy for protecting Internet domain names, private parties have to accept the mandatory administrative proceedings of the World Intellectual Property Organization or any other of the approved dispute resolution service providers.¹⁶ In order for a claim to succeed, it would appear necessary to prove bad faith on the part of the respondent (see arts. 4a(iii) and 4b Uniform Domain Name Dispute Resolution Policy). However, WIPO practice seems to have evolved towards an assumption that any defaulting party is in bad faith, which runs counter to the rule whereby ‘good faith is presumed’ (art. 3 Swiss Civil Code). This presumption was probably also in the minds of the authors of the comment to article 1.7 of the Unidroit Principles, which reads: ‘Standards of business practice may indeed vary considerably from one trade sector to another, and even within a given trade sector they may be more or less stringent depending on the socio-economic environment in which the enterprises operate, their size and technical skill, etc.’

The comparison between stringent practice under the ICANN Policy and the UNIDROIT Principles’ more liberal approach shows that soft law instruments are open to wider interpretation than traditional treaties. This should be to the benefit of the Principles.¹⁷

¹⁶ ICANN’s Uniform Domain Name Dispute Resolution Policy may be found at www.icann.org/udrp/udrp-policy-24oct99.htm and WIPO’s Supplemental Rules for Uniform Domain Name Dispute Resolution Policy at www.arbiter.wipo.int/domains/rules/supplemental.html

¹⁷ To convene a diplomatic conference to try to have the Principles adopted as an international convention might therefore do them a great disservice, assuming it were feasible. See however H. Raeschke-Kessler, *supra* note 10 at 175.

C. Pre-eminence of domestic law

13. What conclusions can we draw from the greater or lesser stringency of rules for interpreting international instruments and the extent to which they are binding, in relation to the application of the Principles as a means of interpreting and supplementing domestic law?

In my view, the tentative conclusion is as follows. Once it has been determined that a domestic law applies (*e.g.* because the parties have opted out of transnational law), the Principles are not binding on the private contracting parties and thus difficult for arbitrators to apply. The autonomy of private parties deserves as much respect as that of contracting states. In respect of private parties, therefore, the Principles are only of persuasive nature. They may function as subsidiary rules when a domestic law is silent on an issue, but they can never lead to the disregard of particular provisions of a domestic law otherwise applicable, unless the parties have clearly intended to depart from such provisions, in those cases where they are free to do so.

14. Difficulties may arise when there is no congruency between the solution under the Principles and that under applicable national law. These will be discussed later. More numerous are the instances in which there is no conflict between the Principles and certain more highly-developed national laws, *e.g.*:

- Place of performance of a monetary obligation is obligee's place of business.¹⁸ Under Swiss law, the solution would be identical¹⁹ but not under French law (*cf.* art. 1247(3) C. civ.).

¹⁸ Grenoble, 23 October 1996, see *Selected case law relating to the UNIDROIT Principles of International Commercial Contracts* at www.unidroit.org/english/principles/caselaw/caselaw-main.htm [hereinafter UNIDROIT Cases] (Case No. 4).

¹⁹ The Grenoble Court of Appeal mentioned that German and French law provide otherwise. In the case in question, French law was superseded by the CISG (art. 57.1).

- Remittal of a cheque does not constitute payment until such time as amount is actually credited.²⁰ Similar solution applies under Swiss law, for instance.²¹
- Amount of damages need not be substantiated with absolute certainty, once the harm has been established with a reasonable degree of certainty. Thus, a court can exercise its discretion in assessing the amount of compensation that should be awarded.²² (*cf.* art. 7.4.3 Principles and art. 42(2) Swiss CO).
- Liquidated damages may be reduced by arbitrator²³ (*cf.* art. 7.4.13 Principles and art. 163(2) CO). Under French law, they may be increased (art. 1152(2) C. civ.).
- Certain obligations such as those relating to confidentiality and dispute resolution may survive the termination of the contract²⁴ (*cf.* art. 7.3.5 Principles and the widely-acknowledged independence of choice of forum, choice of law and arbitration provisions in an agreement).

15. More interesting and challenging are those situations in which the applicable domestic law does not provide a solution similar to that of the Principles. Two kinds of situation may be distinguished:

- (a) the domestic law provides a clear solution, but this is different from the Principles **(II)**;
- (b) the domestic law does not provide a clear solution to the question of law posed **(III)**.

