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INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

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SUMMARY RECORDS OF THE 2ND SESSION

(ROME, 4 TO 8 JUNE 2007)

(Prepared by the Secretariat of UNIDROIT)

1. The Working Group for the preparation of the third edition of the UNIDROIT Principles of International Commercial Contracts held its second session in Rome from 4 to 8 June 2007. The session was attended by Berhooz Akhlaghi (Iran), M. Joachim Bonell (UNIDROIT), Paul-André Crépeau (Canada), Samuel Kofi Date-Bah (Ghana), Bénédicte Fauvarque-Cosson (France), Paul Finn (Australia), Marcel Fontaine (Belgium), Michael Philip Furmston (United Kingdom), Henry D. Gabriel (United States), Sir Roy Goode (United Kingdom), Arthur Hartkamp (The Netherlands), Alexander Komarov (Russian Federation), Ole Lando (Denmark), Takashi Uchida (Japan), Pierre Widmer (Switzerland), Zhang Yuqing (China) and Reinhard Zimmermann (Germany). Guido Alpa (Italy) and João Baptista Villela (Brazil) were excused. The session was also attended by the following Observers: Ibrahim Al Mulla for the Emirates International Law Center, Eckart Brödermann for the Outer Space Committee of the International Bar Association, Christine Chappuis for the *Groupe de travail contrats internationaux*, Stefan Eberhard (substituting François Dessemontet) for the Swiss Arbitration Association, Lauro Gama, Jr. for the Brazilian Branch of the International Law Association, Alejandro Garro for the New York City Bar, Emmanuel Jolivet for the ICC International Court of Arbitration, Pilar Perales Viscasillas for the National Law Center for Inter-American Free Trade, Hilmar Raeschke-Kessler for the German Arbitration Institution, Giorgio Schiavoni for the Chamber of National and International Arbitration of Milan, and Renaud Sorieul for the United Nations Commission on International Trade Law (UNCITRAL). Mohammed Aboul-Enein (Cairo Regional Center for International Commercial Arbitration), Christian von Bar (Study Group for a European Civil Code), Jeremy Sharpe (Center for American and International Law, Institute for Transnational Arbitration) and Matthew Sillett (London Court of International Arbitration) were excused. The session was also attended by Herbert Kronke (Secretary-General of UNIDROIT) and Alessandra Zanobetti (Deputy Secretary-General of UNIDROIT). Paula Howarth (UNIDROIT) acted as Secretary to the Group. The list of participants is attached as APPENDIX.

2. In his address of welcome Kronke first of all indicated that the President of UNIDROIT, much to his regret, was unable to attend the session and that he himself unfortunately would have to miss most of the discussion due to other compelling commitments. He was very much impressed by the very demanding agenda the Group had before it but was confident that the Group's deliberations would be as fruitful as usual. He hoped that on the basis of this year's discussion the Rapporteurs, after further preparatory work including a comparative analysis of existing national and international rules relating to their respective subjects, would be in a position to produce preliminary draft chapters with comments for examination by the Group at its next session in 2008. The ultimate goal was still to complete work on the envisaged third edition of the Principles by 2010.

3. Bonell took the Chair and welcomed the two new Observers, Eckart Brödermann for the Outer Space Committee of the International Bar Association, Lauro Gama, Jr. for the Brazilian Branch of the International Law Association, and Stefan Eberhard, who was substituting François Dessemontet, for the Swiss Arbitration Association. They were all very familiar with the project as demonstrated by the numerous and most valuable publications on the UNIDROIT Principles they have produced over the years. Moreover, in their capacity as practising lawyers they had already widely used the UNIDROIT Principles and would certainly share their experiences with the Group.

4. Bonell then asked whether the Group was prepared to change the order in which the items on the Agenda would be taken. The Group agreed. He then called on Fontaine, Rapporteur on Plurality of Obligors and/or Obligees, to present his position paper.

I. EXAMINATION OF THE POSITION PAPER ON PLURALITY OF OBLIGORS AND/OR OBLIGEEES (UNIDROIT 2007 – Study L – Doc. 102)

5. In introducing his position paper Fontaine pointed out that it reflected the outcome of the preliminary discussion the Group had had the previous year. In addition, he had received a note from Dr. Sonja Meier, a researcher at the Max-Planck-Institut who was conducting research on the topic and had provided him with some interesting comments concerning in particular the general approach to be followed with respect to plurality of obligors and plurality of obligees. As to the legal sources, he had consulted, in addition to the main national codifications, the American Restatement and English case law, especially the relevant provisions of the Principles of European Contract Law (hereinafter PECL) and of the draft Uniform Act on Contracts under preparation within the sixteen African countries of OHADA.

6. With respect to plurality of obligors he pointed out that the starting point was that several obligors undertake the same obligation towards the same obligee (e.g. A and B together borrow \$10,000 from Bank W; affiliated companies A and B rent the same office space from owner W; several construction firms join forces to submit an offer together and the contract is awarded to them; several insurers offer co-insurance for a large risk). There were two basic situations: one – which he suggested calling separate obligations – in which each obligor is bound only for its share and the obligee may claim only that share from any of the obligors, and the other – which he suggested calling joint and several obligations – in which each obligor is bound for the whole obligation, and the obligee may claim performance of the whole obligation from any of its obligors. There was a third and definitely less frequent situation – which he suggested calling communal obligations – in which the obligors are bound to render performance together, and the obligee may claim performance only from all of them, and he proposed to deal with it later.

7. Bonell thanked Fontaine for his excellent paper which would certainly provide a most valuable basis for further discussion by the Group. As to terminology he recalled the lengthy discussion the Group had had at its last meeting which had resulted in an agreement to use the terms now suggested by the Rapporteur.

8. Crépeau wondered whether “joint and several” as used in common law systems really coincided with the French notion of *obligation solidaire*.

9. Bonell recalled that as a general policy the use in the Principles of terms of art peculiar to particular domestic laws did not mean that these terms should necessarily have the same meaning within the system of the Principles. Also in this instance he felt that irrespective of the terms chosen it was up to the Principles to define the meanings of those terms autonomously.

10. Still with respect to terminology Goode had no problem with the word “separate” as such but wondered whether for consistency it made sense to talk about “joint and several” in one place and then “separate” in another. He thought there was some merit in using the same word to describe those obligations that have a several element.

11. Finn had some difficulty concerning the first situation. Was each person separately contracting, taking Fontaine’s first example of a \$10,000 loan, for \$5,000 each? Was that what the contract said? Or did the contract say that they were both contracting for \$10,000? If it is a share that is part of the contract, all they are doing is suing on a separate provision, that is for \$5,000. If it is for \$10,000, how do you say what their share is? They may have their own agreement *inter se*. Now take a partnership that contracts for \$10,000. Each

partner can be sued for the lot or the partnership for the lot. He definitely had some difficulty in understanding what the share was and this became even more pronounced in the example of two companies renting the same space: did each have to rent half the space? It was a purely practical problem he had in understanding what the terms of a contract would be that would internally allocate the shares such that a person would be liable under that contract only for its share.

12. Fontaine pointed out that the examples he had given at the beginning were not classified as either “separate” or “joint and several” but were just situations with several obligors. It was up to the Principles to decide which of the two basic categories was to be the rule and which the exception and whether there should even be a third category, i.e. the so-called communal obligations.

13. According to Goode if one is talking about “separate” liability one is talking about each obligor owing a different obligation, its own obligation. The typical case would be a syndicated loan: a £50,000 loan, each comes in for £10,000 and each is actually an obligor for a distinct portion of the loan. Each obligor is not assuming responsibility for any other obligations of the others. Its obligation is distinct.

14. According to Crépeau, as Fontaine had said at the very beginning, the basic situation was very simple: 3 persons get together and say “we need €15,000 and we have a friend who is ready to lend us €15,000”. If he actually does so he becomes the creditor of the three persons and they are the debtors of €15,000. There are a number of ways to handle their debt towards the creditor. Each can owe a part of that €15,000 or each can owe the whole of it. In the first case they are what are called “separate” debtors and, if they have not agreed for any different division, they will be co-debtors for €5,000 each, or if they agree for €2,000, €7,000 and €8,000 each of them will be co-debtors for each of their shares. Alternatively, they can be “joint and several” co-debtors” if each of them owes €15,000 and the creditor can call them up for €15,000 each.

15. Date-Bah thought that in Goode’s example – the syndicated loan – the obligations were, right from the beginning, separate and therefore the situation may not be one of plurality of obligors at all. If it is a separate deal right from the beginning, he did not see that as a plurality.

16. Goode drew attention to Article 10:101 (2) PECL according to which “Obligations are separate when each debtor is bound to render only part of the performance and the creditor may require from each debtor only that debtor’s part”. He did not see any difference in substance between the situation of separate obligations under the same contract and the situation of separate obligations arising from separate contracts. What was being dealt with here was any situation in which there were separate obligations and each debtor was assuming responsibility only for its own part of the performance.

17. Gabriel disagreed. In his view the discussion had to be confined to a plurality of obligors that have obligations within a single contract since one could hardly conceive a law governing a single contract that affects obligations of anyone who is not party to that contract.

18. Fontaine was not so sure that the Group should deal only with situations of a plurality of obligations under the same contract. He made the example of co-insurance where several insurers undertake to ensure part of one risk, insisting – at least in the practice he knew, perhaps it was different in other parts of the world – that each had a separate contract

while of course excluding joint and several liability which would just run against the very purpose of co-insurance (dividing the risk).

19. Chappuis, referring to Comment A to Art. 10:101 PECL according to which “The fact that several debtors are bound by parallel obligations arising from distinct contracts does not affect the legal nature of each debt”, noted that apparently the situation Fontaine was referring to was excluded from the chapter on plurality of debtors in PECL.

20. Widmer thought that the starting point should be the situation where there is a plurality of obligors and one performance and the Principles should determine when this performance is to be performed in shares or as a whole by each of the obligors.

21. Crépeau agreed with Widmer and referred to Article 1518 of the Civil Code of Quebec according to which “An obligation is joint between two or more debtors where they are obligated to the creditor for the same thing but in such a way that each debtor may only be compelled to perform the obligation separately and only up to his share of the debt”.

22. Bonell referred to Fontaine’s paper which at page 5 states that “The basic assumption is that several obligors undertake the same obligation towards the same obligee”. He felt that Crépeau was absolutely right in recommending that at least for the time being the Group should focus on the most frequent normal situations, i.e. where there is one obligation with several obligors and the problem arises as to what extent each obligor is liable vis-à-vis the obligee. Provided that it is first of all up to the parties to determine the kind of liability they intend to assume, what the Principles have to do is to lay down a default rule for the case where the parties have not otherwise agreed.

23. Goode agreed that nobody so far was really thinking of entirely separate contracts. What was at stake were separate obligations owed under the same contract. For example the contract of insurance: one policy, one contract, but the contract provides for slices of risk to be assumed by each separate insurer. Likewise the syndicated loan: it is a single contract but within it each obligor assumes a slice of responsibility.

24. Also according to Komarov it was important to confine the discussion to situations of several obligations stemming from one and the same legal relationship.

25. Fontaine reiterated that he still had some reservations in this respect. He was thinking of co-insurance where it frequently happens that the insurers insist on having separate contracts, even though they concern their respective shares in the same risk.

26. Bonell invited the Group to take a final decision concerning terminology, and given that there seemed to be general agreement to speak of “joint and several” obligations with respect to Situation 2, what still remained to be decided was the terminology to be used for Situation 1: “separate” or “several” obligations?

27. Gama, Crépeau, Finn and Raeschke-Kessler, though for different reasons, expressed a clear preference for “separate”.

28. Goode agreed.

29. With respect to substance, Fontaine pointed out that the Group had to decide on the so-called default rule, i.e. whether in the situation of several obligors who bind themselves to the same performance towards an obligee the basic rule should be that they

are bound separately or that they are bound jointly and severally. He personally thought the latter solution to be the most appropriate in commercial settings, and this was also the solution adopted by PECL in Article 10:102 (1) stating “If several debtors are bound to render one and the same performance to a creditor under the same contract, they are solidarily liable, unless the contract or the law provides otherwise.”

30. Gabriel too found that the presumption in favour of joint and several liability was the proper solution though different from the position taken by U.S. law where, for reasons which to him were not at all clear, the default rule is “joint” liability.

31. With respect to the so-called sources of joint and several liability Fontaine drew attention to the fact that PECL in Article 10:102 (2) adds that “Solidary obligations also arise where several persons are liable for the same damage.”

32. Bonell wondered whether such a provision which clearly referred to tort liability was appropriate in the context of principles dealing with international commercial contracts only.

33. Lando, Widmer, Crépeau, Komarov and Garro favoured the inclusion of such a rule while Date-Bah, Gabriel, Goode and Furmston were against it.

34. Asked to provide an example of possible applications of such a rule in the context of the Principles, Lando made the case of two persons being liable for pre-contractual negotiations. Admittedly under the Principles pre-contractual liability was considered of contractual nature but the same was not true under a number of domestic laws which consider it of tortious nature. The envisaged additional rule would take care of that.

35. Bonell still felt that if the court or arbitral tribunal was to decide the issue under the Principles the case mentioned by Lando would not even arise because pre-contractual liability would be considered of contractual nature. Lando agreed.

36. Gabriel was thinking of a case where there are two parties of which one in contract and one in some other basis of law, and they both caused the same harm and they both were responsible for €100,000. At first sight in such a case the proposed rule could make sense but at a closer look this is not the case. One should not confuse damages with liability. If two persons caused – one on a contractual level and the other on some other legal basis - the same harm, there would likely be a difference in the level of liability and therefore damages. Thus, for example, the types of economic harms provided for in most contract situations are broader than the types of economic harms provided for in tort. By adopting a provision of the kind proposed there was a risk that a plaintiff who had been injured both because of breach of contract – the widget purchased blew up – and in tort – another person had wrongfully caused the widget to blow up – the defendant in tort, though not being a party to the contract, would become jointly and severally liable for a level of contractual damages that would not be provided for under the underlying tort system.

37. Al Mulla shared Gabriel’s concern.

38. Raeschke-Kessler gave the following example taken from an actual arbitration case: a contract for the erection of a chemical plant in the USA provided that the main contractor was obliged, even after turning the plant over to the owner, to continue fine tuning of the plant. The main contractor brought in a special consultant to do the fine tuning. In performing this task the consultant caused the plant to blow up in total. When the main

contractor was sued under the contract the arbitral tribunal brought also the consultant in the arbitral proceedings and decided that the main contractor and the consultant were jointly and severally liable for the harm caused to the owner. He thought that this example demonstrated the usefulness of a provision of the kind proposed.

39. Asked by Furmston whether the consultant had agreed to the arbitration clause contained in the contract between the contractor and the owner, Raeschke-Kessler confirmed that the consultant did not object to the arbitral tribunal.

40. In the light of the discussion Bonell proposed leaving the question open for the time being and invited the Rapporteur to go on with the presentation of his paper.

41. Fontaine referred to page 12 of his paper dealing with the rules governing joint and several obligations and pointed out that there were two main questions to be dealt with: the first was the obligee's rights against the obligors and the second concerned the recourse between the joint and several obligors. With respect to the first question two different aspects were involved: first of all the main effect of joint and several liability with respect to the obligee, and secondly the defences each obligor may assert against the obligee. In defining joint and several obligations the main effect may already be stated. In this respect he cited Article 10:101 (1) PECL stating "All the debtors are bound to render one and the same performance and the creditor may require it from any one of them until full performance has been received", and Articles 10.7 and 10.8 of the OHADA draft, inspired by the Civil Code of Québec and stating respectively that "Several obligors are solidarily liable where they are bound to the obligee for the same thing in such a way that each of them may be compelled separately to perform the whole obligation and where performance by a single obligor releases the others towards the obligee" and that "(1) The obligee of a solidary obligation may apply for payment of the whole obligation to any one of the co-obligors at its option. (2) Proceedings instituted against one of the solidary obligors do not deprive the obligee of its claim against the others". He did not intend to make at this early stage drafting proposals but just wondered whether the Group agreed that the main effect of joint and several liability was that each of the obligors is liable for the whole performance towards the obligee and that the obligee has an option to ask performance from any of the obligors up to the point where performance is total.

42. It was so agreed, but Garro expressed his preference for the formula used in PECL ("all the debtors are bound to render one and the same performance") to the one used in the OHADA text ("several obligors ... are bound to the obligee for the same thing").

