The Relevance of the UNIDROIT Principles for Judges and Arbitrators in Disputes Arising out of International Contracts

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A. Introduction

The international commercial contract, seen in its wider sense, is the motor of economic globalization. Such contracts are in most cases executed without any difficulty, usually based on specific rules of a branch of business which very often pay little attention to national legal systems. The "pathological case" of default in performance is the relatively seldom exception to the rule. Yet it is with this case that the law courts or arbitral tribunals have to deal. They have to decide which legal system or which laws are to be applied to judge the conduct, the rights and obligations of the parties. The following considerations deal with the role of the UNIDROIT Principles of International Commercial Contracts in the settling of international commercial disputes.

We will have to consider, as our first issue, whether the parties to an international commercial contract can choose the UNIDROIT Principles instead of a national law to govern the contract, with valid and binding effect for judges as well as arbitrators. The discussion will focus on the conflict-of-laws effect, according to which the law chosen is to be applied *in toto* with its mandatory rules and, in principle, to the exclusion of all other laws. The question here is not the application of the rules in the sense of a substantial-law reference, which would mean an incorporation of the Principles as terms of the contract, under reservation of the mandatory rules of a legal order which would have to be determined according to objective criteria. There is no question that such a substantial-law reference to the Principles is admissible. Just as the parties may select Roman Law as the legal basis governing their contract, they are at liberty to incorporate the Principles into the contract.

In the absence of a choice-of-law by the parties, the contract must be subjected to the legal order established on the basis of objective criteria. The second question to be addressed is thus the role of the Principles in the absence of a choice-of-law. Can

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the arbitrator or the state judge apply the Principles rather than national rules of law without the authorization of the parties?

B. The Point of Departure

I. The 'Nationalization' of International Commercial Contracts

The traditional method of private international law submits international contracts to a single legal order whereby separable parts of the contract may, by way of *dépeçage* be located differently. The parties are free to choose the applicable law. In the absence of a choice-of-law by the parties, the law governing the contract has to be identified by determining the law, with which the contract has its closest connection, thus the legal order, where the 'seat' of the contract is to be located. All those who have experience with choice-of-law problems in the field of contracts know about the difficulties in identifying the connecting factors which lead to a satisfactory solution in the absence of a choice-of-law by the parties. The difficulty is not the same for all types of contract. It is apparent, for example, that typical service contracts, such as a contract for the services of a solicitor, architect or engineer, or the contract with a bank, usually focus on the law of the service provider. As far as bilateral contracts with reciprocal performances or investment contracts are concerned, solutions to the problem of localization are often unsatisfactory. The theory of the 'characteristic performance' assumes that the non-pecuniary performance is the decisive one. In the case of a sales contract, as the paradigm of bilateral contracts with reciprocal performances, this leads to an artificial preference for the law of the seller. Pecuniary and non-pecuniary performance are by their very nature opposite but equal. Moreover, the principle fails utterly in the case of barter contracts, a form of trade that is still important for instance in international currency contracts and their derivatives, such as the various forms of swaps – or in the case of contracts regulating relations between companies (e.g. joint ventures). It should also be noted that in bilateral contracts with reciprocal performances the same parties very often change roles, alternating between supplier and buyer.

II. The Aptitude of National Legal Systems to Resolve International Cases

National legal systems, including special commercial codifications, are primarily tailored to resolve national matters. Although the different systems may appear similar at first sight, they differ in specific and important matters. This fact may be disregarded in international trade, at least to the extent of suppletive norms. However when the pathological case arises and the application of mandatory rules is at issue, the specificity of a national legal system often leads to results that the parties did not expect. This applies even in cases in which the parties have chosen the rules of law to govern the contract. The choice-of-law is often a matter of prestige;

naturally, each party wants to ensure that its own law is applied. This conflict is often overcome by choosing a 'neutral' law. My experience has been that prior to the dispute the parties were very often not aware, or at least did not have detailed knowledge, of the substance of the chosen law. They had placed their trust in the legal system chosen as a whole to offer an appropriate solution.

III. The Need to Apply a Legal Order Tailored to the International Nature of the Contract

There is a genuine need in international trade for direct access to an equitable substantive legal order of international character. This would obviate the law finding process by means of private international law. It cannot be overlooked that in the world of international trade, private international law performs only a transitional function. International substantive rules would serve contracting parties better than a complicated system of conflict-of-law provisions that generate references to national legal systems which, by their very nature, are not well suited to international disputes.