²⁰ Court of Arbitration affiliated to the Economic Chamber and Agrarian Chamber of the Czech Republic, award of 17 December 1996, UNIDROIT Cases No. 8.

²¹ ATF 119 II 232; [1987] RSJ 244; more moderate : ATF 124 III 145.

²² United Nations Compensation Commission, decision of 23 September 1997, UNIDROIT Cases No. 12 (first abstract).

²³ Award in an *ad hoc* arbitration in Helsinki, 1998, UNIDROIT Cases No. 15.

²⁴ Chamber of National and International Arbitration of Milan, award of 1 December 1996, UNIDROIT Cases No. 7.

II. The Principles as they diverge from domestic law

A. Exclusive application of domestic law

16. When a clearly applicable domestic law provides a solution at odds with the Principles, it logically follows from the non-binding character of the Principles that the domestic law will prevail, even in international arbitration. Exceptions to this rule occur only where the Principles have been chosen by the parties themselves to govern their relationship or their dispute. Such opting in is possible, as seen above, but only subject to compliance with *ordre public international* according to domestic tradition, and the *lois de police* of third states.

When the parties have chosen a domestic law, arbitrators are not at liberty to override the parties' common intent, for instance on the ground that the domestic law would be difficult or costly to ascertain.²⁵ It should no longer be necessary to expend disproportionate efforts and/or cost on comparative law research, since recognized institutes are now reputed to be able to conduct such research efficiently and accurately.

17. Of course, where domestic law is unsettled, national courts may abandon an internationally isolated stance in order to join the mainstream of cases dealing with international contracts along the lines of the Principles. In this case, the persuasive examples come from precedents or enactments abroad,

²⁵ See however J. Ch. Wichard, *supra* note 1 at 294, stressing that fast-track procedures cannot wait for the lengthy research necessary in order to ascertain information on foreign laws. Disputes over the exact content of the applicable law may arise when provisional relief or interim measures are requested, but they can usually be decided *prima facie* or on a probability basis, avoiding the need to establish the foreign law solution with absolute certainty. There are seldom other fast-track arbitration proceedings requiring lengthy research into the exact content of a 'remote' foreign law. See further M.J. Bonell, 'The UNIDROIT Principles and Transnational Law (2000) V Unif. L. Rev. 199 at 212, maintaining that the reference to the impossibility of establishing the relevant rule of the applicable law mentioned in the Preamble to the Principles does not necessarily imply a total impossibility. The commentary to the Preamble (§ 5) states that the Principles might be applied 'whenever the research involved [in establishing the relevant rule of the applicable law] would entail disproportionate efforts and/or costs'. We

not directly from the Principles, which should be scrutinized in each case as regards their compatibility with other legal systems.

B. Binding national precedents

18. Is an arbitral tribunal at liberty to depart from the domestic courts' interpretation of a domestic law chosen by the parties or otherwise applicable? Let us take the following arbitration as an example. The case hinged on the true weight of inspection certificates established in conformity with the F.O.B. sales contract at the port of departure. The question that arose was whether these certificates could be set aside in favour of the less favorable certificates established when the cargo arrived at the port of destination?

French domestic law was applicable to the sale, according to the common intent of the parties as expressed in their sales agreement. A precedent by the French Court of Cassation clearly stated that certificates issued prior to loading that are deemed by the parties to be final and decisive cannot be contradicted by other certificates established upon arrival.²⁶ Could an arbitral tribunal disregard the clear French case law from such an authoritative source?

The obvious answer was that the arbitral tribunal had to follow French law as understood by the French Court of Cassation. The answer would be no different if some other, more remote law were at stake (although in the age of the Internet remoteness seems a bygone concept). Nor would it be any

respectfully disagree. As a matter of law, the 'relevant rules' have to be ascertained by the arbitral tribunal, with the help and support of the parties (*cf.* art. 16 Swiss PIL Act of 18 December 1987).