43. Turning to the aspect of defences and again, after referring to the relevant provisions contained in PECL (Article 10:111: "(1) A solidary debtor may invoke against the creditor any defence which another solidary debtor can invoke, other than a defence personal to that other debtor. Invoking the defence has no effect with regard to the other solidary debtors. (2) A debtor from whom contribution is claimed may invoke against the claimant any personal defence that that debtor could have invoked against the creditor") and in the OHADA draft (Article 10.10 (1): "A solidary obligor who is sued by the obligee may set up all the defences that are personal to it or that are common to all the co-obligors, but this solidary obligor may not set up defences that are purely personal to one or several of the other co-obligors"), Fontaine wondered whether in substance the Group could agree on general provisions of this kind which could precede further provisions dealing with specific defences.

44. Widmer expressed a slight preference for the OHADA text because it clearly distinguished between common and personal defences.

45. Fauvarque-Cosson also preferred the OHADA text.

46. Uchida felt that the general principles expressed in both the PECL and OHADA texts made the legal status of the obligee weaker and wondered whether this was intentional.

47. Fontaine pointed out that the two texts were in this respect in accordance with practically all national legislations he had consulted.

48. Uchida acknowledged that even the Japanese Civil Code contained a rule of this kind but he personally was of the opinion that an obligor should be permitted to invoke only defences which have the effect of discharging the obligation.

49. With respect to specific defences the Group agreed on having separate provisions on performance and set-off and on merger of debts along the lines of the PECL/OHADA texts.

50. Concerning the release of one of the obligors by the obligee or settlement between the obligee and the obligor, Fontaine again referred to the models contained in PECL (Article 10:108: "(1) When the creditor releases, or reaches a settlement with, one solidary debtor, the other debtors are discharged of liability for the share of that debtor. (2) The debtors are totally discharged by the release or settlement if it so provides. (3) As between solidary debtors, the debtor who is discharged from that debtor's share is discharged only to the extent of the share at the time of the discharge and not from any supplementary share for which that debtor may subsequently become liable under Article 10:106 (3)") and in OHADA (Article 10.10 (3): "When an obligee, by agreement, releases its rights against one of the solidary obligors, the other obligors are discharged of liability for the share of that obligor").

51. Goode expressed some doubts as to the rule set forth in paragraph 3 of 10:108 PECL. He made the example of four obligors liable vis-à-vis an obligee for £10,000 and among themselves each one for £2,500. If one obligor is released from its liability to the obligee for £2,500 why should this affect its liability vis-à-vis the other obligors?

52. Hartkamp shared Goode's concern. In his opinion too the correct rule should be that a release between the obligee and one obligor should not affect that obligor's internal liability towards the other obligors unless the obligee has released the other obligors for the internal part of the contribution of the first obligor. In other words, the joint and several liability of several obligors should be considered as independent in the sense that releasing one of the obligors should not affect the obligations of the others and internally it should not affect the recourse against the released obligor unless the obligee has released the other obligors for part of their obligations.

53. Uchida agreed. This was exactly what he had in mind when he expressed the concern that the rules under discussion weakened the status of the obligee. On the contrary he favoured a rule according to which when the obligee releases one of the obligors this should not have any effect on the other obligors unless otherwise indicated by the obligee.

54. According to Date-Bah if the obligee releases one of the obligors this inevitably reduces the total amount of the joint obligation. If the obligors originally owe £100,000 and subsequently the obligee releases one obligor for £20,000, the total amount owed by the remaining obligors must necessarily be reduced to £80,000 surely.

55. Finn on the contrary felt that a release of one obligor should be treated as affecting only the relationship between that obligor and the obligee but having no effect whatever on the internal relationship among the obligors.

56. Gabriel felt that a distinction should be made between separate liability and joint and several liability. If in the first situation there are four obligors for an obligation of \$100,000 and one of them reaches a settlement with the obligee concerning its share of \$25,000 by paying only \$20,000, the total obligation has to be reduced by \$25,000 and not only by \$20,000. In the situation of joint and several liability the effect of a settlement may be different since the other obligors, after having paid, may come back to the one who has settled.

57. Following Gabriel's intervention both Hartkamp and Crépeau wondered whether release and settlement needed to be treated separately and whether one should in any case clearly distinguish between the external effects, i.e. the effects of release or settlement on the relationship between the released or settling obligor and the obligee, and the internal effects, i.e. the effects of release or settlement on the relationship between the released or settling obligor and the other obligors.

58. Zhang was not so sure that the two levels could always be kept separate, at least where the shares of liability among the co-obligors are not equal.

59. Hartkamp too felt that although theoretically one had to distinguish strictly between the external relationship and the internal relationship, in order to be able to take a well reasoned decision on the external relationship one had to know what would happen afterwards in the internal relationship so as to avoid any injustice in it. He gave an example of a case decided by the Dutch Supreme Court two years ago concerning an intra-group loan. A bank had given the mother company a loan which was then divided by the mother company among daughter companies A, B and C which became jointly and severally liable towards the mother company. Later the mother company wanted to sell A to a third party and at this stage company A obviously had to be freed from its obligations within the group. The mother company released A while B and C remained jointly and severally liable. If the mother company wanted to release A also from its internal obligations vis-à-vis the other obligors, it should have reduced its claim vis-à-vis B and C by the amount of A's internal share.

60. Gabriel felt that Hartkamp was right. In other words, in his opinion too, the PECL rule could only work with respect to separate obligations. On the contrary in case of joint and several liability which is supposed to be the default rule in the Principles, the same rule does not work because there are no shares.

61. Bonell expressed some doubts in this respect. In his view, unless otherwise agreed, in case of joint and several obligations as far as the internal relationship was concerned the co-obligors had equal shares.

62. Gabriel pointed out that the real problem was settlement where one never settles for the full amount of one's share. If one co-obligor's share is \$100,000 and that co-obligor settles for \$50,000, where does the extra \$50,000 go? Under the doctrine of joint and several liability that extra \$50,000 would fall on the shoulders of the other co-obligors. So there really is not a share.

63. Date-Bah agreed and felt that a co-obligor should not be entitled to settle without the authorisation of the other obligors for less than its total share.

64. According to Goode on the contrary it did not matter whether there was full payment by one obligor or simply a part payment. The part payment would go in reduction of the indebtedness with the effect that that part automatically reduces the liability of other obligors, while the remaining part of the first obligor's obligation would be extinguished so that the other obligors would not become responsible for it. In conclusion in his view it did not really matter for the other co-obligors whether the first obligor was released from payment of the whole sum or was released from payment of part of the sum as a consequence of settlement.

65. Bonell asked for further views concerning the different solutions envisaged by Hartkamp on the one hand and Goode on the other. The Rapporteur, relying on the precedents of PECL and of OHADA, seemed to be for Goode's solution.

66. Widmer was in principle for Goode's interpretation.

67. Hartkamp no longer insisted on the contrary rule.

68. Gabriel still had difficulty understanding the solution envisaged by Goode. He gave the following example: A, B and C are co-obligors for \$300,000 who do not pay. The obligee asks co-obligor A to pay. A proposes a settlement for \$50,000 instead of \$100,000. Obligee accepts. Do B and C get a full credit for what the share would have been, which is \$100,000 so that they now owe only \$200,000 or would they remain liable for \$250,000? In his view the first alternative should apply.

69. Goode confirmed.

70. According to Finn, Goode's interpretation was the only rational one as long as the notion of shares among the co-obligors is introduced into their relationship with the obligee.

71. Furmston had difficulty following the whole discussion. In his view, in Gabriel's example, if A, B and C were jointly and severally liable for \$300,000, the obligee could sue any one of them for the full amount and, if one of them paid the full amount of \$300,000, it would have a right to sue the other two for a proportionate share, i.e. for \$100,000 each. If the obligee does a deal with A under which A pays only \$50,000, in his view the other two co-obligors would remain liable for \$250,000. On the contrary what has been suggested was that A's payment of \$50,000 would reduce the outstanding amount to \$200,000. Why?

72. Goode saw nothing wrong with it. B and C were just paying what they would have had to pay if there had been no release. Their position has not been impaired.

73. Komarov said that he too, like Furmston, would like clarification with regard to what was being discussed. He understood that so far a situation of joint and several liability had been assumed. But what would the solution be in case of separate liability?

74. According to Goode, in case of separate obligations, if A pays, it discharges its obligation with no effect on the obligations of the others.

75. Finn insisted that the rule proposed was a true exception to the strict operation of joint and several liability. Indeed if the obligee lodges three claims against the three co-

obligors for the full amount of \$300,000 and then settles with one of the co-obligors, it will no longer have any claim against the other two co-obligors.

76. Fontaine agreed but pointed out that the situation envisaged by PECL and which had been discussed so far was different. There the obligee for whatever reasons sued one co-obligor not for the full amount but only for its share.

77. Chappuis recalled that Hartkamp had at the beginning suggested making a distinction between release and settlement and felt that this should indeed be done. Unless otherwise stipulated by the obligee, a total release of one of the co-obligors can hardly have the same effects as a settlement in which that co-obligor pays \$50,000. In her opinion in this latter case the total amount would be reduced by \$50,000 while she still could not understand those who on the contrary maintained that a settlement for \$50,000 would reduce the amount by \$100,000. In her view it was up to the co-obligors to see what the effect of the \$50,000 payment by one of them meant in their internal relationship.

78. Al Mulla pointed out that, in his experience as a practicing lawyer dealing with these cases, there was always a contract between the parties and the outcome depended on what the contracts provided.

79. Goode tried to explain once more the solution he envisaged. Taking again the example of A, B and C being jointly and severally liable for \$300,000, he thought that everybody would agree that if A is given a total release for no payment at all, B and C would be released from liability to the extent that A has been released from liability, in other words, A's part of the liability disappears so far as B and C are concerned and the release would have no adverse effect on the other co-obligors. Passing to the second situation where it was not a full release for nothing but A had to pay \$50,000, he thought that the partial release should operate in the same way as the full release except of course it only operated as regards the part of the debt that was released, namely \$50,000; yet the remaining \$50,000 had been paid thereby equally reducing the amount owed to the obligee. The result would therefore be exactly the same as if there had been a total release because there has been a partial release plus a partial payment: B and C will remain liable for \$100,000 each, i.e. what the bargain was right from the beginning. With respect to the third scenario, i.e. B becoming bankrupt, in his view this would not affect A. There was no basis for B's trustee in bankruptcy to have a claim against A because such a claim would only exist to the extent that A had not paid its contribution, or rather that B was left with a larger liability than it should have been. But B is not left with a larger liability than it should be; it is left with \$100,000 as is C. That is exactly what they bargained for. There would therefore no basis for a contribution claim against A.

80. Finn agreed with Goode's conclusions but pointed out that the solution envisaged would in practice inevitably result in a disincentive for any obligee to settle with one co-obligor within the limits of its share. Why not sue for the whole amount? He wondered whether the Group wanted to adopt a rule that provided a disincentive for an obligee to settle with one of the jointly and severally liable co-obligors, or to adopt a rule permitting some level of settlement with that co-obligor but which nonetheless still secured to the obligee the full amount of the agreed performance.

81. Hartkamp recalled that earlier in the day the Group had agreed on the principle that a co-obligor is entitled to raise exceptions which are personal to it or which are common to the entire debt. He felt that in such a system it was much more logical – and commercially reasonable - to follow his approach, i.e. that a release relates personally to one of the co-

obligors and should not affect the obligee's relationships with the others. An obligee should be able to decide freely its position towards each of its co-obligors separately. Why should all the co-obligors have to profit from a settlement or a release which is in fact a contract between the obligee and one of the co-obligors only? The rule in Article 10:108 (1) PECL on the contrary states that there is an automatic release also towards the other co-obligors which means that the obligee cannot release only one without the consent of the others. In his view this rule made little sense and should be reversed. However he felt that the Group should not at this point take a final view on the matter but rather ask the Rapporteur to give some further thought to it and report back to the Group next year also in the light of the solutions adopted in other legal systems.

82. In reiterating his position Gabriel on the contrary felt that the rule so far discussed set up the right incentive. Indeed if, as suggested by Hartkamp, the result of settlement by one co-obligor was to allow the other co-obligors to recover from the first co-obligor more than it had settled for there would be no incentive whatsoever for it to settle: it would have to pay the full amount of its share anyway. He therefore supported Goode's position and – to answer Finn's question – thought this was precisely the right incentive because it reflected the actual positions that lawyers and parties need to be in.

83. In summing up the discussion Bonell thought that the two alternative approaches were now clearly delineated and asked the Rapporteur to present them as alternatives in the preliminary draft he is expected to submit to the Group at its next session.

84. Fontaine agreed.

85. Fontaine then passed to the next defence, i.e. waiver of solidarity. There was no provision dealing with the issue in PECL while Article 1532 of the Civil Code of Québec provides that "A creditor who renounces solidarity in favour of one of the debtors retains his solidary remedy against the other debtors for the whole debt" and Article 10.10 (2) of the OHADA draft contains the same provision. He asked for comments first on the practical importance of waiver of solidarity and second on the rule proposed.

86. Hartkamp saw no need for a special rule on renouncing solidarity because it was exactly the same as releasing part of the claim. If the obligee says to one of the co-obligors that he will not sue it for \$300,000 but only \$100,000, this is the same as releasing that co-obligor for \$200,000 while retaining a claim for \$100,000 against it, and the proposed rule quite correctly states that this does not affect the claim against the others.

87. Goode agreed with Hartkamp.

88. According to Furmston English law made a distinction between releases and promises not to sue, and he felt that it was worth having a rule also on the latter.

89. Also Garro disagreed with those who saw no difference between release and waiver of solidarity and felt that, like the Civil Code of Québec, the Principles should contain a special provision on waiver having the same content as that of the Civil Code of Québec.

90. Hartkamp pointed out that such a provision was only needed as long as there was a provision stating that release affects the obligation vis-à-vis the other co-obligors. If, as he had suggested, the reverse solution were to be adopted with respect to release, there would no longer be a need for a special provision on waiver since in both cases the result would be that the obligations vis-à-vis the other obligor remain unchanged.

91. Fauvarque-Cosson mentioned that Article 1211 of the *Avant-projet Catala* provided, contrary to what is now stated in Articles 1214 (2) and 1215 of the French Civil Code, that the share of an insolvent co-obligor is divided among the others including the one who had made the payment or whose solidarity had previously been waived by the obligee.

92. Bonell felt that for the reasons given by Hartkamp it was premature to take a final stand on whether a special provision on waiver of solidarity was needed since it ultimately depended on the content of the envisaged provision on release.

93. Passing to the effect of expiration of limitation period, Fontaine referred to Article 10:110 PECL (“Prescription of the creditor’s right to performance (“claim”) against one solidary debtor does not affect: (a) the liability to the creditor of the other solidary debtors; or (b) the rights of recourse between the solidary debtors under Article 10:106”) and wondered whether a similar rule should be included in the Principles.

94. Hartkamp, though considering such a rule self-evident and therefore superfluous, could nevertheless accept it.

95. While with respect to the proposed rule on the effect of a judgment no objections were raised, as to the proposed rule on death of an obligor it was felt that a provision of the kind contained in Article 1540 of the Civil Code of Québec and in Article 10.12 of the OHADA draft was not advisable. On the contrary it was pointed out that in commercial practice the cases of winding up and splitting of a company were quite important. In this respect it was however objected that dealing with these matters would inevitably bring company law into play which was for a number of reasons inadvisable. The Rapporteur was asked to give some further consideration to the issue.

96. Fontaine agreed.

97. Passing to the next item in his paper, i.e. recourse between joint and several obligors, Fontaine pointed out that a joint and several obligor who has performed upon the obligee’s request normally has a contributory recourse against the other obligors, and that in this respect a number of issues arise: how are the respective shares to be determined? How much can an obligor who has been called on to perform claim from the other obligors? A most technical question: when an obligor claims recovery from the other obligors can that obligor exercise the rights and actions of the obligee? And finally what is the impact of the insolvency of one or several of the obligors on the recourse?

98. As to the determination of the respective shares Fontaine felt that, unless otherwise provided by the contract or the law, the shares should be equal and in this respect he referred to the corresponding provisions in Article 10:105 PECL and Article 10.11 (1) of the OHADA draft.

99. Gabriel agreed but suggested that the Comments mention also that a different apportionment does not necessarily have to be expressly stipulated in the contract but may also be implied.

100. Fontaine agreed and suggested using in this context the usual formula “unless the circumstances indicate otherwise”.

101. Bonell asked for a clarification concerning the reference to “the law”.

102. Fontaine explained that he had merely quoted the language used in Article 10:105 PECL and admitted that in the context of an purportedly self-contained system such as the Principles the reference to another “law” would not in this respect be appropriate.

103. Lando agreed and Bonell concluded that the envisaged formula “unless the circumstances indicate otherwise” would suffice.