Accordingly, it is the essence and purpose of the UNIDROIT Principles to provide international trade with a legal framework containing a complete and balanced system of rules based at the same time on the leading national systems and on international doctrine.

C. The Legal Significance of the Principles for Arbitral Tribunals

I. The Choice of the Principles by the Parties as the Rules Governing the Contract

As is well known, the UNIDROIT Principles are not clad in the form of an international convention, but present themselves in the form of a 'model law' or 'restatement of law'. They do not, however, merely codify the existing current state of affairs, but are innovative in nature, having been developed on the basis of a comparison between the leading systems of private law. The Principles do not have a legal basis in public international law and governmental authority. Their authority rests solely on the international reputation of the institution, the UNIDROIT, and on the quality of the solutions they offer.

Disputes in matters of international trade are nowadays most frequently resolved by arbitral tribunals. The increasing prominence of international arbitration has a number of reasons: the anonymity of the procedure, the possibility of choosing the procedural regulations, legal language and location of the tribunal. Furthermore, the influence that can be exerted on the nomination of the arbitrators and thus the inclusion of judges familiar with the field in question, confidence in the ability to escape the influence of the 'legal climate' at the forum, which often influences the

outcome of a dispute to a greater extent than the applicable law, the belief in the ability to avoid the application of interventionist statutory rules, and the greater freedom of the arbitral tribunal in the choice of the applicable law should be mentioned. On the other hand, it has to be noted that the increasing displacement of state courts by arbitral tribunals with their anonymity and only sporadic publication of arbitration awards has not exactly enriched the legal doctrine in international commercial law.

The choice of a non-statal source of law to be applied before an arbitral tribunal has in the past been the source of many emotional debates, primarily with reference to the application of the so-called *lex mercatoria*, conceived as a set of rules created by the organizations of internal trade themselves. At the current state of debate, it can be concluded that the application of the *lex mercatoria* before an arbitral tribunal is considered admissible, at least in cases where the parties have agreed on this, and that an arbitral award based on the *lex mercatoria* may be enforced. For the arbitral tribunal, the decision is facilitated by the fact that in most legal systems the parties can mandate the arbitral tribunal to decide *ex aequo et bono*. The choice of the *lex mercatoria* can be considered a 'step forward' in comparison. However, the essential differences between a decision based on equity, a decision taken by an *amiable compositeur* with a special mediating function, and a decision based on stricter legal grounds should always be recognized.

For this reason it is quite clear that a choice of the UNIDROIT Principles by the parties must be acknowledged by the arbitrators as reference to a law. The comments to the Principles, therefore, recommend that the explicit choice of the Principles be combined with an agreement on arbitration.

II. The Lex Mercatoria *as the Proper Law of a Contract in the Absence of a Choice of Law*

What is controversial, however, is whether an arbitral tribunal may apply the Principles in cases where the parties have not chosen the UNIDROIT Principles as the law to be applied. Is the tribunal allowed to apply non-state legal norms *par voie directe*, rather than to determine an appropriate national law by means of private international law? In the past this question has repeatedly been raised with respect to the *lex mercatoria*. To justify its application, the hypothesis of a negative choice by the parties has repeatedly been propounded.[1] According to this doctrine, in cases where the parties to international contracts could not agree on the choice of a legal system and where it is evident from the precontractual negotiations that agreement on one of the legal systems linked directly to the contract was impossible, it can (if not, must) be assumed that the parties had tacitly refrained from applying any state

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[1] *See* for example, Pierre Lalive, 'L'arbitrage international et les principes Unidroit' in *Contratti Commerciali Internazionali e Principi Unidroit, Contratti e Commercio Internazionale* (1997), pp. 72, 80.