²⁶ Cass., 25 January 1949, [1949] D.M.F. 235. This precedent was not applied in the final award in ICC case 6653, maybe because none of the parties invoked it: (1993) 120 J.D.I. 1040, J.-J. Arnaldez, Y. Derains, D. Hascher, *Collection of ICC Arbitral Awards 1991-1995* (Kluwer/ICC Publishing, 1997), ICC Publication No. 553, 512. The award stresses that both parties had agreed to arrange for a new inspection at the port of arrival.

different if the UNIDROIT Principles were in disagreement with French case law, which does not appear to be the case in this example.

It should be stressed that an award that departs from the domestic law applicable by reason of the common consent of the parties could appear most unfair to the party pleading on the strength of its research into domestic cases. Hence, reference to the UNIDROIT Principles (or any other source of non-binding regulations) must accord with the common will of both parties or the rules and precedents of the domestic law otherwise applicable. If the parties differ as to the applicability of the Principles, their difference should be resolved as early as possible in the proceedings, so as to safeguard the right of the party opposing applicability to conduct additional research into their true import and their compatibility with the domestic law that such party thought to be exclusively applicable.

C. Binding arbitral awards?

19. In this regard, it is worth considering to what extent arbitral awards in which the UNIDROIT Principles are substituted for national law can be invoked in other awards and court decisions. In the first place, this presupposes easier access to awards in which the Principles are applied. Availability may be limited by confidentiality requirements, but these can usually be overcome by leaving out facts, markets, names and figures, etc.
20. Many arbitrators still shy away from the idea that their awards set precedents. The wish to render justice in the best way possible in the individual case at hand to some extent goes against the idea that their decisions should constitute rules for other cases, and most arbitrators consider that setting precedents is not their role. However, there may be cases – *e.g.* where public policy, such as antitrust issues or the fight against corruption, is at stake – in which arbitral tribunals are mindful of the general import of their decisions.

21. In answering this question, a distinction will be made between trend-setting awards and individual decisions. The final award in ICC case 9797,²⁷ for example, with its emphasis on international commercial law rather than the domestic law that might have been applicable to some issues, appears to be such a trend-setting award, as was the International Sapphire award in its time.²⁸ There have been other awards likewise relating to shareholder agreements in which the Principles are mentioned,²⁹ whereas in other cases dealing with a similar subject matter classical methods of defining the applicable law are used.³⁰ Without the publication of trend-setting awards, the UNIDROIT Principles cannot be expected to bring about rapid changes in domestic law in domestic matters. Even if they are of interest from a comparative law standpoint, awards available in databases relating to the UNIDROIT Principles do not always set an international trend: they may simply restate a well-known rule of national law while giving it also the added value of being in line with the Principles.

For instance, there is an interesting award of the Zurich Chamber of Commerce³¹ in which it was found that the contract should be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances (see art. 4.1.2 Principles).

²⁷ (2001) 12:2 ICC ICArb. Bull. 88.

²⁸ *Sapphire International Petroleum Ltd. v. National Iranian Oil Company*, (1967) 35 *International Law Reports* 136 esp. at 173, where, in the words of Pierre Cavin, ‘it is therefore perfectly legitimate to find in such a clause evidence of the intention of the parties not to apply the strict rules of a particular system but rather to rely upon the rules of law based upon reason, which are common to civilized nations’ (our emphasis).

²⁹ e.g. award of 10 December 1997 in ad hoc arbitration, Buenos Aires, UNIDROIT Cases No. 14; award in ad hoc arbitration of 1998, Helsinki, UNIDROIT Cases No. 15; final award in ICC case 10335, (2001) 12:2 ICC ICArb. Bull. 102.

³⁰ e.g. Swiss Federal Tribunal, ATF 124 III 83.

³¹ Preliminary award of 25 November 1994, Zurich Chamber of Commerce, UNIDROIT Cases No. 16.

This rule was applied *in casu* to protect the addressee of a statement.³² However, it has a broader meaning: in other circumstances, it could be applied to protect the party making the statement, as evidenced by the legislative history of the (now defunct) article 2B of the Uniform Commercial Code (UCC).

When the U.S. Conference of Commissioners for Uniform State Laws examined the draft article 2B UCC for e-commerce, they were confronted with a draft section on choice of law in international e-transactions that protected mainly the party making a statement, rather than the addressee of that statement. The drafting of this provision might have benefited from closer consideration of the UNIDROIT Principles. The entire article 2B endeavour was unsuccessful, but the corresponding Uniform Computer Information Transactions Act is pending before several U.S. state legislatures.