104. As to the extent of contributory claim, Fontaine referred to Article 10:106 (1) PECL stating that “A solidary debtor who has performed more than that debtor’s share may claim the excess from any of the other debtors to the extent of each debtor’s unperformed share, together with a share of any costs reasonably incurred”.

105. Gabriel agreed with the basic rule but suggested deleting the last part of it which in his view could give rise to a great deal of litigation.

106. Finn and Date-Bah even questioned the basic rule which in their opinion was self-evident or at least implicit in the equal shares principle just adopted.

107. Hartkamp, on the contrary, felt that such a rule was necessary since, in the usual example, it would prevent A, who has paid \$300,000, from trying to recover \$200,000 from B on the assumption that B will then recover \$100,000 from C.

108. Widmer agreed.

109. Going on to a new item – rights and actions of the obligee - Fontaine referred to Article 10:106 (2) PECL (“A solidary debtor to whom paragraph (1) applies may also, subject to any prior right and interest of the creditor, exercise the rights and actions of the creditor, including accessory securities, to recover the excess from any of the other debtors to the extent of each debtor’s unperformed share”) and wondered whether a similar rule should appear also in the Principles.

110. Raeschke-Kessler was in favour of having such a rule.

111. Passing to defences Fontaine referred to Article 10.11 (4) of the OHADA draft (“A solidary obligor sued for reimbursement by the co-obligor who has performed the obligation may raise any common defences that have not been set up by the co-obligor against the obligee; it may also set up defences which are personal to itself, but not those which are purely personal to one or several of the other co-obligors”) and mentioned that PECL did not deal with the issue.

112. Hartkamp wondered what would happen if one of the co-obligors had a specific defence against the obligee and another co-obligor, after having paid the debt, takes recourse against the first co-obligor. Can that obligor now use the defence it had against the obligee also against the co-obligor who has taken recourse? He thought that this was an important question not expressly addressed in this article of the OHADA draft.

113. Fontaine agreed that the defences each co-obligor has against the obligee were one thing and the defences among the co-obligors themselves were another, and that the OHADA text covered only the former.

114. Goode, assuming that the discussion concerned only common defences, wondered what the solution would be in the case where it was not clear whether a co-obligor who has been asked by the obligee to pay the whole debt could raise a defence so that that co-obligor prefers to settle and only later on discovers that there was a valid defence.

115. According to Fontaine this could only be decided on a case by case basis.

116. Raeschke-Kessler felt that if there was a defence of time bar and the co-obligor asked for payment does not raise it vis-à-vis the obligee that defence can be raised by the other co-obligors vis-à-vis the first co-obligor when it asks them to pay their shares.

117. Finn wanted to know whether the second part of the OHADA provision stating that “it may also set up defences which are personal to itself” referred to defences the co-obligor has against the obligee or to defences against the other co-obligors suing it.

118. According to Fontaine only the defences against the obligee were meant.

119. Finn had a sense of unease in thinking that the rule they were discussing could lead to the result that one of the co-obligors, after having paid the whole amount, cannot recover from one of the co-obligors that co-obligor’s share because that co-obligor raises against it a personal defence that that co-obligor had against the obligee. This would mean that the obligee was able not only to choose the co-obligor who had no defences against it but also to transfer to the co-obligor who pays in full the liability which the party having the defence otherwise would have had.

120. Gabriel saw nothing wrong with that: it was inherent in joint and several liability. Indeed the fact that one of the co-obligors can use the personal defences it has vis-à-vis the obligee also vis-à-vis the co-obligor who, having paid the full amount, is trying to recover its share, is no different from the fact that one of the co-obligors is simply unable to pay.

121. Hartkamp too had no difficulty with the provision except that it should make clear that the defences at stake already existed at the time the joint and several liability arose. He further suggested that the comments give some examples of personal defences.

122. Turning to insolvency of one or several obligors, Fontaine pointed out that the rule generally adopted was that in such an event the loss will be divided proportionally between the solvent co-obligors. This was also the solution provided by Article 10:106 (3) PECL (“If a solidary debtor who has performed more than that debtor’s share is unable, despite all reasonable efforts, to recover contribution from another solidary debtor, the share of the others, including the one who has performed, is increased proportionally”) and Article 10.11 (5) of the OHADA draft (“A loss arising from the insolvency of a solidary obligor is divided between the other co-obligors, in proportion to their respective shares”).

123. Gabriel noted that the two provisions were not exactly identical insofar as PECL referred in general to the inability “despite all reasonable efforts” to recover contribution from another solidary debtor while the OHADA draft restricted the rule to insolvency.

124. Bonell asked the members of the Group to express their preferences.

125. Gabriel, Date-Bah, Finn and Widmer preferred the PECL formula.

126. The discussion on the rules to govern joint and several obligations having been concluded, Fontaine wondered whether the Principles should also contain rules concerning separate obligations. If the Principles were to have a definition of the kind contained in Article 10:101 (2) PECL according to which “Obligations are separate when each debtor is bound to render only part of the performance and the creditor may require from each debtor only that debtor’s part”, most of what there was to be said would already have been said. What was still to be decided was whether there should be a default rule on the respective liabilities of separate obligors as in PECL (Article 10:103: “Debtors bound by separate obligations are liable in equal shares unless the contract or the law provides otherwise”), possibly with the addition of “unless the circumstances indicate otherwise”.

127. Finn had difficulty in imagining that in a commercial transaction of any significance one could come to the conclusion that an obligor was bound to render only part of the performance to the obligee without the factors leading to that conclusion indicating how much that obligee had to pay.

128. Goode and Gabriel shared Finn’s concerns and were against having such a rule.

129. Chappuis dissented. If there were a rule on separate claims there should also be a rule on how to determine the shares.

130. Lando agreed.

131. On the contrary Fauvarque-Cosson shared Goode’s view. In her opinion too it was more a question of interpretation of the contract and she felt that having just the definition of separate obligations would be sufficient.

132. Gama and Perales Viscasillas agreed.

133. Bonell concluded that there was not sufficient support for a default rule of the kind contained in PECL.

134. Fontaine, in introducing Part II of his paper dealing with plurality of obligees, pointed out that he had proposed the traditional approach, i.e. to deal with plurality of obligees basically as a mirror image of plurality of obligors. It was true that last year this approach had been challenged, in particular by Zimmermann who favoured, with respect to plurality of obligees, a different approach based on co-ownership combined with rules on agency. In this respect reference was made to the model followed by the Dutch Civil Code which however according to Hartkamp had not turned out to be too satisfactory in practice. Zimmermann had introduced him to one of his collaborators at the Max-Planck-Institut (Dr. Sonja Meier) with whom he had a lengthy discussion without however being totally convinced of the merits of the alternative approach.

135. Hartkamp confirmed his reservations concerning the Dutch approach which has given rise to a number of problems. First, with respect to the internal relations, who is entitled to the claims? Moreover, a problem which in practice has arisen in particular in the area of syndicated loans relates to securities given by the obligor. Indeed if the company getting a loan from a group of banks provides security, such security will be attached to the claims which are called common property. Yet this makes it very difficult for single obligees to get out of the arrangement because it still remains to be seen how the co-property of the security is affected by the change in the number of obligees. One solution would be to

invent special structures, e.g. a principal obligee acting as the holder of the security – a kind of trustee – but in Dutch law trusts do not exist.

136. Bonell felt that also in the light of this last intervention the Group should proceed along the lines suggested by the Rapporteur in his position paper, i.e. to follow the traditional approach.

137. Komarov expressed his support for the traditional approach also in view of the fact that it was still the approach followed by most domestic laws and that the Principles were expected to play an important role in countries with less sophisticated legal systems. Maybe the comments could just mention that there are alternative approaches to the subject.

138. Continuing his general introduction Fontaine pointed out that, as in the case of plurality of obligors, there were two basic situations: one where each obligee is entitled to claim its share only and the obligor is bound only for that share towards each obligee; the other, where each obligee is entitled to claim the whole performance and the obligor is bound to perform the whole obligation vis-à-vis any obligee requiring performance. As to terminology it could be the same as with respect to plurality of obligors, i.e. the first situation could be called “separate claims” and the second “joint and several claims”.

139. With respect to separate claims, Fontaine referred to Article 10:201 (2) PECL stating that “Claims are separate when the debtor owes each creditor only that creditor’s share of the claim and each creditor may require performance only of that creditor’s share” and to the default rule in Article 10:202 stating that “Separate creditors are entitled to equal shares unless the contract or the law provides otherwise”. With respect to the latter he wondered however whether the Group wanted to decide in the same manner as it had decided with respect to separate obligations, i.e. to have no default rule at all.

140. Goode agreed on this point. With respect to the definition of separate claims he wondered how this would fit with the situations such as syndicated loans and bond issues where the claims are separate but can only be enforced through a designated person such as a trustee or a lead bank. These were very common situations and if the rule were merely to say that each creditor may require performance only of that creditor’s share, it would not take into account that here each creditor might not be entitled to enforce performance at all.

141. Fontaine, though acknowledging the great importance of syndicated loans in this context, felt however that since the Principles did not deal with specific contracts they should contain only the general rule and mention should be made in the comments that obviously special arrangements such as the one recalled by Goode could be made in practice.

142. According to Gama, at least in civil law systems which do not know trusts, the special situation Good referred to would be a matter dealt with under procedural law.

143. Concerning the basic question as to when, in case of a plurality of obligees, their claims are “separate” and when they are “joint and several”, Fontaine indicated that the rule should be the opposite of what had been decided with respect to plurality of obligors, i.e. the obligee’s claims should be separate unless the circumstances indicate otherwise, because in his view such a rule would correspond to the most frequent cases in practice.

144. Gabriel, recalling that the proposed rule would not correspond to U.S. law where in cases of plurality of obligees the default rule is that the claims are “joint” and not “joint

and several” or “separate”, expressed his preference for the U.S. solution which, in his view, reflected how an obligor would normally consider a claim by a plurality of obligees.

145. Bonell, noting that Gabriel was introducing a new concept, asked him to explain it further.

146. Gabriel pointed out that in the case of a “joint” claim the obligees do not have separate claims but are all in the same boat and can enforce the claim only jointly.

147. Hartkamp asked for further clarification.

148. Goode observed that, at least speaking from the perspective of English law, one would say that obligees were joint if the claim is vested in all of them collectively and the consequence would be that they can only enforce it collectively. It is not just a procedural rule but also affects the substantive right.

149. Furmston added that, as he understood the development of English law, the whole concept of “joint and several” liability had been introduced in order to mitigate the unsatisfactory results of “joint” liability. It was a great invention indeed a long time ago.

150. On a separate matter Furmston felt that if the Principles adopted different default rules for obligors and obligees a problem could arise with respect to situations which constantly oscillate between the two cases. He gave the example of a standard joint bank account which can hourly change from being in credit to being in debit and vice versa.

151. Like Furmston Chappuis wondered whether it was not preferable to adopt the same default rule for plurality of obligors and for plurality of obligees. She referred to the example given by the Rapporteur at page 19 of his position paper in which banks A and B have joined forces to lend together EUR 1,000,000 to Firm W. In this case A and B are co-obligors for granting the loan and co-obligees for repayment of the loan plus interest. It would be very confusing if on the one hand A and B had separate claims and on the other were jointly and severally liable. For this reason she favoured the adoption of one and the same default rule in both cases.

152. Finn too had difficulties with the proposed “separate” claims rule. He urged the Group not to think only of examples involving payment of money and gave the example of a single obligor having to construct a building or a facility for a joint venture of companies. To imagine that each of these companies has a separate claim and share vis-à-vis the constructor seemed to him rather bizarre.

153. Widmer agreed with Finn and felt that the Group would be running into difficulty if it adopted one and the same default rule for every case that might occur in practice. If performance is in money it is easily divisible and then one can choose the solution of “separate” claims but in a construction case it is quite difficult to apply the same rule.

154. Gabriel too felt that the most common case would be communal claims and not separate claims.

155. Bonell asked the Group what in the light of the discussion its preference was with respect to the envisaged default rule: “separate” claims, “joint and several” claims or - as a third possibility - “joint” or “communal” claims.

156. Finn and Gabriel expressed their support for “joint and several” claims.

157. Since no support was voiced for the other two solutions, Bonell concluded that the envisaged default rule should be “joint and several” claims.

158. With respect to the rules to govern joint and several claims, Fontaine referred to Article 10:201 (1) PECL which states that “Claims are solidary when any of the creditors may require full performance from the debtor and when the debtor may render performance to any of the creditors”. One could make things even more explicit by including additional language – as contained in the OHADA draft inspired by the Civil Code of Québec – saying that performance of an obligation in favour of one of the solidary obligees releases the obligor towards the other obligees and the obligor has the option of performing the obligation in favour of any of the solidary obligees, provided the obligor has not been sued by any of them. Obviously the Principles would in any case use the term “joint and several” instead of “solidary”.

159. According to Date-Bah the suggested addition was implicit in the concept of “joint and several” claims.

160. Gama had a question concerning the substance of the rule of Article 10.15 of the OHADA draft. Was the assumption that when the obligor performs a money obligation in favour of one of the obligees but does not pay the whole amount due, that obligor is fully released with respect to the other obligees, or would that apply only with regard to the amount effectively paid?

161. Fontaine replied that the latter was the case.

162. Passing to the question of which defences the obligor may assert against each obligee, Fontaine referred to PECL as a possible model which in Article 10:205 states that “A release granted to the debtor by one of the solidary creditors has no effect on the other solidary creditors” and then continues by stating that the provisions on several defences concerning joint and several co-obligors are applicable “with appropriate adaptations” and refers to the provisions on performance, set-off, merger of debts, effect of judgment, prescription and other defences.

163. Bonell asked for comments and the Group agreed on the approach taken by PECL.

164. Also with respect to the issue of allocation between joint and several obligees Fontaine referred to Article 10:204 PECL (“(1) Solidary creditors are entitled to equal shares unless the contract or the law provides otherwise. (2) A creditor who has received more than that creditor’s share must transfer the excess to the other creditors to the extent of their respective shares”) and to Article 10.16 of the OHADA draft (“(1) As between themselves, solidary obligees are entitled to equal shares unless the contract or the law provides otherwise. (2) An obligee who has received more than its share is bound to reimburse the excess to the other obligees in proportion to their respective shares”) as possible models.

165. The Group agreed and Bonell once again thanked Fontaine for his excellent position paper and the way in which he had introduced it to the Group thereby making a most valuable contribution to the discussion. In preparing the preliminary draft and comments to be submitted to the Group at its next plenary session, Fontaine would certainly take into account the various views expressed at the present session.

II. EXAMINATION OF THE POSITION PAPER ON ILLEGALITY (UNIDROIT 2007 – Study L – Doc. 101)

166. In introducing his position paper Furmston first of all drew attention to the preliminary questions set out in paragraph 2. With respect to the first of them, i.e. whether there should be more than one level of illegal contracts, he felt that the answer should definitely be in the affirmative and gave the example of a contract of employment containing a provision for payment of salary dressed up as expenses which, at least under English law, would be entirely invalid while a contract of employment containing - as many contracts of employment do - an invalid promise by the employee not to compete with his former employer after the end of the employment would certainly be valid and only the non-competitive provision would be unenforceable. For the time being he proposed to call the first level of illegality black illegality and the second grey illegality. He then recalled that many countries have a category of contracts that are prohibited by statute. Thus for instance, in England as well as in many other countries there is a licensing system for insurance companies whereby insurance is divided into a whole range of categories and one has to get a license for the kind of insurance one wants to write: if an insurance company writes a kind of insurance for which it does not have a license the contracts are considered invalid because prohibited by statute. It was however his view that in the context of the Principles there was no room for such a category of illegality since UNIDROIT is not a sovereign State and does not have a legislature.

167. Bonell recalled the lively discussion the Group already had on these issues and in particular on the advisability of having, like PECL, two levels of illegality, one which may be called immorality, i.e. where the contract violates fundamental principles and values, and the other which may be called illegality in a narrow sense, i.e. where the contract is contrary to applicable mandatory provisions. He asked the Group not to re-open that general discussion but to make comments and suggestions reflecting its outcome.

168. Crépeau pointed out that defining illegality was rather easy as long as one argued with reference to a specific legal order: thus e.g. Article 1373 (2) of the Civil Code of Québec speaks of a contract or prestation "that is neither forbidden by law nor contrary to public order" and everybody understands that the reference is to Québec's statutory law and the fundamental principles of Québec society. On the contrary, where there is no such specific legal order - as is the case of the Principles - so that the terms of reference have to be found at the international level, the question arises as to the nature and content of such internationally accepted terms of reference.

169. Furmston agreed and suggested distinguishing between the two levels of illegality.

170. Al Mulla pointed out that in general a distinction is also made between formal illegality and substantial illegality.