law, and thus enabled the arbitral tribunal to apply non-state law. In the famous decision *Primary Coal Inc. (USA) v. Compania Velenciana de Cementos Portland*, of 1 September 1988,[2] which led to widely acclaimed confirmatory judgments by the *Cour d'appel de Paris*[3] and the French *Cour de Cassation*,[4] the tribunal held on the issue of the direct application of the *lex mercatoria* without the approval of the parties: '*Non seulement elles (s.c. les parties) n'ont voulu ni du droit Espagnol ni du droit de l'Etat de New York mais on est même fondé à penser que du fait, qu'elles ont écarté le droit anglais, elles n'ont pas voulu d'un droit quelconque et qu'elles ont préféré un droit purement international...*' (pp. 710 and 711). Sober analysis, however, leads to the conclusion that the assumption of a 'negative choice of law' is purely hypothetical. One may also ask why the arbitral tribunal did not try to obtain by an explicit mandate to apply non-state law by questioning the parties. In any case, it cannot be concluded from the mere fact that the parties were unable to agree on the application of any one national legal order, either by choice-of-law or by virtue of statements during the court proceedings, that they had rejected the application of a national legal order. In this case it would, *per se*, be the task of the judge to determine autonomously the law to be applied. Indeed, in the case at hand, the Spanish party vigorously disputed having made a tacit negative choice-of-law, which led to the decisions mentioned above.

Until now, and primarily with regard to the specific nature of the *lex mercatoria*, I have taken the view that an arbitral tribunal should only refrain from applying a national law if it is authorized by the parties to do so.[5] There is, however, an essential difference between the UNIDROIT Principles and the so-called *lex mercatoria* in the traditional sense. The *lex mercatoria* is based on laws created by trade itself and by its institutions. It is not a consistent legal system, but rather a heterogeneous order created primarily by associations within a branch of business (*sociétés des marchands*), which has given it the character of corporative law. The *lex mercatoria* is a 'law in the making' and 'law in flux'. It is characterized by a high degree of spontaneity and is by its very nature incomplete. Its main legal sources are trade customs and prefixed contract terms elaborated by trade associations; this 'law' has developed different solutions from association to association, which in case of dispute often leads to a 'battle of forms'. A further point that needs to be taken into account is that the *lex mercatoria*, contrary to popular opinion, is a law mainly intended for the settlement of disputes; it is less concerned with the equity or adequacy of its solutions. It is, particularly in the law of contract terms, a strict law. In this respect, it leaves little room for application of the general principle of good faith. The aim of the law of contract terms is to ensure friction-free international

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2 (1990) *Journal de l'Arbitrage*, p. 702 et seq.
3 Clunet 1990, p. 43 et seq. with note by Goldmann.
4 Clunet 1992, p. 177 et seq.
5 For a more detailed account see Frank Vischer, 'General Course on Private International Law', (1992) *Rec. des Cours* 232, p. 142 et seq.

trade, which necessitates a certain rigour of the rules. As Georges Ripert and René Roblot, both leading commercial lawyers, have stated: '*Le fonctionnement donne au droit un caractère mechanique qui n'est d'ailleurs pas sans danger car il ne permets pas de tenir compte de certaines situations individuelles. Il faut parfois que le droit civil, qui reste sous-jacent vienne corriger l'injustice qui résulterait de cette injustice.*'[6] This fact is not overlooked even by avid supporters of the *lex mercatoria.* They see a correction for this in the application of the 'general principles recognized by civilized nations', as set out in Article 38 of the Statute of the International Court in The Hague; thus at the level of public international law.

However, this raises the question of the precise content of these general legal principles constituting one of the sources of public international law. Details are what count in a legal dispute, rather than general principles, such as *pacta sunt servanda* or 'good faith'. The latter, in particular, demands concretization, which presupposes that it is embedded in a legal system. Different laws have different views on what is the precise meaning of legal abuse or 'estoppel'. General principles, as a rule, do not answer precise questions.

III. The UNIDROIT Principles as the Proper Law of a Contract in the Absence of a Choice of Law

In contrast to the *lex mercatoria*, the UNIDROIT Principles of International Commercial Contracts are not a spontaneous, incomplete body of rules subject to continuous development. Rather, they are a *création savante* based on a careful comparison of existing legal systems. Like the 1980 United Nations Convention on Contracts for the International Sale of Goods (CISG), they contain a Cartesian approach. They are not the expression of trade customs nor a compilation of clausal law, but rather a codification of the basic principles of commercial law with the aim to provide just and reasonable rules which also consider the individual situation with the help of equitable civil law principles. They thus constitute more of a counter-point to the *lex mercatoria* than an element of it. In this sense the Principles are not a 'new *lex mercatoria*'. For the supporters of the *lex mercatoria* the Principles bring with them the danger of a petrification of commercial law comparable to that resulting from legislation. From this perspective, the Principles are at odds with the idea of an autonomously created commercial law, and would certainly hinder the constant development of new rules. If my impression is correct, the supporters of the *lex mercatoria* of the Goldmann school generally take a sceptical view of the UNIDROIT Principles or even reject them altogether. Interestingly, the very supporters of the *lex mercatoria* are raising another criticism against the Principles, namely that they create a kind of soft law by referring to underlined terms and