22. There will probably be too many contradictions between awards for them to be cited as precedents, especially in the absence of firm rules on the comparative authority of the various arbitration institutions and arbitral awards. Let us take the example of the rate of interest to be paid for a sum in arrears.³³ A few awards appear to take the line that article 7.4.9(2) of the Principles can be construed as allowing 1% or 2% to be added to the Interbank offered rate (*e.g.* in London), even if the Principles do not provide for this when mentioning ‘the average bank short-term lending rate to prime borrowers’.³⁴ In certain other awards this phrase is considered as a reference to the actual Interbank offered rate.³⁵ Some arbitrators set out to find the

³² This award could be of interest to Swiss scholars and arbitrators, but is unlikely to be referred to by Swiss courts when applying their domestic law.

³³ For other examples – on hardship – see H. van Houtte, *supra* note 13 at 187ff.

³⁴ *e.g.* final award in ICC case 8128, UNIDROIT Cases No. 9.

³⁵ *e.g.* award of 17 November 1994 in an *ad hoc* arbitration, (1996) Y. B. Comm. Arb. 13, esp. p. 37.

legal rate of interest;³⁶ others apply the contractual rate;³⁷ and at least one award has been published in which it was bluntly stated that one party requested 10% and the other offered 8%, so the rate would be 9% – an example true Salomonic justice!³⁸ Y. Derains³⁹, P. Karrer⁴⁰, H. Schönle⁴¹ and many others have explored the tortuous arbitral case law on this matter.⁴²

23. In referring to these cases, we wish firstly to show that arbitral awards appear generally not to set precedents, as noted above. However, it might be encouraging in some cases for the arbitrators to consider how other arbitrators have interpreted UNIDROIT Principles, and counsel should therefore research previous awards in which the Principles have been applied – although no one could be accused of professional negligence for not doing so!
24. Secondly, the interest question shows that when domestic law has already laid down a solution, an award that sidesteps such solution in favour of a principle of international law would be unjustified. This point of view will be explained below.

³⁶ e.g. final award in ICC case 8817, (2000) Y.B. Comm. Arb. 355 at 367.

³⁷ e.g. Chamber of National and International Arbitration of Milan, award of 1 December 1996, UNIDROIT Cases No. 7.

³⁸ Award of 23 July 1981 in an *ad hoc* arbitration, (1983) VIII Y.B. Comm. Arb. 89.

³⁹ Y. Derains, 'Intérêts moratoires, dommages-intérêts compensatoires et dommages punitifs devant l'arbitre international' in *Etudes offertes à Pierre Bellet* (Paris: Litec, 1991), 101 at 120.

⁴⁰ P. Karrer, 'Transnational Law of Interest in International Arbitration', in E. Gaillard, ed., *Transnational Rules in International Commercial Arbitration*, ICC Pub., Paris, 1993, at 223.

⁴¹ H. Schönle, 'Intérêts moratoires, intérêts compensatoires et dommages-intérêts de retard en arbitrage international' in *Etudes de droit international en l'honneur de Pierre Lalive* (Basel: Helbing & Lichtenhahn, 1993), 649.

⁴² K. Berger, 'Der Zinsanspruch im Internationalen Wirtschaftsrecht' (1997) 61 *RechtsZeitschrift* 313 at 333ff; idem, *International Economic Arbitration* (1993) at 625ff; D. J. Branson & R. E. Wallace, 'Awarding Interest in International Commercial Arbitration: Establishing a Uniform Approach' (1998) 28 *Va. J. Int'l L.* 919 at 923; J.O. Honnold, *Uniform Law for International Sales Under the United Nations Convention*, 2d ed. (Kluwer, 1991) at 424.

D. Concurrent application of domestic law and the UNIDROIT Principles?

25. Interest on sums in arrears is probably one of the first questions to have been settled in most domestic legislations. For example, article 1153 of the French Civil Code (now, together with law no. 75-619) expressly limits interest to the legal rate (fixed at 4.26 % for the year 2002). Exceptions such as commercial practices and security are mentioned in the law.