171. Raeschke-Kessler, referring to Crépeau's remark, pointed out that in international arbitration parties very often do not choose the domestic law of either party but a neutral third law: thus for instance in the case of a dispute between a Québécois company and a U.S. company the parties may choose Swiss law with Switzerland as the place of arbitration. In such a case the arbitral tribunal will disregard all mandatory laws of Québec and the U.S. unless they correspond to what the Swiss regard as international public policy, with the result that the arbitral award rendered in Switzerland may be executed elsewhere, e.g. in a

third country where the party has assets, but not in Québec or in the U.S. because it is against the *lois de police* or mandatory rules of public order of Québec or of the U.S.

172. Goode wondered whether it would be helpful at this stage to distinguish the concept of illegality from the consequences of illegality.

173. Proceeding to the examination of the preliminary questions, Furmston referred to the case of a perfectly valid contract which however one of the parties has performed by breaking the law. The classic example was that of a contract of carriage of goods by sea where the carrier overloads the ship. He thought that the Principles should deal with the issue.

174. Komarov agreed and referred to the well known and widespread practice of money laundering where the sales contracts or other types of contracts concluded are perfectly valid but one of the parties pays with illegally obtained or “dirty” money.

175. Furmston announced that he would expressly mention the very important example of money laundering given by Komarov.

176. According to Lando the question raised by Furmston could be satisfactorily answered by a provision such as Article 15:102 PECL provided that one accepts the philosophy underlying it. Indeed if the statutory rule setting a limit to the ship’s load does not expressly provide for the effects in case of its violation, according to Article 15:102 PECL the contract may be declared to have full effect, to have some effect or to have no effect or to be subject to modification.

177. Raeschke-Kessler agreed that a provision of this sort covered the impact on commercial contracts of rules of administrative law (safety regulations, health regulations, environmental standards, etc.), but cases of illegality such as money laundering were in a different category.

178. Goode pointed out that in addition to contracts unlawful in the making and contracts unlawful in the performance, there was – at least in English law – a third category, namely contracts unlawful in the purpose which may be known to one party only or to both. For example, I contract to sell a gun which I am told by the buyer he wants for shooting game and in fact he is buying the gun to kill his next door neighbour. Is that a real third category or does it come into either of your two categories?

179. Zhang wanted to raise a question in relation to the example given in paragraph 2.3. While fully understanding the facts involved, he wondered whether one ought to consider that it might not be within the jurisdiction of the arbitral tribunal to decide on matters relating to administrative law or criminal law. In this context he referred to a number of Chinese arbitration cases where the invalidity of a contract had been invoked on account of bribery and where the arbitral tribunal refrained from deciding on the matter in view of the fact that it was within the exclusive jurisdiction of Chinese domestic courts.

180. Bonell reminded that corruption would be discussed more in detail at a later stage, also in the light of a paper presented on the subject by Raeschke-Kessler. He seemed to remember that this paper dealt with among others the question as to whether or not the mere allegation of corruption was sufficient to become relevant in arbitration proceedings or whether a final judgment by the competent court was needed.

181. Both Zhang and Crépeau insisted that not even the example of the overloaded ship referred to by the Rapporteur in paragraph 2.3 should be dealt with because it concerned a violation of an administrative rule and as such had nothing to do with the validity/invalidity of the contract as such.

182. Bonell recalled that on the other hand Goode, in a previous intervention, had favoured dealing also with cases where it was not the contract itself but its performance that was illegal, but maybe he was thinking only of those cases where both parties were aware of this while in Furmston's example the shipper apparently did not know that the carrier was going to overload the ship.

183. Also Gabriel favoured dealing with the case set out in paragraph 2.3 as well as with Komarov's example of a contract in which payment is made with dirty money. Both these cases had in common that the respective contracts implied an act of performance which was illegal per se and were therefore different from the case where the contract and its performance were absolutely valid (e.g. the purchase of a gun paid with clean money) but its purpose was illegal (e.g. the gun was purchased in order to kill a person).

184. Goode pointed out that in such cases the question was whether the guilty party could enforce the contract. Supposing the gun was defective, could the buyer sue for the defects?

185. Furmston felt that the gun case was actually quite difficult but maybe not too frequent in the context of international trade, leaving aside illicit traffic in arms.

186. Widmer urged the Rapporteur to be more precise in his examples as to the facts.

187. Gama wondered whether consideration should be given to a case which he himself was not so sure how to handle. An international joint venture is set up in Ruritania to produce ethanol; in order to produce the necessary sugar cane local workers are employed but the terms of employment, though legal according to Ruritanian law, are contrary to ILO labour standards or internationally accepted labour standards as they are currently being discussed at WTO level. Would these kinds of agreements be immoral, illegal or what else? And should they be considered at all by the Principles?

188. Furmston thought it all depended on the kind of contract in question. Clearly the employment contracts between the Ruritanian employer and the workers in the fields would be outside the scope of the Principles. On the other hand the contracts which wicked multinational companies conclude to buy ethanol from Ruritanian manufacturers who impose on their employees standards which are internationally regarded as unacceptable could give rise to problems of validity.

189. Gabriel found that the example given by Gama was very interesting and undoubtedly quite frequent in international trade practice. On the other hand however he raised a flag of caution insofar as the Principles should not be overly ambitious and enter politically highly sensitive fields which after all still had to be fully explored.

190. Hartkamp raised a point of methodology. Given the precedent of PECL, what had to be decided first was whether the Group intended to follow, at least in substance, the approach of PECL or something entirely different. If the first was the case, why not focus on the two basic provisions contained in Articles 15:101 and 15:102 and see what adaptations

might be necessary. In other words he saw little use in starting from scratch with all kinds of examples and questions without knowing what the basic approach should be.

191. Bonell thought that the Group had already expressed its preference for the basic approach taken in PECL, i.e. to have a two tier system along the lines of Articles 15:101 and 15:102.

192. Lando expressed his preference for the inductive method so far followed.

193. Also Goode saw great merit in testing as many typical fact situations against a proposed rule as possible as that was the best way to test its strengths and its weaknesses. He referred as an example to Article 15:101 PECL on contracts contrary to principles recognised as fundamental in the laws of the member States of the European Union. While this was a formula which was fine for the European Union because of course courts of all member States and arbitrators must apply the rules of Community law, at international level it obviously could not work. What principles were recognised as fundamental at international level? And what happens in case of conflict between such principles and the applicable domestic law?

194. Garro, like Hartkamp, suggested keeping the discussion focused on the two tier system provided in Articles 15:101 and 15:102 PECL.

195. Fauvarque-Cosson agreed and with respect to contracts violating mandatory rules wondered whether the effects should always be as expressly stated in the rules in question or whether in the context of the Principles one might envisage a more flexible approach.

196. With respect to contracts contrary to fundamental principles Gabriel, while agreeing that such principles must be recognised as fundamental at international level, wondered whether this meant only fundamental principles of international law or also fundamental principles of law in general.

197. In reply to Fauvarque-Cosson Date-Bah expressed doubts about the possibility of disregarding the applicable law with respect to the effects of a contract violating the mandatory rules of that law. If a mandatory rule provides that in case of violation the contract is invalid and as such with no effects, how could the Principles be realistically expected to provide otherwise.

198. Bonell recalled that mandatory rules quite often do not expressly state that a contract violating them is null and void let alone what the effects of such an invalid contract would be.

199. Fauvarque-Cosson added that in a number of cases the rules do not even say that they are mandatory so that it is up to the judge to qualify the rule and decide whether it is mandatory (*d'ordre public*) or even internationally mandatory (*lois de police*). Also with respect to the consequences of their violation, the rules are often silent. Traditionally a contract contrary to *ordre public* is considered null and void, but this is no longer the case and in particular in the context of international commercial transactions the prevailing view is that the contract must produce some effects and therefore partial nullity should be favoured. At least in France over the last 10 or 15 years, partial nullity has very much expanded but this development has taken place not in the black letter rules themselves but in their application by the courts. She concluded that at least where the applicable mandatory rules

do not expressly state the sanction for their violation the Principles should provide maximum flexibility.

200. Turning to paragraph 3 of his paper dealing with the definition of illegality Furmston suggested adopting a definition consisting of a broad statement followed by a substantial number of examples.

201. Zimmermann recalled that the Group already last year had agreed in principle on a two tier system along the lines of PECL. In other words a distinction should be made between contracts so tainted and so bad that they cannot be countenanced at all and contracts violating mandatory rules which may or may not be invalid. With respect to the former category he suggested a general formula such as "A contract is of no effect to the extent that it is contrary to principles recognised as fundamental by the international community of States" on the understanding – to reply to Gabriel's question – that such fundamental principles are to be found not only in international documents such as the U.N. Charter, the Universal Declaration of Human Rights, etc. but can also be extracted from domestic laws.

202. Bonell noted that this was also basically what the Rapporteur himself had suggested except that a list of examples following the general formula was still missing.

203. Furmston announced that he would provide such a list later during the session. The list would certainly be much shorter than that provided by the American Restatement which gave more than 100 examples, very few of which however related to international commercial contracts and a large number to competition law and to speculative transactions. Assuming that the Group agreed with him that competition law and speculative transactions should be left out, the list he had in mind would certainly start with corruption which was certainly of prime importance and also mention money laundering and some commercially relevant cases of infringement of human rights such as the ethanol example.

204. With respect to the general formula, Fontaine recalled that Bonell, in his introductory paper presented at the previous session (UNIDROIT 2006 – Study L – Doc. 99), had suggested the formula "contracts contrary to internationally recognised fundamental rights and values" and asked Zimmermann to repeat his formula in order to see whether the two were basically the same.

205. Zimmermann read out his proposal "A contract is of no effect to the extent that it is contrary to principles recognised as fundamental by the international community of States".

206. Goode had no problems with either formula except that Zimmermann took it for granted that contracts contrary to such fundamental principles were always completely null and void. He definitely preferred a formulation which simply indicates the nature of that type of illegality as distinguished from the lower type but leaves the consequences to be dealt with later on, hopefully in the flexible way adopted by PECL.

207. Finn entirely agreed with Goode. If corruption was in the black zone – and he assumed that for the moment it was – it was clearly not the case that every corruptly induced contract would be considered completely invalid. Corruption can take a variety of forms so that it may be advisable to provide for a variety of responses ranging from unenforceability to a right for one party to avoid, or to change the amount of the stipulated commission. He thought that the merit of having a two tier system was that it allowed a

conceptual distinction between the violation of fundamental international principles and the violation of mandatory rules. However the effects of these two kinds of violation should be dealt with in the same manner, i.e. providing maximum flexibility.

208. Furmston agreed. Even indisputably black contracts may have legal effects, depending on the relevant circumstances (i.e. where only one party is aware of the violation of a fundamental principle).

209. Crépeau too felt that one thing was the definition of the different types of illegality and another thing was the effects, while in Zimmermann's proposal the two were combined.

210. Jolivet confirmed that also in international arbitration practice the two aspects are distinguished. At the same time however illegality is generally understood in a very broad sense (e.g. "Contracts contrary to general principles of international trade are illegal") without necessarily distinguishing between black and grey contracts.

211. Fontaine had no objection to being more flexible concerning the effects even of the black contracts but felt that should the effects ultimately be dealt with in one and the same manner, there might no longer be a valid reason for distinguishing between the two types of illegality.

212. Bonell noted that the Group seemed to agree that also with respect to the effects of the black contracts a flexible approach was preferable, thereby considerably departing from PECL. Concerning Fontaine's remarks he commented that indeed the U.S. Restatement had adopted a unitary approach with respect to what it calls in general "unenforceable" agreements insofar as there are no further sub-categories and the criteria for determining the effects are one and the same.

213. Zimmermann agreed that the sole reason for having a two tier system was that the legal consequences of the two types of illegality were different. Though realising that the majority of the Group was in favour of a unitary approach with respect to the legal consequences, he nevertheless wanted to make a last and final plea for a two tier system according to which the black contracts should have no effects whatsoever and that only with respect to the grey contracts a flexible approach should be adopted. In his view most of the concerns expressed with respect to such a system could be met by appropriate rules on the unwinding of black contracts.

214. Goode on the contrary thought that even with respect to the black contracts the effects ultimately depended on the circumstances. He made the example of corruption which certainly constitutes one of the most serious kinds of illegality but from that it does not necessarily follow that its effects should be the same on all parties including a party which might not have been aware of the corruption. In other words the effects had nothing to do with the seriousness of the violation but depended on the circumstances of the case and the extent to which both parties were involved or only one of them.

215. Bonell asked Zimmermann to explain what he considered a sort of contradiction in terms, i.e. to state that a contract contrary to fundamental principles is "of no effect" and at the same time envisage some restitutionary remedies depending on the circumstances of the case. Would this not mean that the contract produces some effects?

216. Zimmermann pointed out that many national laws (e.g. French or Dutch law) live with that system, i.e. they say a contract is invalid so it has to be unwound but there are certain rules concerning the unwinding regime, e.g. that if one party's hands are tainted by immorality, that party cannot recover.

217. According to Furmston the final decision as to whether there should be one or two categories of illegality should be postponed until the matter of the effects has been discussed.

218. Bonell asked Raeschke-Kessler to present his paper "Corruption in Foreign Investment – Contracts and Dispute Settlement between Investors, States, and Agents" which in view of the present session he had transmitted to the Secretariat for distribution to the members of the Group.

219. Raeschke-Kessler informed the Group that the paper had been written in collaboration with Dr. Dorothee Gottwald in 2006 for the Commission on International Law on Foreign Investment of the International Law Association (ILA). The starting point of the study was real life experience. In Country X a consortium established and led by the World Bank financed the construction of a power plant system for a value of more than 10 billion dollars which was to be paid for by the electricity produced by this power plant system. The contracts expressly prohibited the Host State from changing its laws so as not to affect the income to be derived from the power plant. The power plants had been constructed and were producing energy when, after a change in Government, the new Government declared all contracts invalid because of corruption alleging that the members of the former Government had taken more than one billion dollars as a bribe. The Supreme Court of Country X issued an injunction staying arbitration proceedings in London on the ground that due to the corruption also the arbitration agreement in the contracts was invalid, with the consequence that the domestic courts of Country X had exclusive jurisdiction in the dispute. The parties finally settled but if the arbitral tribunal had rendered a decision it would certainly not have found the contracts invalid *in toto* with no restitutionary remedies for the consortium because this would have meant that the Host State would have had the plants for free. The arbitral tribunal would probably have taken a decision along the lines of Article 15:102 (3) PECL, i.e. adapting the contracts or holding them only partially invalid. Moreover, in his paper he had addressed also other topics, above all the principle of State responsibility which is well established in international law and says that a State is responsible for the acts of its own government: in other words, if any of its even highest ranking officials is corrupt, the State may not later use this as an argument for the invalidity of the contracts entered into with foreign investors, with the consequence that the contracts obtained by bribery could be held at least partially valid and restitution possible. Such an approach might be contrary to the solutions traditionally adopted at domestic level but is absolutely prevailing in current international commercial practice. Even at domestic level there are exceptions and he made the example of a decision rendered by the German Federal Supreme Court some fifteen years ago. The facts of the case were as follows. State X had entered into a contract with a German company for the construction of an oil refinery. According to the contract the home minister of the Host State was entitled to a commission of 5% of the total contract price and such a percentage was clearly exorbitant. However the Government was toppled and the home minister fled the country. After completion of the refinery the home minister of the new government asked the German construction company for the agreed 5% commission which the German company paid. When the former home minister who had stipulated the contract in turn requested the 5% commission from the German company, that company however refused on the ground that it had already paid the commission to the new home

minister. The German Supreme Court held this to be correct thereby confirming the validity of the contract notwithstanding the bribe.

220. Bonell thanked Raeschke-Kessler for his presentation and was confident that the Rapporteur would take into account the many interesting suggestions it contained.

221. Furmston confirmed and announced that he would pay special attention to corruption with respect to which in his view among others a distinction should be made between the effect of the bribe on the main contract and the effect vis-à-vis the receiver of the bribe.

222. Before continuing the discussion on the Rapporteur's position paper, Hartkamp wanted to come back to the basic question as to whether there should be a two tier system or whether the distinction between contracts contrary to fundamental principles and contracts contrary to statutory law should be given up. He was still in favour of the two tier system because in his view fundamental principles were too important to be equated with any statutory provision, whether of criminal or administrative nature. Admittedly there were exceptional circumstances in which even a contract contrary to fundamental principles, public order, good morals – however defined – may produce some effects but this in his view would normally bring into play the law of restitution. In this respect he disagreed with Raeschke-Kessler according to whom in the example given the contract should in no case be considered null and void. In his view if the bribe is discovered before the contract is executed the new government should be able to say "we are not going to perform this contract because it is null and void", while only if the contract has already been performed is it important to prevent State X from receiving the project for nothing and this could well be achieved by restitutionary remedies.