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[6] *Traité de droit commercial*, Vol. 1 (Paris, 1991, 14th ed.), No. 72.

general legal principles, such as good faith, with the effect of endangering the certainty of the law.[7]

The characteristics of the Principles as a codification would in my opinion permit an arbitral tribunal to apply the Principles in place of state law even without the authorization of the parties. The Principles generally provide a balanced legal solution, in some cases one that is better than the national law applicable according to the rules of private international law. The application of the Principles does not require the dubious construct of a negative choice-of-law. The Principles would be applied on the basis of their proper quality and their specific orientation towards the problems of international commercial contracts.

The direct application of the Principles would, however, require that the contract has no ambiguous connection with a single national legal system Without the approval of the parties a direct application can, therefore, only be considered once the arbital tribunal has established that the dispute is not closely connected to any national law.

A further condition is that the national law applying at the seat of the arbitration tribunal permits a decision to be taken on the basis of a non-state legal order, if none has been chosen by the parties, even without their approval. For Switzerland, Article 187(1) of the Swiss Federal Act on Private International Law (PILA) states that in the absence of a choice of the applicable law the tribunal shall decide the dispute 'according to the rules of law with which the case has the closest connection'. This raises the question whether the notion 'closest connection' encompasses considerations other than strictly territorial ones. I should rather favour an extension in this sense. The British Arbitration Act of 1996 permits a decision on the basis of rules which are not part of state law only 'if the parties so agree' (s. 46(1)(b)). By contrast, the French *Cour de Cassation* in its abovementioned decision of 1992 in the case *Compania Valenciana de Cementos Portland v. Société Primary Coal* saw an adequate basis for a decision on the strength of the *lex mercatoria* in Article 1496 of the *Nouveau Code de Procédure Civile*, even in the absence of agreement of the parties. This provision states that in the absence of a choice by the parties the arbitrator is to apply *les règles de droit qu'il estime appropriées*. The UNIDROIT Principles could certainly be considered as such *règles de droit*.

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[7] *See* Institute of International Business Law and Practice of the International Chamber of Commerce (ed.), *Unidroit Principles for International Commercial Contracts, a new lex mercatoria?*, especially the Conclusion by Jérome Huet, p. 270.

D. The State Court and the Principles

I. The Significance of the Parties' Choice of the Principles to Govern the Contract

The questions mentioned above are more difficult to answer if the dispute is brought before a state court. As we have seen, the Principles are a codification of the central principles applying in international trade, but they are a codification lacking state authority or a status in public international law. To repeat the question: does this fact preclude a state court from recognizing the parties' choice of the Principles as a choice-of-law resolving the conflict of laws? Or may the court only recognize the Principles as an incorporated part of the contract in the sense of a substantial-law-reference?

What is the meaning of 'law' for a judge? It is not possible to answer the question here, which touches on the very fundamentals of law and legal philosophy. The traditional opinion equals, in a positivistic manner, law and state. The law is what has been determined by the state and is enforced by it. Yet it is of course recognized that many areas of social life are not in fact regulated by the state, but rather by private-autonomous means. 'Self-regulation', so often recommended these days, has established a foothold within Swiss commercial law, as the example of the new rules on the organization of the stock exchange under recent Swiss legislation shows. However, as is commonly known and accepted, such 'law-making' cannot be authoritative and effective unless there is some forum of delegation of legislative powers or at least toleration by the state. The power of the state to make laws and its monopoly of the lawful use of force and coercive measures are seen as being in a close dialectical relationship. One consequence of this approach, given that the Principles are 'not a law, not a bill of law but, so far, a draft of a possible future law',[8] could be that the choice of the Principles would not be considered to have the desired conflict-of-laws impact. The Principles could not prevail against the mandatory rules of the national law determined by the rules on conflict of laws. The state judge, as a state organ, would be bound to apply national law, whether of domestic or foreign origin or of the law of international conventions.