Article 104(3) of the Swiss Code of Obligations directly sets the legal rate of interest for sums in arrears at 5%, but with the escape clause that a higher ‘discount rate’ might apply in business transactions. As discounting of bills of exchange is no longer common in modern Swiss practice, the Swiss Federal Tribunal has interpreted that provision in accordance with contemporary practices.⁴³ Hence, the legal rate in Switzerland appears to protect the creditor better than does the legal rate in France. However, it does not fully compensate the creditor, as the legal rate is always lower than the bank rate charged to most clients. In both systems, the merchant who is not a ‘prime borrower’ might experience a higher loss if required to refinance business via the bank rather than using the amount due and not paid by the other party. Both the Swiss and French codes have therefore provided the possibility for the creditor to receive further compensation subject to different preconditions in each case (bad faith under French law (art. 1153(4) C. civ.), negligence under Swiss law (art. 106 CO)). The Principles, on the other hand, do not make the award of additional damages conditional upon such requirements (art. 7.4.9(3)). This is in line with the right to full compensation under art. 7.4.2, to which there is but one exception, namely that the non-performance be excused under the Principles (art. 7.4.1).

⁴³ ATF 122 III 53; ATF 116 II 140.

26. In my view, the delicate balance struck between the conflicting interests of the debtor and the creditor under domestic law should not be upset by arbitrators without the consent of both parties to apply the UNIDROIT Principles. The international character of a transaction does not affect the rationale of domestic legislatures when determining the legal rate of interest.
27. A possible exception to the exclusive application of domestic law is when the CISG is applicable, as article 7.2 of the CISG refers arbitrators to general principles, of which the UNIDROIT Principles seem to be the best expression but not the only one⁴⁴. Domestic legislation might also refer to general principles.⁴⁵ If it refers to trade practices, then the UNIDROIT Principles are not eligible. Once again, it is only through the application of a binding instrument such as the CISG that the Principles might be considered applicable as a derogation from the national law that would be applicable by consent of the parties or through application of rules of conflict.
28. Of greater interest than the inoperativeness of the Principles, due to their conflict with domestic law, is the extent to which they may help to interpret and supplement national provisions.

⁴⁴ See partial and final awards in ICC case 9875, 12:2 ICC ICArb. Bull. 95 at 97 (Principles as source among others of the Lex Mercatoria); Final Award in ICC case 10114, 12:2 ICC ICArb. Bull. 100 at 102 (Principles as codifying "international practices").

⁴⁵ e.g. Dutch Civil Code, art. 3.12 of which provides that in an international context the court shall take into account the 'legal convictions valid in international contract law'; see final award in ICC case 8486, (1999) 10:2 ICC ICArb. Bull. 69 at 70, UNIDROIT Cases No. 19.

III. The Principles as they supplement domestic law

A. The need to supplement domestic law

29. As has been noted by Professor Bonell,⁴⁶ ‘even highly sophisticated legal systems do not always provide clear and/or satisfactory solutions to the special needs of current international commercial transactions’.
30. We have already observed that there is no need to depart from clear legal solutions in the applicable domestic law when the arbitration is not in equity or *ex aequo et bono* and when neither party has provided for application of the Principles or transnational law in general. Further, it is for legislators rather than arbitrators to decide whether a clear solution is ‘satisfactory’. If arbitrators happen to believe that the application of a clear legal solution would be unfair in the case at hand, they should reason their decision in such a way as to circumvent the inequitable consequences of such legal solution. No arbitrator should ever be blind to the requirements of justice, equity and good conscience.
31. However, the Principles come into play in a different setting – when the domestic law is silent over a particular question. A cursory examination of arbitral awards citing the UNIDROIT Principles shows that the following rules have been applied by the arbitrators in cases where they were not clearly stated in domestic law:
- Duty of good faith in pre-contractual negotiations⁴⁷ (*cf.* Principles art. 2.15). Of course, *culpa in contrahendo* is known in civil law systems, but – in Switzerland, at least – is not stated in an explicit provision.