223. Continuing the presentation of his paper, Furmston, with respect to paragraphs 3.2.2 and 3.2.4, suggested leaving out competition law and speculative transactions such as wagering and gaming. Indeed the former is now the subject of elaborate legislation in most countries of the world and the Principles could hardly claim to add anything useful to it, while with respect to the latter it would be extremely difficult if not even impossible nowadays to distinguish between the sort of transactions one has with one's bookmaker and the sort of transactions one has with one's banker in relation to derivatives. As to international Conventions (paragraph 3.2.3) he thought that it should be made clear in the Principles that parties, by choosing the Principles as the applicable law, should not be able to avoid the application of the mandatory rules contained in a given international convention which would otherwise govern the contract. Passing to the effects of illegality (paragraph 4), he strongly recommended the adoption of a flexible regime since the experience of the mechanical application of rigid rules as to the effects of non-validity was not at all encouraging. Certainly one would expect that as a rule a contract which is clearly illegal would not be subject to specific performance and that as a rule one would not obtain an award of damages. But there are situations in which one party does not know facts which are relevant as to whether the contract is of a prohibited kind so that the transaction is clearly illegal from one side but not necessarily clearly illegal from the other. Moreover in other situations one might allow part of the contract to be enforced and part of the contract to remain with no effects. As to the restitutionary remedies that could be granted, he wondered whether he should deal with them in the context of the chapter on illegality or whether it was the task of the Rapporteur on unwinding of failed contracts.

224. Concerning this last issue, Bonell recalled that last year it had been agreed that for the time being the Rapporteur on unwinding of failed contracts should abstain from

dealing with the effects of illegal contracts as also with the effects of the occurrence of a resolutive condition and other cases of failure of a contract. On the contrary the Rapporteurs on conditions and on termination for just cause should produce preliminary rules also on this aspect so as to permit at a later stage an exchange of views with the Rapporteur on unwinding of failed contracts in order to compare their respective approaches and finally decide whether to have the effects dealt with in a separate specific chapter or in connection with each type of failure.

225. With respect to the Rapporteur's suggestion not to deal with competition and speculative transactions, Fontaine wondered what this actually meant. One might well refrain from mentioning for instance restrictive trade practices as examples of illegal contracts but this could hardly mean that within the system of the Principles such practices are admitted even though for instance the relevant prohibitions of EC law are applicable.

226. Furmston agreed that a contract between a French and a German company which is clearly contrary to European competition law ought to be invalid also under the Principles. His suggestion not to mention expressly violations of anti-trust law was simply prompted by the fact that for instance the same contract between Chilean and Argentinian companies could be perfectly valid since the EC law would not apply.

227. Jolivet thought that even within Europe the situation was far from clear as demonstrated by a recent case between a French and a Belgian company in which the contract had been considered invalid in Belgium by Belgian courts but not by the French courts which had granted the exequatur to the award. In international arbitration the issue of illegality for violation of competition law was in general rather controversial and this in particular as far as the question of whether such issues should be raised *ex officio* by arbitrators.

228. Asked by Furmston which law governed the transaction concerned, Jolivet answered that as far as he could recall it was Dutch law.

229. Raeschke-Kessler recalled the case the Group had discussed last year, i.e. an arbitration case between a French and a German company governed by Swiss law; neither of the parties pleaded European competition law before the arbitral tribunal sitting in Switzerland; only after the arbitral tribunal had issued its award did the losing party find out that it could have raised the issue of violation of European competition law and bring the case before the Swiss Federal Court for annulment of the award; yet the Swiss Federal Court did not annul the award on the ground that European competition law was not considered to be part of the Swiss *ordre public international*.

230. Hartkamp pointed out that a Dutch court would certainly declare *ex officio* a contract violating European competition law null and void. It would also annul an arbitral award where competition law has not been taken into consideration. But it is not certain that an arbitral tribunal sitting in the Netherlands would be under a duty to apply European competition law *ex officio* because to do so might be considered to be outside its mandate. He, like Fontaine, personally felt however that the arbitral tribunal should have applied European competition law because otherwise there is a risk that the State court will set aside the award.

231. Date-Bah wondered whether with respect to speculative transactions there was really universal consensus as to their illegality and thought that, contrary to the case of the violation of competition law, they should not even be mentioned in the comments as an

example of illegality since there might well be regions in the world where they are perfectly valid.

232. Chappuis agreed completely with Furmston's insistence on a flexible approach concerning the effects of illegality. With reference to Article 15:102 PECL which in this respect indicates four possible solutions, i.e. full effect, some effect, no effect, or be subject to modification, she pointed out that a party which was unaware of the facts giving rise to illegality had a further possibility, i.e. to choose between avoidance and non-avoidance of the contract.

233. Finn, while in general agreeing with Chappuis, pointed out that there were however situations where the ignorance of one of the parties should be totally irrelevant and as an example mentioned the organisation of child sex tours to south east Asia, guest worker activities, etc., all commercial transactions but with a particularly vicious underlying purpose.

234. Hartkamp also agreed with Chappuis but felt that it was sufficient to mention it in the Comments.

235. Bonell closed the discussion and thanked the Rapporteur for his willingness to provide later on in the session a list of examples of possible illegality for discussion. On the basis of such a list the Group would certainly be in a much better position to define further the subject and the solutions to be adopted on the various aspects involved.

III. EXAMINATION OF THE POSITION PAPER ON UNWINDING OF FAILED CONTRACTS (UNIDROIT 2007 – Study L – Doc. 100)

236. In introducing his position paper Zimmermann recalled that the present version of the Principles already contained rules dealing with the topic, namely in the context of avoidance and of termination. These rules were largely identical but left a number of questions unanswered. Moreover, as discussed last year, there were also other situations where a contract has failed with respect to which however the Principles did not provide a restitution regime. Such situations were for instance hardship, failure to reach agreement, invalidity as a result of illegality and occurrence of a resolutive condition. Since most of these situations have not yet been dealt with he had focused in his paper on avoidance and termination. Instead of going through the entire paper which he was sure the members of the Group had already read, he suggested proceeding directly to an examination of the draft rules proposed at the end of his paper in paragraph 47.

237. Bonell thought there was great merit in this approach, on the understanding however that the basic question, i.e. whether to deal with the effects of the various types of failure of a contract in a separate specific chapter and possibly in a unitary manner or whether they should be dealt with in the context of the chapters dealing with the respective types of failure, maybe even in a different manner, was still open and should only be decided by the Group after having discussed the draft rules proposed respectively by Zimmermann and by Dessemontet in their position papers and those rules still to be submitted by Furmston and Fauvarque-Cosson.

238. Zimmermann agreed.

239. Introducing Rule 1 in paragraph 47 of his paper, Zimmermann pointed out that the rule basically reflects what is already stated in the Principles in Articles 3.17 (2) and 7.3.6.

240. Goode, while acknowledging that Zimmermann was merely suggesting a solution already provided in the Principles, wanted to raise a general question with respect to the effects of termination. Article 7.3.5 says – and this would certainly reflect also the English position – that termination of the contract releases both parties from their obligation to effect and to receive future performance, while it would not affect what has gone before. But then comes Article 7.3.6 imposing restitution thereby practically blurring any difference as to the effects between termination and avoidance, whereas in England one would on the contrary say that accrued rights and obligations are not affected by termination. In his view the rather peculiar approach adopted by the Principles stemmed from the fact that the paradigm case taken was the sales contract. Indeed in the context of a sales contract if a party terminates, this involves restitution. By contrast, if the cases where there are continuing performances were taken as the paradigm case, the rule would be that accrued rights and obligations are not affected by termination unless one party has failed to receive any part of what it had bargained for, in which case restitution would be appropriate. He wondered whether it was not preferable to change the system of the Principles and consider what is currently the rule, i.e. restitution, the exception and what is currently the exception, i.e. no restitution, the rule.

241. Zimmermann saw no logical inconsistency between Articles 7.3.5 and 7.3.6 because the former merely says what happens in the future. It does not say that this is the *only* effect of termination. On its part Article 7.3.6 says what happens as far as the past is concerned. He agreed with Goode's analysis as far as the paradigm case chosen but pointed out that he had thought that it was not up to him to propose a change in the basic approach taken in this respect by the Principles.

242. Widmer wondered whether Rule 1 and Rule 6 could be combined into one rule.

243. Raeschke-Kessler wondered whether Rules 1 and 6 adequately took care of the economic interests of the party who terminates a long term contract. That party may have terminated the contract for reasons which lie in the future and if it has to return what it has received, including the benefits, this might put it at a disadvantage.

244. Bonell, as a point of order, reminded the Group that Articles 7.3.5 and 7.3.6 had been adopted in the first edition of the Principles and have so far proved to be generally acceptable. He urged the Group not to re-open discussion on the two provisions unless there were compelling reasons to do so.

245. Chappuis felt that in general more consideration should be given to long term contracts, services contracts and other complicated contracts such as distribution agreements, etc. As to the effects of avoidance or termination she reminded that avoidance or termination were not necessarily the end of the contract as the parties may well have agreed on certain effects such as a duty of confidentiality arising after avoidance or termination.

246. Bonell recalled that Article 7.3.6 of the Principles and Rule 6 of Zimmermann's paper precisely addressed the peculiarity of contracts different from sales. As to the second remark made by Chappuis, it was along the lines of a remark made by Fontaine at the Group's previous session and the Group at that time had felt that the issue was one of party autonomy.

247. Zimmermann drew attention to Article 7.3.5 (3) which actually states that “termination does not affect any provision in the contract for the settlement of disputes or any other term of the contract which is to operate even after its termination”.

248. Goode just sought clarification about the rule according to which an innocent party who terminates the contract is required to give back all the benefits it has received. To him this meant that the guilty party can, by simply breaching the contract, force a situation in which it escapes from the effects of what has turned out to be an unprofitable bargain. In his view this was a real problem which should be addressed either in the black letter rules or in the comments.

249. Bonell seemed to remember that the problem was taken care of by the last words of Article 7.3.6 (1).

250. Zimmermann added that perhaps the comment could be even more explicit. On the other hand however he reminded Goode that the innocent party always has the right to claim only damages; if it decides also to terminate the contract, it should accept that performances already rendered will have to be returned.

251. Furmston felt that in a typical construction contract where the contract is terminated half way through for breach, it was quite hard to think of situations in which restitution would be helpful to the innocent party. He, like Goode, had difficulty accepting a system where restitution is the rule and only in the comment is it said that there might be cases where restitution is not possible or appropriate.

252. Bonell recalled that the system has been in place since 1994 and has not generally met with substantial criticism.

253. Finn agreed with both Goode and Furmston, but conceded that the formula “not possible or appropriate” used in Article 7.3.6 was sufficiently flexible to take care of the problem they raised. However, Rule 2 in Zimmermann’s draft mentions only the case where restitution is “not possible” and this in his view was not acceptable.

254. Zimmermann pointed out that if the Group wanted to adopt the same language used in Article 7.3.6, i.e. adding also a reference to the case where restitution is “not appropriate”, he had no difficulty doing so.

255. Finn thought that it was also a question of emphasis. Article 7.3.6 does not speak in dogmatic language; it uses the words “may” and “appropriate”. Rule 2 on the contrary states a dogmatic rule with exceptions. Maybe it was only a matter of emphasis but in his view the emphasis was of fundamental importance. In the wording of the Principles there is a sweet delight in a certain ambiguity and he thought it important to maintain it.

256. Gabriel pointed out that in case of a fundamental breach by one party there were basically three possible results. One is that the innocent party says “I’ll go ahead and accept the performance from the breaching party and sue for damages”. The second possibility is that the innocent party terminates the contract and just wants to walk away from it so that mutual restitution is appropriate. The third situation – and this was the one Goode had raised and that seemed to create problems – is an intermediate situation where the innocent party no longer wants to be in the contract and therefore terminates it but at the same time wants to retain the benefits it had received so far so that restitution would no longer be

appropriate. He thought that the language of Article 7.3.6 was flexible enough to take care also of that third situation.

257. Bonell wondered whether the problem could be solved simply by combining Zimmermann's Rules 1 and 2 into one provision and aligning its language along that of Article 7.3.6 (1).

258. Date-Bah and Fontaine agreed.

259. Zimmermann had no difficulty in following such a suggestion but asked for further enlightenment as to the kind of cases covered by the formula "not appropriate".

260. Furmston raised another question of principle which had not yet been discussed, i.e. whether it would be appropriate to have exactly the same rules for avoidance and termination. Rules 1 to 7 as they stand now were perfectly acceptable also to a common lawyer if they applied only to avoidance while this was not so if they were intended to apply also to termination.

261. Zimmermann wondered whether, with the addition of the words "not appropriate", Furmston would have the same difficulty.

262. Furmston denied that it was only his personal concern and insisted that at least in common law systems there was a substantial difference, as to the effects, between avoidance and termination. While in case of avoidance there is as a rule no claim for damages so that restitution is very important, in case of termination the innocent party will always have the remedy of damages and restitution is inevitably less important.

263. Bonell noted that this might be the reason why in Article 3.17 there is no mention of "if restitution in kind is not ... appropriate".

264. Crépeau drew attention to another important difference between Article 3.17 and Article 7.3.6, i.e. the exception provided for by Article 7.3.6 (2) with respect to long term contracts.

265. Goode acknowledged that Article 3.17 on the one hand and Articles 7.3.5 and 7.3.6 on the other had been adopted from the very beginning and should therefore not be changed if there were no very strong reasons to do so. However, he had great difficulty in understanding a system which first states that "Avoidance takes effect retroactively" (Article 3.17) while "termination releases both parties from their obligation to effect and to receive future performance" (Article 7.3.5 (1)), but then grants restitution also in case of termination (Article 7.3.6) thereby providing also for the latter the effect of retroactivity. He suggested that at least the comment should make it clear that in actual business life there are a great many cases in which restitution would be absolutely unfair to the innocent party because it would actually give a premium to the guilty party's position.

266. Bonell noted that at present Comment 2 to Article 7.3.6 is rather cryptic ("this is so in particular when the aggrieved party has received part of the performance and wants to retain that part") and wondered whether Zimmermann was prepared to develop it a bit more in the light of the discussion which had taken place during this session.

267. Zimmermann agreed but asked assistance from Goode for this purpose because he still was not absolutely certain how to describe the cases Goode had in mind.

268. Bonell suggested that the new comment to the envisaged unitary rule on the effects of avoidance and of termination should also take into account Furmston's statement according to which restitution was essential only in case of avoidance while in case of termination damages may well be sufficient.

269. Zimmermann had no difficulty with such an approach. In his view however even in case of avoidance restitution might exceptionally "not be appropriate".

270. Zimmermann then went on to explain another novelty in his draft, i.e. that not only the performance(s) received but also the benefits derived from such performance(s) have to be returned (Rule 1; cf. also paragraph 9 of his paper). The admittedly ambiguous term "benefits" had been taken from CISG (Art. 84): it included the fruits of an object (both the natural fruits and the proceeds supplied by an object or a right by virtue of a legal relationship) and the advantage of being able to use an object. The rationale of the rule was that if an object has to be returned, it has been retained without good cause and consequently that also all the benefits deriving from that object have to be returned.

271. Crépeau supported the proposed rule but wondered whether one should go further and add - in the light of the general principle of good faith laid down in Article 1.7 - a rule similar to what is stated in Article 1704 of the Civil Code of Québec according to which the fruits and revenues of the property being restored belong to the person who is bound to make restitution provided that he is in good faith, i.e. did not know the reason for the invalidity.

272. Bonell just noted that Article 1.7 referred to good faith in an objective sense, while Article 1704 of the Civil Code of Québec apparently referred to the subjective state of mind of a party, i.e. the knowledge or lack of knowledge of the facts leading to the avoidance of the contract.

273. Finn was not sure he had fully understood Zimmermann's proposal. He made the example of a software development contract where the software is prepared in modules which ultimately will be integrated but some of which are capable of commercial exploitation even before integration and are actually commercially exploited by the purchaser of the software. If the contract is terminated, would the benefits from the commercial exploitation of the modules have to be returned under the proposed rule, even though the commercial exploitation may have taken considerable effort and skill on the part of the purchaser.

274. Zimmermann said yes, but asked for comments on Crépeau's proposal which differed from his own proposal.

275. Chappuis thought it was not a good rule; at most she could accept a reference to the general principles of good faith and the prohibition of inconsistent behaviour as possible limitations to the rule proposed by Zimmermann.