I should proffer a different opinion. Excluding consumer contracts and other protective contracts, the conflict of laws in international contracts is based on the internationally recognized principle of the autonomy of the parties with regard to the choice-of-law. In other words, the parties may themselves choose the law to be applied and are not restricted in any way in their choice. In almost all legal systems, a connecting factor between the law chosen by the parties and the contract or the parties is not required. If they so desire, the parties to a supply contract between a Swiss and a

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[8] See ibid., Hilmar Raeschke-Kessler, p. 170.

French company may choose Chinese law to govern the contract. The virtually unrestricted freedom to select the applicable law is the central pillar of international commercial contract law. From its close to universal recognition, one can indeed conclude that the principle of party-autonomy has a transnational legal basis.

This raises the question: if the parties are allowed to select a national legal order, however distant, as binding law, why should they not be permitted, in place of a national law, to choose a balanced, non-state legal order? The limitation of the choice of a law with a conflict-of-law effect to a national state law could be justified with the argument that the state is the sole guarantor of a just order. It is feared that an extension of the choice-of-law to non-state legal orders could expose the judge to legal orders of an unbalanced, even arbitrary character.

It may be conceded that it would indeed be too much to ask of a judge to apply rules of law whose substance is so vaguely defined as, for example, the *lex mercatoria*. When it comes to the Principles, however, these concerns seem irrelevant. The Principles represent a codfication of high quality and homogeneity in contents, which in many respects even surpasses the quality of traditional national legal orders. And they represent a clear and stable codification created by an approved international organization. For this reason, the state judge, too, should be permitted to honour the choice of the Principles to govern the contract. The recognition and the application of the choice of the Principles by the state judge would legitimate them as an acknowledged source of international trade law. Such a judiciary act would confirm the legal quality of the Principles.

By contrast, the proposal drawn up by the Lando Commission on European Contract Law in 1997 (Art. 1.103) would leave it to the proper law of the contract to determine whether a choice of the Principles could be considered valid in solving a conflict of laws. Yet such a 'detour' via the law on the conflict of laws does not appear to be the best solution. All the difficulties associated with the localization of the international contract would be revived and the solution of the dispute would be made more difficult rather than facilitated. That, in turn, is contrary to the aims of the Principles.

Moreover, the question of the essential difference between a state judge and an arbitrator arises. As we have seen, in the law of arbitration the choice of a non-legal order by the parties has to be honoured by the arbitrators. Why should the state judge be placed in a different position than the arbitrator with respect to the application of the Principles. Is the essential difference merely that the state judge is an organ of the state and is therefore tied to a state law, be it domestic or foreign? The fact that the state judge personifies a state organ and is therefore required to adhere to state law does not preclude him or her from granting far greater scope to the autonomy of the parties in international relationships than in national cases, a scope that encompasses the application of non-state law, whose authority is derived from its contents and its quality. In *national relationships* the application and enforcement of the national legal and social order is the central issue. The judge acts as the guarantor of this order. In *international relationships*, on the other hand, where the parties have exercised a choice-of-law, an international contract is subject to

national rules of law only and solely by virtue of the autonomy of the parties to decide conflicts of laws in a binding manner. Frequently, the contract is not incorporated into the so-called 'social sphere' of the country selected. An international commercial contract remains a multi-state phenomenon that cannot float freely above the law, but must, in the event of dispute, be subjected to a binding legal basis for decision. In my view, there is no dogmatic necessity to accept only a state legal order as such a basis.

Finally, the wording of the Swiss Federal Act on Private International Law (PILA) does not foreclose such an approach: Article 116(1) of the PILA merely states on the law to be applied by the judge that 'contracts are governed by *the law* chosen by the parties'. Article 117(1), on the other hand, states that 'failing a choice of law, contracts are governed by the *law of the state* with which they have the closest connection'. I would not dare to allege that in the case of a choice by the parties the expression 'law' without any reference to a 'state' was consciously chosen by the legislator as a broader formulation. But statutory texts become divorced from their historical background and begin a life of their own. This should be borne in mind for the questions at hand.

II. The Significance of the Principles in Case of a Choice of a National Legal Order by the Parties

Both a state judge and an arbitrator are obliged to respect a valid choice of a national law. In accordance with almost all laws on arbitration, Article 187(1) of the Swiss PILA stipulates for international tribunals that the issue is to be decided on the basis of the law chosen by the parties. If the parties have chosen a national legal order, this choice is binding upon the judge and even the arbitrator and excludes the application of the Principles.

