

Basic Instruments on International Contract Law

A Comparative Analysis of CISG, UNIDROIT and PECL

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The international trade has a long rooted history that runs several millennia back. Trading across political boundaries emphasized the necessity to reduce diversity among the legal systems governing commerce. As a result during 11th century a set of commercial law principles has emerged, namely Lex mercatoria which unified the rules of commerce for large portions of the world.

In recent decades the Globalization and the phenomenal increase in the use of information and communication technology have accelerated the trade between and among nations making the international commercial transactions complex, complicated and omnipresent. With this development, increased the significance of law for the purpose of governing and regulating such transactions, but one will not possibly be able to gather all applicable law out of a single legislation that is in force in a particular state. The lawyers and judges need to search and contrast the different laws that might apply to a particular situation and to opt the most appropriate law to the transaction in dispute.

The complexity and scepticism attached to and the strenuous effort required by this process necessitated the importance of having a neutral and uniform set of laws that will have a universal applicability. Consequently several international instruments on contract law were created, most important being the United Nations Convention on Contracts for the International Sale of Goods (hereinafter CISG), the UNIDROIT Principles of International Commercial Contracts (hereinafter UNIDROIT principles) and the European Principles of Contract Law (hereinafter PECL).

The objective of this essay is to analyze comparatively, the relative importance of the aforesaid international instruments on the contract law. The essay will first introduce the three main instruments- CISG, UNIDROIT and PECL. Secondly it will discuss the applicability of these instruments and will finally compare and contrast their similarities and differences while discussing whether the concept of good faith becomes binding by virtue of application of these instruments.

According to the traditional approach the national law is the applicable law to international contracts. The Permanent Court of International Justice in the *Serbian and Brazilian Loans Case* held that "any contract which is not a contract between states in their capacity as subjects of international law is based on the municipal law of some country".

However this supremacy of national law is inappropriate to international contracts because these contracts are of transnational nature and not connected to a single state. Further with the growth of online transactions the determination of the exact physical location of a particular transaction becomes more difficult. Moreover the national law is aimed at regulating the domestic transactions and therefore is unsuitable to govern international transactions.

With the introduction of the aforesaid instruments significant changes have taken place in the international contract law arena. First of all it is important to discuss the applicability of these instruments. The UNIDROIT Principles are applicable to international commercial contracts and are aimed at harmonizing the law on such contracts. Further the UNIDROIT principles may be used to interpret other international conventions. The applicability of CISG is confined to the International Sale of goods contracts and is objected to provide a modern, uniform and fair regime for the international sale of goods. PECL on the other hand is intended to illuminate basic rules of contract law and the law of obligations which are held in common by most of the states in the European Union and is applicable to all contracts within the European Union may it be cross-border or domestic, commercial or consumer.



All these 3 instruments share common features. One of the most important features of them is the party autonomy which allows the parties in international contracts to select the governing law of the contract. Principle of party autonomy is entrenched in Article 1.1 of UNIDROIT principles, in Article 6 of CISG and in Article 1:102 of PECL. However in all these instruments the principle of party autonomy subjects to certain exceptions which will be discussed in the due course of this essay.

The second important concept that is commonly adopted by all these instruments is the concept of *pacta sunt servanda* which says that the terms of the contract between the parties must be respected and observed. This concept has always been attached a significant importance. In *Liamco v. Libya* it was held that "The principle of the sanctity of contracts... has always constituted an integral part of most legal systems. *pacta sunt servanda* is expressly recognized by Article 1.3 of the UNIDROIT principles. CISG and PECL on the other hand do not expressly recognize this principle. Nevertheless a deep analysis into these two instruments reveals that this principle is embodied in both of these instruments.

The CISG recognizes the good faith principle (which will be discussed in detail in the latter part of this essay), therefore it can be said that it requires the parties to perform the contract bona fide without negligent, malicious and fraudulent contravenes. Further CISG enables a party to claim damages for the failure to perform the contractual undertakings by the other party. Moreover it adopts specific performance as a primary remedy. Article 30 and 53 of CISG recognize the duty of the seller to deliver and the duty of the buyer to effect payment while Articles 71-73 and 79 show that the binding effect of the contract cannot be avoided due to a simple change of circumstances or frustration of contract, unless the requirements listed in these provisions are present. It is apparent from these provisions that under CISG the parties shall perform what they have undertaken where there are no unusual handicaps.

PECL also recognizes the specific performance as a remedy. Also it contains rules governing performance which regulate the place, time, order of performance, and the method of payment. As per Article 9: 501 a party who suffered a loss due to the non performance by the other party can claim damages for such loss where it is not excused. These principles imply *pacta sunt servanda* though it is not expressly recognized in PECL.

The Instruments provide that the impediments beyond party's control and the principle of hardship are the only available exceptions to this rule. *Under first exception which is founded upon the principles of force majeure, frustration and wegfall der Geschäftsgrundlage*, there must be an impossibility to perform, over which the particular party has no control and it has the effect of suspending the duty of performance. Impediment to perform is recognized by Article 7.1.7 of the UNIDROIT Principles, Article 8:108 of PECL and Article 79 of CISG. The pre-requisites for the exemption: Impediment beyond Control, Unforeseeability, Unavoidability, Notice and causation are almost similar in all these instruments.