276. Fauvarque-Cosson felt that a reference to Article 1.8 was sufficient, since what was at stake in the case under discussion was the prohibition of inconsistent behaviour, i.e. that a party may not ask restitution of the benefits if it knows that the other party had reasonably acted in reliance on the validity of the contract.

277. In the light of the discussion Bonell wondered whether the Group could agree on a reference to Articles 1.7 and 1.8 in the comments: after all this would be in line with a

drafting technique frequently used throughout the Principles, while if such reference were included in the black letter rule itself one might have to reconsider all the other provisions of the Principles which too have to be read in the light of the general principle of good faith but where this is stated only in the comment.

278. Widmer agreed.

279. Raeschke-Kessler preferred to mention the possible exception to the rule proposed by Zimmermann in the black letter rule itself, e.g. using a formula such as “whenever appropriate according to the circumstances of the case” or the like.

280. Garro agreed that a reference in the comment to Articles 1.7 and 1.8 would be sufficient but he could also accept additional language in the black letter rule as suggested by Raeschke-Kessler if this was felt necessary by some members of the Group.

281. Komarov preferred additional language in the black letter rules.

282. Goode confessed to having great difficulty in following the entire discussion and asked for clarification. If one party delivers defective goods, thereby committing a fundamental breach, the innocent party has a right of termination: why is it suggested that this party must have acted in good faith, i.e. not have been aware of the defects, in order to retain the benefits of the goods received? In his view, if this party had known of the defects, it would not be entitled to terminate at all.

283. Crépeau gave the following example. A sells a property to B and A knows that it can avoid the contract while B thinks that the contract is perfectly valid. B receives the property which while in B's possession produces natural and/or civil fruits. When B avoids the contract B is under a duty to return the property but, being in good faith, should be able to keep the civil or natural fruits the property produced.

284. Bonell felt that at this stage of the discussion the Group should first decide on the proposal made by the Rapporteur, i.e. that also the benefits have to be returned, and that only if this proposal is carried should further consideration be given as to whether the proposed rule should be further qualified as proposed by Crépeau.

285. Gabriel and Uchida were in favour of Zimmermann's proposal.

286. Hartkamp too favoured the proposal but was also in favour of the qualification suggested by Crépeau. In reply to Goode he made the following example. In case of sale of goods a buyer uses the goods delivered and only two months later discovers a defect. In the first two months the buyer is what Crépeau called a good faith purchaser whereas if after the discovery of the defects and during the unwinding of the contract it continues to use the goods it would be in bad faith. In other words it is still entitled to terminate the contract but together with the goods it must return the benefits it had received from them after the discovery of the defects.

287. Zimmermann, while noting that there was a large majority in favour of his proposal, urged the members of the Group to make up their minds as to the addition suggested by Crépeau.

288. Gabriel was hesitant about re-opening the discussion on Zimmermann's proposal but thought a distinction should be made between different kinds of benefit. He made the

example of the purchase of a car. The buyer uses the car for six months, after which he discovers a serious defect and terminates the contract. There can be no doubt that the buyer has to return the car, as well as to pay for the value of the personal use of the car for six months; on the contrary the buyer would not be bound to return the profits he made by using the car as a taxi.

289. Zimmermann, asked by Bonell to express his views on this example, said he would rather tend to include also the profits among the benefits which have to be returned. In any case he thought that the term “benefit” which he had taken from CISG was a rather ambiguous term which needed to be further explained in the comments.

290. Bonell urged the members of the Group to express their views on Crépeau's proposal to make restitution of the benefits dependent on the bad faith of the innocent party.

291. Widmer, Raeschke-Kessler and Uchida were in favour of Crépeau's proposal while Goode was against it.

292. Hartkamp suggested that the Group take a final decision only after the Rapporteur has submitted his comparative survey on this issue.

293. Fontaine agreed with Hartkamp and suggest that the Rapporteur not only make a comparative analysis but also give examples taken from different types of contracts and concerning not only avoidance but also termination.

294. Goode reiterated his difficulty in understanding Crépeau's proposal with respect to termination for breach of contract.

295. Bonell hoped that not only Crépeau himself but also Chappuis, Raeschke-Kessler and other members and observers who supported Crépeau's proposal would submit examples to the Rapporteur by e-mail so as to permit him to take them into account when preparing his draft for the Group's next session.

296. Passing to paragraph 2 Zimmermann drew attention to a proposed departure from the present text of the Principles, i.e. the use of the formula “compensation for value” instead of “allowance”. The reason for his preference for the new formula was that “allowance” was extremely vague while “compensation for value”, at least if – as he suggested - value is understood as the market value, was much more precise.

297. Bonell seemed to remember that it was precisely because of its flexibility that the term “allowance” had been chosen in the present text of the Principles.

298. Date-Bah was not sure that the formula suggested by the Rapporteur was necessarily more precise since “value” may well be understood in a subjective sense.

299. Perales Viscasillas too preferred the term “allowance” precisely because it was flexible enough to mean also compensation for the market value as shown by Illustration 3 to Art. 7.3.6.

300. Widmer objected that at least Illustration 4 to Art. 7.3.6 leads one to conclude that “allowance” referred to a subjective value.

301. Finn wondered whether the term “allowance”, used in the Principles since their appearance in 1994, had met with any substantial criticism. If not he saw no reason for changing it. Moreover he definitely favoured the additional language “whenever reasonable” which appears in Article 7.3.6 (1) but not in the Rapporteur’s draft.

302. Zhang on the contrary supported the change suggested by the Rapporteur.

303. Uchida too supported the Rapporteur’s proposal. He pointed out that when translating the 1994 version of the Principles into Japanese, he had great difficulty in understanding the concept of allowance.

304. Goode raised a general point of principle. He thought that when something in the text has been around for a long time, it should not be changed unless there were very compelling reasons for so doing.

305. Hartkamp felt that since the Group was discussing a new draft on restitution it should not be bound to stick at all costs to the wording of the present text of the Principles.

306. Fauvarque-Cosson recalled that the French version used the term “restitution ... en valeur” thereby confirming that “allowance” does not necessarily exist as a legal concept in other languages.

307. Bonell referred to the Italian version where on the contrary “allowance” had been deliberately translated as “indennità” and not “valore”.

308. Zhang insisted on the extreme vagueness of the term “allowance” and reiterated his preference for “compensation for value”.

309. Gabriel pointed out that the Uniform Commercial Code regularly speaks of allowance and that this has not given rise to any problems.

310. Asked by Zimmermann what allowance meant in U.S. law, Gabriel answered that it basically corresponded to “value” either in a subjective or objective sense, depending on the circumstances.

311. Hartkamp did not care so much whether the term “allowance” or “value” was used, provided that it was clear what was meant. He recommended the adoption of a more precise formula in the black letter rule itself and suggested choosing between “the market value of the performance” or “the value which the performance has had for the receiving party”.

312. Fontaine, like Hartkamp, did not think that simply by substituting “value” for “allowance” the provision would be more precise. In his view it was not advisable to speak in the text merely of “value” and to add in the comments that it means “market value”, since there are in fact many different types of values that could be taken: market value, subjective value, value of replacement, book value, rebuilding value, value taking depreciation into consideration, and so on. He suggested that the Group should first decide whether it wanted to stick to the present approach of flexibility or preferred to be more precise; in the latter case it should then think of a more precise formula than just “compensation for value”. He himself preferred to retain the term “allowance”.

313. Crépeau and Widmer agreed with Fontaine.

314. Goode too favoured retaining the term “allowance” also in view of the fact that a market value does not exist in all cases. However, like others, he favoured more explanation as to the possible meanings of allowance in the comments.

315. Gabriel and Komarov agreed.

316. Zimmermann stated that he would be happy to go along with the majority view. As to the requested additional explanation in the comments about possible different meanings of the term “allowance” he asked Gabriel to provide him with further information concerning U.S. law.

317. Proceeding to explain why he did not retain the additional words “whenever reasonable” appearing in Article 7.3.6 (1), Zimmermann pointed out that he had done so because Article 3.17 did not contain these words and he thought that the two texts should be aligned. If the Group thought that they should be kept, he was however quite prepared to do so provided that this should apply also to avoidance.

318. Bonell seemed to remember that there was no special reason for not including the words “whenever reasonable” also in Article 3.17.

319. While Widmer was not in favour of having these additional words, Goode, Finn, Lando and Raeschke-Kessler were.

320. It was decided to have the words “whenever reasonable” with respect to both avoidance and termination.

321. Introducing Rule 3 dealing with the question as to who should bear the risk of accidental destruction or deterioration of the goods while they are in the possession of the party who eventually has to return them, Zimmermann pointed out that there were two basic questions to be settled: first, who should bear the risk? Secondly, how should the chosen risk regime be implemented? As to the first question, he suggested that the risk should be born by the person who is in control of the object when the destruction or deterioration occurs, i.e. the purchaser, or more generally the person who is in possession of the object. As to the second question, he suggested adopting a flexible solution, i.e. still to permit avoidance or termination but to provide that, if restitution in kind is no longer possible, the purchaser pays compensation for value unless the destruction or deterioration is attributable to the other party.

322. Goode had difficulty following Zimmermann’s arguments and expressed doubts as to the appropriateness of choosing sales contracts as the paradigm case in the context of restitution. He wondered how the rule suggested by Zimmermann would match with the rules on the passing of risk in CISG.

323. Zimmermann explained that the proposed rule was intended to apply not only to sales contracts but to all types of contracts which involve a property transfer and as such pose the problem of who should bear the risk for accidental destruction or deterioration of the goods if they have to be returned.

324. Goode made the example of a sales contract where the seller had delivered defective goods thereby allowing the buyer to terminate the contract but the goods were destroyed at a time when according to the applicable rules on the passing of risk the risk had

passed to the buyer. Supposing that the destruction or deterioration was not attributable to the other party but was a pure accident, Rule no. 3 which says that “in cases of destruction or deterioration the recipient of the performance does not have to pay compensation if, and in so far as, the destruction or deterioration is attributable to the other party” would not apply. Did that mean that in such a case the buyer still had to pay the price? If this was so, it would be contrary to the applicable rules on the passing of the risk under the sales contract, according to which the buyer would not have to pay the price since he had a right to reject the defective goods from the start and this right would not have been lost even if the goods were later destroyed.

325. According to Zimmermann if neither the seller nor the buyer can be blamed for the destruction of the defective goods, Rule no. 2 would apply which states that “If restitution in kind is not possible, compensation for value has to be paid”.

326. Goode objected that this was nowhere stated and insisted that the case where the buyer had received defective goods and had not yet paid the price when the goods were accidentally destroyed was still unsettled by the Principles. In his view in such a case the risk would not have passed since due to the defective nature of the goods the buyer had actually a right to terminate the contract.

327. Bonell thought that as long as the contract has not been terminated – as was the case in Goode’s example – the passing of the risk was governed by the applicable sales law, while Zimmermann’s rules related to the situation where the contract had been terminated. If the buyer had already paid the price it may claim it back, while if it has not paid the price it is no longer bound to do so. Zimmermann’s rule was only concerned with the question of who should bear the risk of an accidental destruction of the goods which as a consequence of termination should be returned to the seller.

328. Hartkamp agreed: if the buyer has terminated the contract because of the defects in the goods, and the goods cannot be returned because they have been destroyed by an Act of God, the buyer does of course not have to pay the price but according to the proposed rule in the chapter on restitution he has to pay the value of the goods received. One may like the rule or dislike it, but the rule as such is quite clear.

329. Furmston expressed doubts as to the appropriateness of the rule proposed by Zimmermann.

330. Raeschke-Kessler on the contrary supported the proposed rule which in his view was the only economically sound one since the risk should be placed on the party who having control over the goods is in the best position to ensure the goods against accidental destruction or deterioration.

331. Since the language “compensation for value has to be paid” used in Rule no. 2 had given rise to some misunderstanding Bonell wondered whether the Rapporteur was prepared to replace it by “allowance” so as to make it clear that such obligation had nothing to do with the obligation to pay the price under the contract.

332. Zimmermann agreed.

333. Furmston gave the example of a contract for 1000 tons of wheat to be shipped in February. The seller ships 1000 tons of wheat on the first of March and tenders documents including the insurance policy which the buyer however properly rejects on the grounds that

the goods are not in conformance with the contract. The ship on which the goods are carried is then sunk by an event which is not attributable to either the seller or to the buyer. The seller is entitled to payment of the insured amount, so why should the buyer be obligated to pay the price or even only to account for the value of the goods lost?

334. Lando shared Furmston's concern: if a person has committed a fundamental breach, it should take the consequences of what happens to the goods after its breach of the contract.

335. Hartkamp pointed out that also under Dutch law the solution would be different from the rule proposed by the Rapporteur: the buyer's obligation to return the goods is in principle governed by the same rules which generally apply to contractual obligations, i.e. if the buyer is not able to perform that obligation he is liable to pay damages except where the impossibility to perform is not attributable to him in which case he would not have to pay any compensation.

336. Zimmermann observed that the case under discussion was expressly addressed in paragraph 34 of his position paper stating that "What happens if the object deteriorates, or is destroyed, *after* the contract has been terminated? After termination, the purchaser is under a duty to return the object received. Any non-performance of that duty gives the seller a right to claim damages according to Art. 7.4.1 unless the non-performance is excused under Art. 7.1.7 (*force majeure*). In other words: from the moment of termination the normal rules on non-performance apply". In other words, exactly the same solution is envisaged that Hartkamp and Lando have proposed.

337. Finn just wanted to ask a question by way of clarification. Article 7.1.1 defines non-performance as a "failure by a party to perform any of its obligations under the contract". Is an obligation that arises in consequence of termination and on the election of a party properly described in your legal systems as an obligation "under the contract". I just don't know. It wouldn't be regarded as an obligation under the contract in my country any way.

338. Lando asked Zimmermann to explain the difference between the rule he was proposing and the solution adopted in this respect by CISG.

339. Zimmermann referred to paragraph 26 of his position paper where he had explained the reasons for not following CISG in this respect. CISG operates with a device of excluding the right of termination if the object has deteriorated or has been destroyed. This is an all or nothing solution. He thought a more flexible solution was more appropriate, particularly for cases of deterioration.

340. Hartkamp objected that it was not clear at all that the draft Rules no. 1, 2 and 3 were concerned only with the case where the goods are destroyed after termination. He would anyhow suggest adopting the same solution in all cases where the goods have been destroyed by an event for which the buyer is not responsible, irrespective as to whether the destruction occurred before or after termination, and the rule should be that the buyer should not be liable to pay the value of the goods to the seller if the seller has breached the contract.

341. Zimmermann pointed out that in his paper he was dealing only with the situation envisaged by Article 82 CISG, i.e. where the goods were destroyed before termination has been declared, while for the reasons indicated in paragraph 34 he did not specifically address

the situation where the goods were destroyed after termination: in this case he thought that the normal rules of non-performance would apply. If the Group so wished he could add an express provision to this effect in his draft.

342. Lando wondered what the situation would be where an arbitral tribunal has to decide on the basis of the Principles a dispute relating to a sales contract between two parties situated in two different contracting States of CISG. Would they have to apply Article 82 CISG or the different rule proposed by the Rapporteur?

343. Bonell felt that if the parties have expressly stipulated the application of the Principles, they would prevail over CISG, Article 82 included. On the contrary, if there was no express choice of the Principles as the applicable law and the arbitral tribunal intended to apply them merely because it considered them an expression of the *lex mercatoria* or the like, CISG, as the *lex specialis*, should prevail.

344. Goode insisted that the Principles should apply the same rule as CISG, i.e. to put the risk of deterioration or destruction of the goods on the seller, unless the deterioration or destruction was due to an act or omission of the buyer.

345. Furmston recommended not limiting discussion to sales contracts. He gave the example of a contract to construct a building and half way through the construction the contractor goes bankrupt and the contract comes to an end. The building is not only unfinished but also damaged. In practical terms he thought the solution would depend on the insurance arrangements since it was inconceivable that contracts of that kind do not contain provisions about who is to insure the building between the time construction starts and the time it finishes. Normally, at least in England, it would be the contractor who would be under the duty to insure, maybe even in the joint names of the employer and the contractor, with the consequence that the issue so far discussed would be totally academic.

346. Widmer admitted that after hearing these last interventions he rather supported Goode's and others' view that it should be the party in breach who should bear the risk.

347. Komarov on the other hand supported the rule suggested by Zimmermann and explained in paragraph 34 of his paper provided that it was made clear that it was applicable only to situations in which deterioration or destruction takes place before termination, while after termination the normal rules on non-performance of the contract would apply.

348. Bonell wondered whether in view of the different opinions expressed during the discussion the Rapporteur was prepared to revise his draft rules and to present two alternative draft rules concerning risk.