III. The Significance of the Principles in the Absence of a Choice of Law

In the absence of a choice-of-law the state judge must determine the applicable law according to objective criteria. As we have seen, the 'closest connection' is the relevant criterion. For the state judge Article 117(1) PILA explicitly states that the law of the *state* that is most closely connected to the contract is to be applied. In Article 187(1) PILA on the rules of arbitration, there is no specific reference to the *law of a state* but merely to *law tout court*. Thus, at first sight, it appears that at least under Swiss Private International Law, the state judge, is precluded from applying the Principles in the place of state law in the absence of a choice of law by the parties.

In his remarkable article 'Das autonome Recht des Welthandels' (The Autonomous Law of World Trade),[9] Michael Bonell convincingly demanded that

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[9] (1978) 42 *Rabels Z*, p. 485.

the judge should not be obliged to apply all mandatory rules of the applicable law, but rather only the mandatory provisions common to the legal systems involved in the case. This, he argued, is the only way to avoid the negative consequences of a multiplicity of binding rules associated with the artificial nationalization of an international commercial contract. In his contribution to the *Festschrift* for Gerhard Kegel, Hans Stoll proposed a similar solution.[10] I myself subscribe to this opinion, shared by many international lawyers.[11]

Once it is recognized that genuinely international commercial contracts can often not be submitted without arbitrariness to one of the relevant national laws for the purposes of deciding a dispute, but rather that all the laws directly involved should be considered, the Principles clearly are an instrument to develop 'multinational' norms for such decisions.

It would be scarcely feasible for a judge to examine all the legal systems which may be involved, as to the congruence of their mandatory provisions. The Principles, which, after all, are based on a comparative analysis of the leading legal systems, help to overcome this problem. Once the necessity of 'reducing' the binding norms in accordance with the goal and the specific nature of international trade transactions is acknowledged, a state judge should not ignore the Principles altogether, even if the parties have not chosen them.

Moreover, it should be noted that the Principles also provide an answer to questions that are not dealt with in most national laws. For example, the Principles determine which party is obliged to take the necessary measures to obtain a public permission (Art. 6.1.14). The UNIDROIT Principles also contain balanced rules for the preliminary question of which standard terms are to be applied and provide rules for the so-called 'battle of forms' (Art. 2.22); these kinds of rules are scarcely ever found in national laws.

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[10] *Richterliche Inhaltskontrolle bei internationalen Handelsgeschäften* (Stuttgart, 1987), p. 623.

[11] Frank Vischer, 'General Course on Private International Law' (1992) *Rec. des Cours* 232, p. 135. To give one example: an international court of arbitration in Switzerland was called upon to answer the following questions. A contract had been drawn up between a non-Swiss firm and a non-Swiss agent concerning representation in Hong Kong. The contract explicitly precluded the agent having a claim for compensation for loss of custom on termination of the contract. The parties had chosen to apply Swiss law. Thus, in principle, the provisions governing agency contracts in Art. 418a et seq. of the Swiss *Obligationenrecht* were to be applied. According to Art. 418u, the right to compensation for loss of custom is mandatory. It must be asked whether its mandatory nature should be enforced in the case of a contract that had no intrinsic link with Switzerland. In other words, is it the aim of Art. 418u merely to protect agents in Switzerland, or, if Swiss law has been chosen, also to protect foreign agents operating in Hong Kong? In my view there is much to support the view that, to use a fashionable expression, the norm should be 'teleologically reduced' with a view to the international dimension. In the absence of proof of a genuine need for protection, as with a small agent, and when the contractual preclusion of compensation occurred without coercion and when it is clear that the parties were not aware of the binding nature of the protective norm in Swiss law, the mandatory provision of Article 418u should not have to be enforced.

More generally, a trend towards the incorporation of substantial laws can be observed in international contract law. For instance, the Inter-American Convention on the Law Applicable to International Contracts of 18 March 1994, which was drawn up with the participation of 17 Latin American countries and the US and Canada, stipulates 'that the Court shall also take into account, the general principles of international commercial organizations' (Art. 9(2)). As Friedrich K. Jünger stated, it was primarily the UNIDROIT Principles that the authors had in mind.[12] In this sense, the Principles should, in the absence of their explicit choice by the parties, be used as an important subsidiary or complementary source of law in the law-finding process of the state court.