⁴⁶ M.J. Bonell, ‘The Unidroit Principles and Transnational Law’ (2000) V Unif. L. Rev. 214. A. Hartkamp, ‘The Use of the UNIDROIT Principles of International Commercial Contracts by National and Supranational Courts’ in *New Lex Mercatoria*, 253 at 258-259 gives eleven examples of provisions in the Principles that are lacking in some domestic laws.

⁴⁷ See Final Award in ICC case 9651, 12:2 ICC ICArb. Bull. 76 at 79 (good faith as a means to interpret the provisions of a contract), 81 (good faith in negotiations under Art. 2.15 (2) of the Principles).

- Significance of the parties' behaviour after entering into the contract with respect to the interpretation of their common intent (*cf.* art. 4.3(c) Principles). The question is disputed not only in New Zealand⁴⁸ but also in France⁴⁹. In Switzerland the same solution applies on the basis of case law⁵⁰. This provision might be sufficient for an arbitrator to find that the Principles are applicable, when no party has objected to their application where it was conceivable that an arbitral tribunal might resort to them.
- The Principles mention hardship and *force majeure* (Act of God) (*cf.* arts. 6.2.2, 6.2.3 and 7.1.7), whereas they are not mentioned in Swiss codes, although both are recognized under *clausula rebus sic stantibus* and article 119 of the Code of Obligations. An award expressed the view that the Principles' provisions on hardship do not yet reflect current practice in international trade,⁵¹ hence only an explicit reference by the parties could make such provisions applicable. The case law established by the famous French case, *Canal de Craponne*,⁵² in the 19th century and confirmed for instance in 1921,⁵³ still prohibits any change to remuneration, as do the Principles, art. 6.2.3(4)(b) (with a few exceptions such as lease of real estate).
- Distinction between a fundamental breach of contract and any other breach⁵⁴ (*cf.* art. 7.3.1(1) Principles). In Switzerland, this distinction is not stated in the provisions on non-performance contained in article 97 *et seq.* of the

⁴⁸ See award in *ad hoc* arbitration in Auckland, New Zealand, 1995, UNIDROIT Cases No. 17.

⁴⁹ For an affirmative decision see Cass. civ., 13 December 1988, Bull. civ. 1998. I.239.No.352; see also F. Terré, *Les Obligations* (Paris, 1999) at. 414.

⁵⁰ ATF 121 II 350.

⁵¹ Final award in ICC case 8873, (1998) 125 J.D.I. 1017 at 1019, (1999) 10:2 ICC ICArb. Bull. 78.

⁵² Civ., 6 March 1876, D.P. 1876.1.193 (Annot. Giboulot), *Les grands arrêts de la jurisprudence civile*, t. 2 (Paris, 2000), No. 163.

⁵³ Cass. civ., 6 June 1921, D.P. 1921.1.73; see also Cass com., 18 January 1950, D.1950.227.

⁵⁴ See Chamber of National and International Arbitration of Milan, award of 1 December 1996, UNIDROIT Cases No. 7.

Code of Obligations, which leads to considerable uncertainty when a lasting relationship is revoked without notice of termination or reference to a just cause for such termination, but simply stating the breach of an obligation and failure to perform within the grace period allowed by article 107 of the Code of Obligations.

- Loss of a chance (*cf.* art. 7.4.3(2) Principles⁵⁵). Although an acknowledged ingredient in civil liability principles, *e.g.* in France and Switzerland, this notion is not regulated in the civil codes of these countries. In contractual matters it is nonetheless one of the heads of damage most frequently invoked by claimants when seeking compensation. The Principles usefully provide for compensation to be fixed ‘in proportion to the probability of its occurrence’, which is as detailed a rule as can be expected, and sufficiently detailed to guide arbitral tribunals trying to compensate for the loss of this most volatile of business assets.
- Non-pecuniary harm is mentioned in article 7.4.2(2) of the Principles. It is important not to limit this provision to the ‘physical suffering or emotional distress’ given as examples, but also to include disturbances to business climate caused by many disputes. Contrary to the above-mentioned Milan award, Swiss law provides for redress to the benefit of legal entities in this regard.⁵⁶

32. Is it not striking that we should observe such a dearth of legislative provisions for issues that regularly come up in the domestic courts? The intellectual appeal of the UNIDROIT Principles stems from the will squarely to confront these issues and to give as detailed a solution as possible. A further reason for enthusiasm is of course the wish to harmonize solutions on a worldwide scale. This explains why one of the Principles’ purposes is to assist in the interpretation of existing international instruments. They have

⁵⁵ *Ibid.*

been given no similar role with regard to domestic law. Does this necessarily mean that they do not or may not in fact fulfil such a role?