349. Zimmermann agreed.

350. Finn felt that the question of when risk passes varies from contract type to contract type so that it was impossible to cover all situations with a single rule. He therefore suggested considering the adoption of a very flexible rule that would accommodate all situations that might occur in practice. Such rule could state that in case of destruction or deterioration the recipient of performance does not have to pay an allowance if the destruction or deterioration is attributable to the other party unless it would be appropriate in the circumstances to pay such allowance.

351. According to Fauvarque-Cosson one could go even further and decide not to have a rule at all dealing with the question of risk, thereby allowing the greatest possible degree of flexibility.

352. Fontaine and Date-Bah expressed their support for Finn's approach.

353. Zimmermann agreed to take account of Finn's proposal as a third alternative solution but asked Finn to provide him with an actual draft proposal.

354. Proceeding to Rule 4 stating that an allowance also has to be paid for the benefits that a party has failed to derive from the performance in accordance with ordinary business practice, Zimmermann referred to paragraph 16 of his paper for further explanation. He did not feel strongly about the rule but simply wanted to draw the Group's attention to a potential problem under discussion in connection with CISG which is silent on the matter. An example where the rule would apply would be the case of a seller who keeps the money received from the buyer in its pocket instead of depositing it in a bank: in such a case the seller would nonetheless be obliged to return the contract price together with interest.

355. Lando felt that the cases envisaged by Rule 4 were not so important as to justify having such a rule in the Principles.

356. Goode found the whole rationale behind the proposed rule difficult to accept. Taking again the example given by Zimmermann, why should the seller have to return the price plus interest as from the moment it received the money and not only after the obligation to return the price arises? He therefore definitely favoured the deletion of proposed Rule 4.

357. Perales Viscasillas recalled that also Article 84 (1) CISG provides that "If the seller is bound to refund the price, he must also pay interest on it, from the date on which the price was paid".

358. Zimmermann confirmed that Article 84 (1) CISG had been the inspiration for Rule 4 but precisely for the reasons pointed out by Goode, he had added the proviso that the rule applies only on the condition that the party concerned knew or ought to have known of the ground for avoidance or termination.

359. Fauvarque-Cosson was against Rule 4. After all it was one thing to impose restitution of the price plus interest but quite another to impose an allowance for all kinds of benefits a party could have gained from the performance but failed to do so.

360. Gabriel agreed with Fauvarque-Cosson.

361. Zhang, Uchida and Komarov on the contrary were in favour of keeping Rule 4.

362. Crépeau was content with the general rule expressed in Rule 1.

363. Widmer, though not initially being in favour of a provision of the kind envisaged in Rule 4, wondered whether it was necessary in order to maintain consistency with the general rule that benefits have to be returned. Indeed, why should a party who has been able to derive benefits from the performance received have to return them while a party who has not attempted to obtain any benefit at all gets away with simply returning the performance.

364. Gama cautioned that ordinary business people also lose money so that there should not be a presumption that they would always receive a benefit from it.

365. In the light of the discussion Bonell thought that the majority of the Group was against proposed Rule 4.

366. Zimmermann wondered whether the same majority would also be against a rule like Article 84 CISG concerning restitution of interest only.

367. Lando and Fauvarque-Cosson were in favour of such a limited rule on interest.

368. Finn on the contrary was against it and warned against the Principles becoming excessively regulatory.

369. Widmer, Date-Bah and Fontaine agreed.

370. Goode pointed out that since, contrary to CISG, the Principles in Article 7.4.9 already state that if a party does not pay a sum of money when it falls due, the aggrieved party is entitled to interest, there was no need for the proposed Rule 4. Indeed it follows already from Article 7.4.9 that in the cases so far discussed the seller would have to return the price plus interest as of the moment the obligation of restitution arises.

371. In the light of the discussion Bonell concluded that there was insufficient support for proposed Rule 4.

372. Zimmermann then explained the rationale behind Rule 5 and the Group decided to keep the rule but to replace the words “expenses incurred on the object received” with “expenses linked to the performance received”.

373. In introducing Rule 6, Zimmermann pointed out that essentially it had been taken from Article 7.3.6 (2). However he suggested introducing two modifications: first of all to extend the rule laid down in Article 7.3.6 also to include restitution after avoidance; secondly to subject the rule that restitution may only be claimed for the period after avoidance or termination not only to the condition that the contract be divisible but also to the further condition that “neither of the parties has a reasonable interest in the mutual restoration of the past performances”. An example thereof was given in paragraph 43 of his paper: A contracts regularly to service B’s fire engines; after 3 years it turns out that A has not in fact regularly serviced the fire engines but has only done the barest minimum to keep them going; if B terminates it would not be fair to leave matters as they are as far as the past three years are concerned since B has paid much more than the value of the services it has received.

374. With respect to the first suggested modification Goode thought that in case of avoidance there was no point in distinguishing between the past and the future and that everything should be unwound. With respect to the second suggested modification, he felt that it was just a question of damages which the party who has received less than it had paid for was entitled to.

375. The Group agreed with Goode concerning the second modification while, with respect to the first, it asked the Rapporteur to amend the rule as presently worded and to submit the new draft rule to the Group at its next session.

376. In introducing Rule 7, Zimmermann recalled that the principle of concurrence of restitution was already stated in Articles 3.17 (2) and 7.3.6 (1). However since it had been decided that also benefits derived from the performances have to be returned, the question arose as to whether also the restitution of such benefits has to be made concurrently. In his view the answer could only be in the affirmative.

377. Finn wondered whether the principle of concurrence could work in case of termination of a complex joint venture agreement.

378. Fauvarque-Cosson wondered whether Finn's point would be met by adding the words "insofar as it is reasonable".

379. Fontaine drew attention to Article 6.1.4 (1) which, with respect to order of performance in general, provides that "To the extent that the performances of the parties can be rendered simultaneously, the parties are bound to render them simultaneously unless the circumstances indicate otherwise". Admittedly Rule 7 referred to a particular context but he thought that the language used in Article 6.1.4 (1) could be taken as a source of inspiration for rewording the proposed Rule 7.

380. Bonell wondered whether a reference in the comments to the general rule laid down in Article 6.1.4 (1) would be sufficient.

381. Chappuis asked whether the Rapporteur was prepared to address also the unwinding of illegal contracts.

382. Zimmermann thought it would be best to proceed inductively and first to develop a model on the basis of the two main cases that have already received some attention in the Principles, i.e. avoidance and termination. This model, once agreed upon, could then be tested against other cases such as when a contract has been concluded, when resolute conditions have occurred, hardship and of course also illegality, the most important one.

383. In closing the discussion Bonell first of all thanked, also on behalf of the Group, Zimmermann for the excellent work he had done. He then recalled that the Group had already decided to ask the Rapporteurs on the chapters on conditions, illegality and termination for just cause to include in their drafts also tentative provisions on the effects of such failures of the contract.

IV. EXAMINATION OF THE POSITION PAPER ON CONDITIONS (UNIDROIT 2007 – Study L – Doc. 103)

384. In introducing her paper, Fauvarque-Cosson recalled the preliminary discussion the Group had had on the topic at its previous session. In the light of that discussion she had listed the various questions that could be addressed in the envisaged chapter on conditions and it was now up to the Group to consider them more in depth so as to permit her to produce a preliminary draft for the Group's next session.

385. With respect to terminology, Gabriel suggesting adopting the same approach as that taken in Article 16:101 PECL, i.e. defining the concepts of suspensive and resolute conditions in such a way that they are easily understood and then putting in parentheses the respective terms.

386. Akhlaghi asked for some clarification as to the difference between “conditions” and “terms”.

387. Bonell recalled the lengthy discussion the Group already had on this matter at its previous session - which Akhlaghi had unfortunately been unable to attend - and the outcome of which was recorded in the report on that session (UNIDROIT 2006 – Study L – Misc. 26, paragraphs 192-211). He expressed the hope that the discussion would not be re-opened.

388. Komarov suggested that for the sake of clarity the title of the chapter should be “conditional obligations” and not simply “conditions”.

389. Goode agreed.

390. Uchida objected that “conditional obligations” was too narrow since also rights might be conditional.

391. Crépeau observed that in the civilian tradition the term “obligation” included both rights and duties and in support of Komarov’s proposal recalled that also the Civil Code of Québec spoke of “conditional obligations” (cf. Articles 1497 *et seq.*).

392. Uchida agreed in principle with Crépeau but added that he had in mind the case where a condition was attached to the right to terminate the contract and wondered whether such a case should be dealt with in the chapter on conditions.

393. Fauvarque-Cosson asked for further comments on Gabriel’s suggestion to use the same terminology and structure as that of Article 16:101 PECL.

394. Goode, Widmer, Finn, Fontaine and Date-Bah supported Gabriel’s suggestion.

395. Chappuis, while agreeing on the advisability of having a definition of the two kinds of condition, expressed a preference for the terms “condition precedent” instead of “suspensive condition” and “condition subsequent” instead of “resolutive condition” which in her opinion were better known at international level.

396. Lando recalled that PECL used the terms “suspensive” and “resolutive” conditions and that the Rapporteur for the chapter on conditions was a common lawyer (Michael Bridge).

397. Crépeau too preferred the terms “suspensive” and “resolutive” conditions.

398. Garro on the contrary thought that in the English version of the Principles the terms “condition precedent” and “condition subsequent” should be used since they were the terms of art used in the common law jurisdictions.

399. Bonell observed that at least the US Restatement did not use the term “conditions subsequent”.

400. Chappuis, referring to the work of the *Group de travail contrats internationaux*, pointed out that the terms “condition precedent” and “condition subsequent” were the ones most frequently used in international contract practice.

401. Gabriel explained that the Restatement does not use either the terms condition precedent or condition subsequent but provides a definition of these two kinds of condition.

402. It was decided to have an open provision defining the two kinds of condition followed respectively by the qualifying terms “suspensive condition” and “resolutive condition” in brackets.

403. Passing on to the scope of the envisaged chapter on conditions, Fauvarque-Cosson asked whether the Group thought that the matters listed in her paper at pages 10-12, i.e. impossible or unlawful condition, discretionary condition, conditions implied by courts or imposed by law, time limit, renunciation, burden of proof, should be specifically addressed.

404. With respect to the first item (“impossible or unlawful condition”), Brödermann gave two examples of what in his experience was an extremely frequent situation in international contract practice. The first related to contracts for the use of certain equipment for data transmission in outer space where the parties want to make sure that it will be used only for legal purposes. Was this a condition and how should it be expressed in the contract? The second example concerned the vast category of State contracts where in the course of negotiations an intermediary may show up asking for the payment of a “commission” and the other party wishes to make sure that if paid the requested sum of money will be used only for legitimate purposes. Again, was this a condition and how should it be expressed?

405. Finn wanted to know whether in the examples given the parties merely intended to put some limitations on the manner of performance of the contract so that a violation of the respective contract clause would amount to a breach of the contract or alternatively wanted to subject the contract to a veritable resolutive condition the occurrence of which would put an end to the entire contract.

406. Widmer wondered whether in the examples given by Brödermann it was really a question of conditions and not of charges or what in German law are called “*Auflagen*” which qualify an obligation to the effect that their non fulfilment would amount to a breach of contract. This showed how important it was to have a clear definition of “conditions” in the Principles.

407. Garro agreed and referred to the remarks made by the Rapporteur on this subject at the bottom of page 7 of her paper.

408. Zimmermann pointed out that it had to be decided on a case by case basis whether the parties intended to subject their contract to a real condition or merely to impose on one of the parties a charge. He too thought that the distinction between the two situations had to be addressed in the Principles, either in the black letter rules or in the comments.

409. With respect to unlawful conditions, Lando thought that it was not necessary to deal with them since there was no difference between an illegal contract and a contract subject to an illegal condition so that the subject would already be taken care of by the envisaged chapter on illegality.

410. Garro agreed.

411. Zimmermann pointed out that in any event the very notion and the effects of “unlawful” conditions had to be aligned with the notion and the effects of “illegal” contracts to be dealt with in the envisaged chapter on illegality. As to impossible conditions, he felt that there was no need to deal with them: a condition was a future and uncertain event whereas an impossible “condition” was not uncertain at all and could therefore never be considered a real condition.

412. Fontaine agreed with Zimmermann on this last point. With respect to unlawful conditions the real problem was whether or not they should affect the whole contract. The OHADA draft adopted the first solution but for instance Swiss law made the effects dependent on the intention of the parties. He thought that the issue should be addressed in the envisaged chapter on conditions.

413. Gama partly disagreed with Zimmermann regarding impossible conditions. While Zimmermann was right with respect to legally impossible conditions, as far as materially impossible conditions were concerned he gave the example of a bank guarantee subject to the resolutive condition that the beneficiary gives notice of the other party's default within 48 hours. What if in a given case the beneficiary due to circumstances not attributable to it was not in a position to get the relevant information of the other party's default within 48 hours of the occurrence of the default? Should the condition be considered as fulfilled and therefore the guarantee become unenforceable?

414. Goode thought that it all depended on the time at which the condition is to be determined impossible or not, i.e. at the time of the conclusion of the contract or at the time when the condition is required to be fulfilled?

415. Precisely because of the difficulty mentioned by Goode Zimmermann thought it inadvisable to deal with impossible conditions. Impossible when? Originally or subsequently? And impossible how? Objectively or subjectively?

416. Perales Viscasillas, noting that PECL not only provided a definition of conditions in the text but indicated in the comments a number of examples, wondered whether the Group could agree on both the definition and the examples.

417. Schiavoni gave the example of a contract entered into between a State and a foreign private company whereby the State undertook to transfer to the foreign partner a certain percentage of shares of one of its companies provided that it was able to privatise within a certain period of time a certain number of other companies. Was this a true condition and if so what kind of condition? A so-called potestative condition? He personally had some doubts as to whether the Principles should address too many questions concerning conditions.

418. Asked by Bonell to draw first conclusions from the discussion, Fauvarque-Cosson thought that a provision on impossible and unlawful conditions appeared to be necessary in order to make it clear what the effects of such conditions were, i.e. whether they nullify the entire contract or only the condition as such. This latter approach had been adopted for instance in the *Avant-projet Catala* (cf. Article 1174) which provided that, while as a rule an impossible or unlawful condition nullifies the entire contract, exceptionally only the condition may be struck out if in actual fact that condition was not a decisive reason for the parties' having entered into the contract. Another possibility was to adopt the Swiss approach according to which it depended on the intention of the parties whether they wanted to be bound notwithstanding the impossible or unlawful condition.

419. Crépeau favoured a flexible approach and felt that due consideration should also be given to whether or not the contractual obligations were divisible since, if they actually were, a possible sanction of an impossible or unlawful condition could be the partial nullity of the contract keeping the remaining part of the contract not affected by the impossible or unlawful condition alive.

420. Date-Bah and Gabriel cautioned against being too ambitious and pointed out that another possibility would be not to deal at all with impossible or unlawful conditions.

421. Bonell invited comments on the next item discussed by the Rapporteur in her paper, i.e. so-called discretionary or potestative conditions.

422. Widmer was against dealing with this issue. In his view a contractual engagement dependent on the intention of one of the parties was by its very nature invalid.

423. Goode was not so sure that this was always the case and recalled that the feature of the so-called options to sell or to buy was precisely that it was up to the party to whom the option was granted to decide whether or not to exercise it.

424. Bonell observed that it was questionable whether options were really contracts subject to a – discretionary or potestative – condition or rather contracts granting one of the parties the right to buy from or to sell to the other party certain goods within a given time and on certain conditions.

425. Zimmermann expressed strong reservations about a rule such as the one contained in Article 10.3 of the OHADA draft (“An obligation that depends upon a condition that is at the sole discretion of the obligor is null”). Such a rule could only give rise to misunderstandings, while in his view it was a question of contract interpretation in general to determine in each given case whether the party concerned intended to be bound or not: if not there was no contract at all; if yes there was no further problem.

426. Chappuis and Finn entirely agreed with Zimmermann.

427. Crépeau referred to a similar provision of the Civil Code of Québec (Article 1500) which he thought was more complete as it covered also the so-called options (“An obligation that depends upon a condition that is at the sole discretion of the debtor is null; however, if the condition consists in doing or not doing something, the obligation is valid, even where the act is at the discretion of the debtor”).

428. In drawing the conclusion of the discussion Fauvarque-Cosson thought it preferable not to have a rule on discretionary or potestative conditions: mention in the comments along the line indicated by Zimmermann was sufficient.

429. With respect to “conditions implied by courts or imposed by law”, Goode pointed out that to a common lawyer these were absolutely familiar concepts, i.e. they were just another way of describing a legal duty, but he was rather surprised to see them referred to in the context of “conditions” in the meaning under discussion at present.