E. The Problem of Mandatory Rules

I. The Principles and Mandatory State Rules

Even if we regard the parties' choice of the Principles as binding on the state judge in a conflict of laws, the question remains whether our solution is compatible with the provisions of the UNIDROIT Principles on the precedence of mandatory state rules. On the one hand, the Principles themselves contain binding rules. They are usually characterized by the phrase 'The parties may not exclude or limit this duty' (Art. 1.7(2)). This covers the principle of good faith and fair dealing and rules derived from this principle, such as the reduction of grossly excessive payments for non-performance (Art. 7.14.13) or excessive unilaterally set prices or the limitations on exemption clauses (Art. 7.1.6). Rules regulating error, mistake, fraud or threat must by their very nature be mandatory if they are to make sense.

On the other hand, Article 1.4 of the Principles states 'Nothing in these Principles shall restrict the application of mandatory rules, whether of national, international or supranational origin, which are applicable in accordance with the relevant rules of private international law'. Taking this wording into account, the provision refers, in the case of mandatory law, to the private international law of the forum in question. Thus, in a case before a Swiss judge, Swiss conflict law would have to determine whether, and if so which mandatory rules are to be applied alongside or in place of the Principles.

II. Precedence of International Mandatory Rules

The answer to the dilemma should be found in the acknowledgement that, within the law of contracts, there are mandatory rules of different quality and importance for the conflict of laws.

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[12] 'The Inter-American Convention on the Law Applicable to International Contracts' in (1994) *Am. J. Comp. L* 42, p. 381.

On the one hand we have the mandatory rules of private law, whose primary aim is to guarantee and mediate between the private interests of the parties. Such protective norms are the exception in commercial law (as opposed to consumer protection law, for instance). Even if a mandatory norm of this type should exist, the question is whether it must also be applied in an international relationship.

Along with the mandatory norms of private law there exist rules with different purposes. They are characterized by a particularly close relationship to governmental policies and express specific economic, social or legal concerns. No state will refrain from enforcing them. The German doctrine speaks of *Eingriffsnormen* which, somewhat inadequately, can be translated as 'intervention norms' or lois *d'application immédiate*, although these are expressions that only approximate the character of the rules. Such norms can originate in the *lex fori* or in a legal order of a third country. Usually their application presupposes the existence of a close connection between the contract and the national legal and social order of the state that has enacted the norm. Articles 18 and 19 of Swiss PILA and Article 7 of the Rome Convention reserve the application of these directly applicable rules. Their specificity lies in the fact that they demand application irrespective of the law determined by the private international law of the forum. What is decisive in our context is that they cannot be excluded by the choice of another law by the parties: they are directly applicable and not subject to the same conflict rules as the compulsory protective norms.

My interpretation of Article 1.4 of the Principles refers to this distinction between the mandatory norms of private law on the one hand and the *lois d'application immédiate* on the other. The reservation of mandatory rules in Article 1.4 of the Principles should contain only mandatory rules of the second category, i.e. rules resulting from 'intervention norms' (or *lois d'application immédiate*) and rules with international public policy (*ordre public*) character. They should not encompass purely private law protective norms, even if they are compulsory.

Accordingly, if the parties have chosen the Principles as the law governing their contract, they are exclusively applicable. They are subject only to the rules which are to be applied irrespective of the law chosen by the parties. This places the Principles on the same level as any other state-law order. Any other solution would inevitably lead to an irreconcilable conflict of laws. The legal effect of error, mistake, fraud, or threat, for example, cannot simultaneously be governed by more than one legal order.

F. Concluding Remarks

My remarks may appear revolutionary to many readers. In particular, objections may be raised to the claim that even a state judge should honour a choice of the UNIDROIT Principles by the parties as binding in the same way as the choice of a

national law. I am convinced that my proposals would be in the interests of international trade. They ensure that disputes can be adjudicated on the basis of a balanced set of rules developed in the tradition of the leading systems of commercial law. Uniform international substantive rules meet the needs of international trade better than the nationalization of international contracts by means of international private law. Even I, a devotee of private international law will accept this fact, even if it should lead to a reduction or rather displacement of the significance of private international law.