B. The Principles as a means of interpreting domestic law

33. A consistent feature of most of the arbitral awards examined is that the arbitrators go to great lengths to show that the applicable domestic law and the Principles provide for identical solutions.⁵⁷

Only a minority of the decisions studied (approximately 10 out of 40) mention that the Principles embody a solution divergent from the (sometimes unclear) domestic law,⁵⁸ which in certain cases was declared not to be applicable.⁵⁹ There were also cases in which the application of the UNIDROIT Principles was rejected.⁶⁰

34. The general emphasis placed on conformity between the Principles and domestic law is proof enough that, in the absence of an agreement between the parties in this regard, arbitrators as well as judges (with the possible

⁵⁶ ATF 95 II 481.

⁵⁷ According to K.P. Berger, *supra* note 5 at 661-62, 'the number of addressees who had indicated that transnational law had been used "in connection with domestic law", *i.e.* above all with respect to the supplementation and interpretation of domestic law tended to be higher than the number of addressees who indicated that transnational law served to actually replace domestic law as the *lex causae*'. 54% of those addressees who had indicated that they were aware of the use of transnational law used it to 'supplement domestic law' whilst 33% used it to 'interpret domestic law' (for the category 'arbitration').

⁵⁸ Partial award of 4 September 1996 in ICC case 8540, UNIDROIT Cases No. 6; award of 17 December 1996, Court of Arbitration affiliated to the Economic Chamber and Agrarian Chamber of the Czech Republic, UNIDROIT Cases No. 8; award in an *ad hoc* arbitration in Helsinki, 1998, UNIDROIT Cases No. 15; preliminary award of 25 November 1994, Zurich Chamber of Commerce, UNIDROIT Cases No. 16; award in *ad hoc* arbitration in Auckland, New Zealand, 1995, UNIDROIT Cases No. 17; final award in ICC case 8240, (1999) 10:2 ICC IC Arb. Bull. 60, UNIDROIT Cases No. 18; final award in ICC case 8486, (1999) 10:2 ICC IC Arb. Bull. 69, UNIDROIT Cases No. 19; award 4 December 1996 in *ad hoc* arbitration in Rome, UNIDROIT Cases No. 21; award of 21 April 1997 in *ad hoc* arbitration in Paris, UNIDROIT Cases No. 25; see also Court of Appeal of Grenoble, 24 January 1996, [1997] Rev. arb. 87 (Annot. Y. Derains, who notes that French law would give a similar result to arts. 2.21 and 4.6 of the Principles).

⁵⁹ *e.g.* Court of Appeal of Grenoble, 23 October 1996, UNIDROIT Cases No. 4.

exception of the Court of Appeal of Grenoble) might be reluctant to push aside domestic law in order to apply the Principles as *lex mercatoria*. Therefore, the best way of availing oneself of the benefits of the UNIDROIT restatement while avoiding controversies that might cause the award to be subject to lengthy judicial scrutiny on appeal or even denied enforcement later on is to apply both the Principles and domestic law. This has been done, for example, when determining gross mistake⁶¹ and best efforts.⁶²

Use of the Principles as a means of properly interpreting domestic law presupposes that domestic law is ambiguous and therefore calls for interpretation. It should not prove too difficult to find ambiguities in the law in countries where there are many active scholars. Elsewhere, where the small number of controversies is matched by a relative lack of statutes and published precedents, the Principles will rather be called upon to supplement domestic law.

35. The most innovative approach might well be for European arbitrators to cite both the UNIDROIT Principles and the Principles of European Contract Law (PECL). This practice can already be found in some ICC awards.⁶³ More detailed study of the similarities between the two private restatements are obviously needed. The difficulty will be for arbitrators to sort out the dissimilarities and to opt for one rule or the other in the event of conflict – which underlines the necessity for UNIDROIT and PECL working parties to cooperate closely or have regard to each other's solutions. The decision to

⁶⁰ e.g. final award in ICC case 8873, (1999) 10:2 ICC ICArb. Bull. 78, UNIDROIT Cases No. 23; final award 5 May 1997 in ICC case 7365 (concerning art. 7.4.9 Principles), UNIDROIT Cases No. 26; judgment of 5 March 1997 delivered by court in Zwolle, Netherlands, UNIDROIT Cases No. 24.