The principle of Hardship says that if the performance of a contract was possible, but an adverse change in the circumstances surrounding the contract made the continued performance of the contract by the affected party burdensome, thus amounts to an undue hardship, such party can invoke the principle of *clausula rebus sic stantibus*. This concept is expressly recognized by the UNIDROIT and PECL principles. CISG on the other hand does not expressly mention hardship, despite it has to be gathered from Article 79 of CISG. Article 79 is a vague provision therefore in interpretation a broad approach has to be adopted. Most of the scholars support such a wide interpretation and are of the view that the change of circumstances shall be treated as an impediment within the meaning of Article 79. Thus a conclusion can be drawn that the concept of Hardship is recognized under CISG.

As mentioned earlier all three instruments recognize and provide for the specific performance as a primary remedy for non performance and it is another significant similarity among these instruments.

All the instruments provide for the adequate assurance of performance according to which one party can, if it appears to him that there will be a fundamental breach of the contract by the other party, though not expressed directly, demand an adequate assurance of performance and withhold the performance on his side. This is embodied in the Article 7.3.4 of UNIDROIT principles, 8:105 of PECL and 72 of CISG.

Other most important concept that is held in common by all these instruments is the principle of good faith. This principle can be regarded as one of the founding principles of *lex mercatoria*. PECL does not define good faith but the addition of the words 'fair dealing' implies the ability to adopt an objective test. Article 1:201 of PECL imposes a duty on the parties to act in good faith and to engage in fair dealing. Further PECL contains principles that require to negotiate in good faith, not to disclose confidential information and that aimed at preventing fraud and taking of unfair advantages. These Articles strengthen the concept of good faith and fair dealing embodied in Article 1:201. The UNIDROIT principles recognize good faith and fair dealing by Article 1.7 that contains the words 'in international trade' which implies that the expected standard by the Article is what prevails in International law. Article 7 of CISG recognizes the concept of good faith. However it only requires the interpretation of the provisions of CISG in good faith and does not impose a duty of good faith on the contracting parties under the sales contract. However many cases that have considered the principle of good faith in CISG recognized it as imposing such an obligation on the contracting parties. In a German case (Machinery Case) the court held that the concept of Good Faith imposes a substantive obligation on the party to disclose all the necessary information to the other party. In *NV AR v NVI* the court held that the doctrine of Good Faith was substantive and preclude parties from capricious behaviour advancing self-interest to the detriment of the other party. In *Condensate crude oil mix case* the court after taking good faith principle in CISG into consideration held that the standards of the various legal systems do not apply; instead it must be directed to the observance of Good Faith in international trade. Thus it appears that CISG, similar to UNIDROIT principles emphasizes the concept of good faith as recognized by international law.

As far as it is considered whether the principle of good faith become binding by virtue of these instruments, it is clear that the UNIDROIT and PECL are both non binding instruments. When considering CISG there is no principle that good faith is binding under Article 7 but in a recent case decided in Germany (Clay Case) which considered Article 7 of CISG it was held that Article 77 and Article 80 reflect a principle of good faith binding on the contracting parties.

When considering the differences between these instruments it appears that one of the basic differences among them lies within their application as mentioned earlier in this essay; CISG and UNIDROIT principles both are of universal application but CISG is limited only to the sales contracts while UNIDROIT principles apply to all the international commercial contracts. The application of PECL on the other hand is confined to the European Union.

Further CISG is a binding instrument whereas the UNIDROIT and PECL Principles are non-binding instruments; therefore the CISG will take precedent over the two latter instruments.

If the parties opt the UNIDROIT or PECL principles as the governing law of their contract it will prevail over Domestic mandatory rules but will always take effect subject to the international mandatory rules. This is embodied in Article 1.4 of UNIDROIT principles, Article 1:103 of PECL. Under the CISG on the other hand as far as matters governed by the Convention are concerned, no mandatory rule of national, supranational and international law will be applied. The reason lies on



the fact that the states which adopt the instrument have undertaken a duty to apply the Convention wherever the Convention provides uniform rule in substitution to any other legal rule.

UNIDROIT principles are also used to fill the gaps in CISG thus shows to play a supplementary role. Most notable weakness in CISG is that it sets forth only a primary framework for the recovery of damages therefore gives a wide discretion to the judges in determining the loss suffered by the aggrieved party. This has resulted in scepticism, conflicts and more litigation. It has been widely accepted that the UNIDROIT Principles can be used to remedy this defect.

In conclusion it can be said that the CISG, UNIDROIT and PECL principles are based almost on the same concepts and principles with slight variations and differences. They have played and continue to play an enormously important role in the international commercial law arena and they co-exist with each other, filling gaps, obliterating weakness and strengthening one another. There is no doubt that these three instruments are the greatest achievement of the international commercial community which is vastly moving and developing. However there are still areas to be developed in all these instruments most important being the facilitation for the transactions involving intangible goods, software and electronic transactions and also they must be developed and amended frequently according to the timely commercial needs