⁶¹ Final award in ICC case 583, (1999) 10:2 ICC ICArb. Bull. 33 at 36-37.

⁶² Final award in ICC case 8331, (1999) 10:2 ICC ICArb. Bull. 65 at 67.

⁶³ e.g. final award in case 8817, (2000) Y.B. Comm. Arb. 355 at 367 (at § 51 reference is made to ‘one of the principles of European commercial law’); final award in case 8128, (1996) 123 J.D.I. 1024 at 1027 (French translation of German award); interim award in case 9474, (2001) 12:2 ICC ICArb. Bull. 60.

have five members common to both preparatory committees is one step towards achieving this.⁶⁴

36. In the long term, it is academic teaching that will create future generations of lawyers and judges who turn to the UNIDROIT Principles whenever they are in doubt about the solutions under their respective domestic laws.

In our courses on the Swiss law of obligations, for instance, the CISG, the UNIDROIT Principles and the PECL are all compulsory reading and the subject of comparative study. If more law schools provide an introduction to the Principles in their courses on domestic law, domestic contract law is likely to be truly rejuvenated. The worst development that could occur for the Principles is for them to appear as the preserve of arbitrators and counsel in international arbitration. Practitioners in general need to learn more about them, since the impact of arbitral awards on the evolution of domestic law remains rather limited.⁶⁵

Conclusion

37. As arbitral tribunals increasingly apply the Principles, this should also lead to welcome feedback to their authors. They may not remain indifferent to awards that reject the Principles as too divergent from current practice in

⁶⁴ See R. Michaels, 'Privatautonomie und Privatkodifikation', (1998) 60 *RabelsZeitschrift* 582. It may be worthwhile for an arbitrator to consider whether the UNIDROIT Principles embody the same solution on a given issue as the Principles of European Contract Law, as this would consolidate the status of the *lex mercatoria*. See H. Raeschke-Kessler, *supra* note 10 at 174. As the author points out, reference might also be made to the CISG where the case concerns the sale of goods. However, the following reservations are worth mentioning:

(a) If the CISG is declared not to be applicable by the parties in their agreement, then examination of its solutions is not permissible; such a provision may or may not imply a rejection of the UNIDROIT Principles themselves, depending among others whether the subject matter of the contract is outside the scope of the CISG.

(b) When the application of the CISG is ruled out by its own provisions, it should not be applied by way of comparison. Such would be the case for a licensing agreement, for instance.

⁶⁵ See K.P. Berger, *supra* note 5 at 668: 'Law school courses, continuing legal education, law review articles and moot courts are possible ways to solve the problem.'

international trade.⁶⁶ Further, the publication of annotated editions of the Principles with citations of relevant cases would facilitate both the Secretariat's preparatory work for a possible revision and the correct understanding of the practical significance of the Principles. It might also prevent conflicting awards, when the difference is really of minor importance and not the outcome of contrasting philosophies.⁶⁷

Finally, we believe that the respect commanded by the Principles through their intrinsic value will bring them into widespread use throughout the world.

⁶⁶ e.g. final award in ICC case 8873, (1999) 10:2 ICC ICArb. Bull. 78 at 80, UNIDROIT Cases No. 23; final award in ICC case 7365 (re art. 7.4.9), UNIDROIT Cases No. 26; final award in ICC case 9029, (1999) 10:2 ICC ICArb. Bull. 88.

⁶⁷ As an example, the award of 15 June 1994 of the International Court of Arbitration of the Austrian Chamber of Commerce, UNIDROIT Cases No. 1, which applied art. 7.4.9(2) Principles, with an ICC award cited by K.P. Berger, "[International](#) Practice and the UNIDROIT Principles of International Commercial Contracts", (1998), 46 *The American Journal of Comparative Law*, p. 142, in which application of art. 7.4.9(2) was rejected as there was no prime rate for US\$ credits in Sweden.