430. Bonell thought that in order to avoid possible misunderstandings it was preferable to speak of “conditions imposed by law” or “legal conditions”.

431. Goode made the example of a contract which by law is subject to a licence by a given public authority. Should this situation be dealt with in the chapter under consideration or was it one already covered by the provisions on performance and non-performance in general (especially by those on impediments)?

432. Fontaine pointed out that, while conditions imposed by law were not conditions in a strict sense because there was nothing uncertain about them, what was uncertain was whether the required public permission or authorisation was granted or not. The Principles did already contain special provisions on public permission requirements (cf. Articles 6.1.14–6.1.17). When these provisions were drafted nobody was thinking of a separate chapter dealing with conditions in general, but since such a chapter is now under consideration one might think of incorporating the provisions on public permission requirements into the new chapter. In other words, if there were going to be in the Principles provisions dealing with conditions in general, would they not apply also to public permission requirements which consequently could be simply referred to in the comments as one particular type of condition, i.e. conditions imposed by law.

433. Widmer agreed.

434. Bonell, while inviting the Rapporteur to give further consideration to the matter, expressed some reservations as to the idea of dropping the present Chapter 6 Section 2 on public permission requirements. It has been widely recognised as being one of the most original parts of the Principles and could perhaps have a *raison d'être* even in the presence of a separate chapter on conditions in general.

435. Passing on to the question of whether the Principles should address the question of a possible time limit within which the condition must occur, or in the absence of an indication on this point in the contract, Fauvarque-Cosson thought that one might argue that the condition has to occur “within a reasonable time”.

436. Widmer and Chappuis supported the proposal.

437. Crépeau suggested adopting rules similar to the ones contained in Articles 1501 and 1502 of the Civil Code of Québec, stating “If no time has been fixed for fulfillment of a condition, the condition may be fulfilled at any time; the condition fails, however, if it becomes certain that it will not be fulfilled” and “Where an obligation is dependent on the condition that an event will not occur within a given time, the condition is considered fulfilled once the time has elapsed without the event having occurred, and also when, before the time has elapsed, it becomes certain that the event will not occur. Where no time has been fixed, the condition is not considered fulfilled until it becomes certain that the event will not occur”, respectively.

438. Finn, while accepting a time limit for suspensive conditions, had some difficulty with resolutive conditions or conditions subsequent. He gave the example of long term contracts containing a provision according to which in the event of bankruptcy, take-over or other similar traumatic events the contract should come to an end: such protective devices should not be subject to any time limit since it was clearly the intention of the parties to keep them there for the entire duration of the contract.

439. Brödermann had some doubts whether by such clauses the parties really intended to subject the contract to veritable resolutive conditions. In his experience the purpose of such provisions was rather to grant the right to terminate the contract with the consequence

that if the respective events occurred the contract was not automatically put to an end but it was left to the parties to decide on its fate on a case by case basis.

440. Bonell recalled that the somehow related topic of termination of long term contract for good reason or just cause still had to be discussed.

441. Garro felt that the discussion so far had amply demonstrated that the main problems arbitrators and judges have to face in practice are of two kinds: first of all, to determine whether a particular event referred to by the parties in the contract amounted to a veritable condition; secondly, if this were the case, to determine what the effects of such a condition in the case at hand would be. With respect to both problems the Principles could only provide some basic rules and criteria, while it ultimately all depended on the intention of the parties which had to be determined in each given case. He urged the Rapporteur to highlight this fact in the comments so as to avoid any misunderstanding about the actual scope of the envisaged black letter rules.

442. Gabriel agreed with Garro and suggested not dealing at all with the question of time limits for conditions.

443. Goode, like Finn, thought that conditions subsequent or resolutive conditions were typically events that the parties do not want to occur so that there was absolutely no reason to set any time limit for them.

444. Date-Bah agreed with the two previous speakers.

445. Zhang and Perales Viscasillas on the contrary were in favour of a rule stating that if the parties have not indicated any time limit for the condition, the condition must occur within a "reasonable time".

446. In summing up the discussion Bonell felt that there was not sufficient support for any rule on time limits for conditions. At the same time, however, there was general agreement that the issue should be mentioned in the comments - preferably under a separate heading - and the differences highlighted that in this respect existed between suspensive and resolutive conditions and that in any case it all depended on the intention of the parties to be determined in the light of the circumstances of the case.

447. Also with respect to the items "renunciation to the benefit of the condition" and "burden of proof" referred to by the Rapporteur at page 12 of her paper, it was decided not to deal with them in the black letter rules.

448. Passing on to the issue of "interference" (cf. pages 12-14), Fauvarque-Cosson thought it should be addressed in the Principles, and indicated as possible models Article 16:102 PECL and Article 10.4 of the OHADA draft. She proposed to focus first of all on the consequences of a party's interference - or should one speak of "undue" or "unfair" interference? Article 16:102 PECL says that "the condition is deemed to be fulfilled" in the case of suspensive condition, and that "the condition is deemed not to be fulfilled" in the case of resolutive condition. Yet what did this mean? That the contract is considered as absolutely enforceable so that the other party may even claim specific performance or merely that the party in default is liable for damages? She favoured the first solution but obviously it was up to the Group to take a stand on this rather important question.

449. Goode and Zimmermann were in favour of a rule on undue interference.

450. Fontaine agreed with the two previous speakers but pointed out that the issue of a party's interference with the fulfilment of the conditions had two implications. One was at present under discussion and concerned the so-called negative interference, i.e. where a party's conduct prevents the condition from occurring. Yet there was also the so-called positive interference to be considered, i.e. the duty of the party to cooperate in order to permit the occurrence of the condition. He gave the example of a contract subject to a license requirement and Party A being obliged to apply for the license. If Party B, as may well happen in international contracts, were in a position to influence the granting of that license, it should be under a duty to co-operate with Party A in order to obtain the license and bring the contract into effect. He recalled that in Comment 3 to Article 6.1.14 the Principles already expressed this idea, though only in the context of public permission requirements ("If a party needs further information from the other to file an application (e.g. information relating to the final destination of the goods, or information as to the purpose or subject matter of the contract), the other party must furnish such information pursuant to the duty of co-operation (Art. 5.1.3). Should that party not furnish such information it may not rely on the obligation of the first party").

451. Goode thought that Fontaine had raised a good point and supported the idea of specifically addressing the issue, at least in the comments, to the envisaged article on interference.

452. Zimmermann thought that Article 16:102 PECL, by stating that "If fulfilment of a condition is prevented by a party, contrary to duties of good faith and fair dealing or co-operation, and if fulfilment would have operated to that party's disadvantage, the condition is deemed to be fulfilled", did cover, though in an indirect manner, the issue.

453. Brödermann warned against overemphasising a party's duty to cooperate in this respect. Not obstructing the occurrence of a condition was one thing but imposing a legal duty to cooperate in order to ensure its occurrence quite another. If the parties have agreed on a particular risk and cost allocation, why should the law interfere with their agreement and impose a different allocation?

454. Finn agreed with Brödermann's reservations and recalled that Article 5.1.3, stating the duty of cooperation in general terms, made it very clear that each party shall co-operate with the other party only if and to the extent that such co-operation may reasonably be expected. He was reluctant to impose any form of obligation to co-operate that goes beyond what can reasonably be expected.

455. Bonell wondered whether the Group could agree on the following: to deal expressly in the black letter rules with the so-called negative interference, while referring in the comments to the issue of the so-called positive interference as an application of the general duty to co-operate laid down in Article 5.1.3.

456. While Goode agreed, Fontaine wondered why the Principles should address only with respect to public permission requirements the so-called positive interference.

457. Fauvarque-Cosson gave the example of a contract for the sale of an apartment subject to the condition that the buyer obtains a bank loan. The buyer is certainly under a duty to use its best efforts to obtain the loan – at least this is the position taken by French courts which generally impose on the buyer the burden of proving it has done its best to obtain the loan and deny that the buyer can walk out of the contract without paying the

indemnité d'immobilisation by simply saying "Sorry, but I did not get the loan from my bank". She wondered however whether these cases had anything to do with positive interference at present under discussion.

458. Hartkamp pointed out that also in the Netherlands there was ample caselaw on this problem, and the courts have generally decided in the same manner as the French courts but they did so on the basis of a rule which is an almost literal translation of Article 16:102 PECL, i.e. stating that the buyer "prevented" the condition from being fulfilled if it failed to take all the steps necessary for its fulfilment.

459. Finn thought that the scenario Fontaine had in mind when proposing a rule on the so-called positive interference was exactly the opposite from the one mentioned by Fauvarque-Cosson and Hartkamp, i.e. that the duty to use best efforts to obtain the loan for the buyer was also on the seller if it was in a position to achieve this result. He insisted that in his view this would go too far.

460. Zimmermann objected that Finn's concern was met by Article 16:102 PECL with the formula "... contrary to duties of good faith and fair dealing ...". In other words, one cannot expect more than what is fair and reasonable as far as co-operation and fulfilling conditions that bring about the contract are concerned.

461. Widmer agreed with Zimmermann.

462. In summing up the discussion Bonell noted that there was agreement to make a reference to the so-called positive interference in the comments along the lines stated in the comments to Article 6.1.14, i.e. to refer to the general duty of cooperation and to its being limited to acts or omissions that the other party could reasonably expect to have occurred.

463. Passing on to the practical consequences of interference, Bonell asked for comments on the questions posed by the Rapporteur in her introductory remarks.

464. Goode thought that the idea of granting the remedy of specific performance went too far. He gave the example of a contract subject to an export license. If the duty to take reasonable steps to get the license was on the seller and the seller fails to use its best efforts to get it, it is unrealistic to state that the condition is deemed to be fulfilled because obviously the goods cannot be exported. The only conceivable remedy was therefore damages. The same would be the case if the duty to obtain the export license were on the buyer, since – again – if the licence is not granted because of the buyer's failure to take the reasonable steps, it would not be fair to allow the seller to ask for payment of the price notwithstanding the fact that the seller is unable to deliver the goods. He therefore thought that the very formula "the condition is deemed to be fulfilled" was not recommendable since it would unduly oversimplify matters.

465. Zimmermann wondered whether the general limitations provided for the remedy of specific performance in Chapter 7 Section 2 of the Principles would be sufficient to meet Goode's concern.

466. Goode was hesitant to agree on that and thought it should be better clarified.

467. Gabriel confessed that he was not as bothered as Goode on this point. A statement to the effect that a condition is deemed to be fulfilled does not necessarily mean

that also the underlying obligation can be performed: on the contrary, it could very well simply mean that since the performance cannot be rendered, damages have to be paid.

468. Furmston agreed with Gabriel and thought that it was just a question of improving the drafting of the rule on which there seemed to be general agreement.

469. Zimmermann proposed keeping the language as proposed but mentioning, as in PECL, in the comments that “deemed to be fulfilled” can mean only damages, exactly along the lines indicated by Gabriel and Hartkamp.

470. Fauvarque-Cosson insisted that the issue at stake was not whether it could mean damages – on that everybody agreed – but whether it could also mean specific performance.

471. Hartkamp thought that it should be left open since it all depended on the kind of obligation involved.

472. In summing up the discussion Bonell pointed out that there seemed to be agreement that the exact meaning of “deemed to be fulfilled” depended on the circumstances of the case and that the point should be made clear in the comments.

473. Turning to the last item concerning the effects of the occurrence of a condition, Fauvarque-Cosson recalled that when discussing the issue at its previous session the Group had expressed a clear preference for prospective or *ex nunc* effects, and wondered whether this was still the case.

474. Fontaine was in principle in favour of prospective effects but wondered whether in the case of resolutive conditions this would be in line with the general approach taken with respect to unwinding of failed contracts.

475. Zimmermann, while admitting that this had still to be examined in more detail, expressed with respect to conditions his preference for the option of prospectivity which would be not only in line with the trend prevailing nowadays at international level, but also with the position taken by the eminent German scholar Bernhard Windscheid who already more than a hundred years ago had pointed out that retrospectivity should be the absolute exception to be adopted only if there were cogent reasons to do so.

476. Goode agreed but warned against adopting a concealed retrospectivity as had been done with respect to termination for breach.

477. Brödermann pointed out that in practice sometimes retrospective effects were more appropriate. He gave the example of a contract still being negotiated between the lawyers of the parties involved while for economic reasons the production of the goods concerned has already started. If the contract still needs some form of public authorisation or permission, the parties definitely want the suspensive condition of the granting of such permission to have retrospective effects.

478. Zimmermann felt that this was an absolutely legitimate concern which however would be taken care of by the formulation “unless the parties agree otherwise”.

479. Fauvarque-Cosson raised the additional question as to whether the Group wanted her to draft also a special rule concerning acts which are accomplished *pendente conditione* or while the condition was still pending and to what extent the chapter on conditions should

deal with all the various scenarios that might occur as a consequence of the fulfilment of a condition – an approach that might lead deep into the realm of the law on restitution or unjust enrichment.

480. Zimmermann reiterated his position in this respect. The Rapporteurs on conditions as well as on illegality should propose draft rules also with respect to the effects of the occurrence of a resolutive condition or of illegal contracts, while he would further define the general provisions on unwinding of failed contracts – *rectius*: of avoidance for defects of consent and of termination for non performance – the Group had previously discussed during this session. Once the respective drafts were on the table the Group would be in a position to assess whether they fitted each other and to take a final decision accordingly.

481. Fauvarque-Cosson wanted to know whether the Group expected her to go beyond Article 16:103 PECL and add a rule stating that the occurrence of a condition has no retroactive effects unless circumstances indicate otherwise and a rule dealing with the acts accomplished *pendente conditione*.

482. Bonell thought that with respect to the first question the answer was clearly in the affirmative (at least as far as the comments were concerned) and that also the second issue should possibly be addressed by the Rapporteur. He thanked Fauvarque-Cosson for the excellent preparatory study she had produced and expressed his absolute confidence in her ability properly to take into account the various positions that had emerged during the discussion when preparing the draft chapter on conditions to be submitted to the Group at its next session.

483. Before the end of the discussion Crépeau wanted to raise a general point concerning third party rights in the case of the occurrence of a resolutive condition as well as in all other cases of failed contracts. What happens if the goods which have to be returned have in the meantime been sold to a third party? Moreover did it matter whether that third party, when it acquired the goods, knew or ought to have known of the reasons which had led to the failure of the contract between the original parties.

484. Bonell recalled that proprietary rights had been deliberately omitted throughout the Principles and thought that it was hardly conceivable to deal with proprietary rights in the context of unwinding of failed contracts without having a common framework concerning transfer of title.

485. Goode did not think it necessary to deal with property law as such: in his view what was at stake was simply whether a contract could be unwound if it related to property which in the meantime has been disposed of to a third party. He gave the example of a seller who had been induced by the buyer's fraud to enter into the sales contract and subsequently wanted to avoid the contract but in the meantime the goods have been resold by the buyer. Admittedly the Principles should not deal with the transfer of title between the buyer and the third party but may well address the question as to whether, provided that the transfer was valid under the applicable rules of property law, the seller was still entitled to avoid the contract.

486. Zimmermann failed to see how the remedy of asking for avoidance could be affected by the valid resale of the goods to a third party. If the latter was the case the only question was how to cope with the buyer's impossibility to return the goods to the seller but this question has already been addressed by the Principles by providing that the buyer should make allowance for the value of the goods.

V. EXAMINATION OF PAPER ON “SOME ILLEGALITY PROBLEMS” (UNIDROIT 2007 – Study L – Doc. 101 addendum)

487. Introducing the addendum to his position paper entitled “Some Illegality Problems” he had prepared during the session at the Group’s request, Furmston explained that the paper contained a list of hypothetical cases of contracts which might or might not be considered illegal. Its purpose was to stimulate discussion and canvas the reactions of the members of the Group so as to permit him to have a better idea as to the kind of rules to be drawn up in the envisaged chapter on illegality.

488. Bonell questioned the significance of the “geographical note” at the beginning of the paper. He failed to see the reason for examining only hypothetical cases that relate to member States of the European Union.

489. Furmston admitted that such geographical restriction was relevant only in Case 6 while it was irrelevant in all the other cases. He then proceeded to illustrate the cases set out in his paper.

490. With respect to Case 1, Furmston pointed out that there were cases in both England and the United States in which transactions of this kind have been held to be illegal, but he wondered whether this was also the view of the Group.

491. Date-Bah thought that while the case might be against the securities laws of particular countries and therefore be considered illegal in those countries, at international level and in the context of the Principles, he could not see why it should be illegal.

492. Gabriel thought that more facts were necessary in order properly to evaluate the case. In particular he wanted to know where the three shareholders got the information which led them to believe that there would be a takeover bid: if they had read about it in the Wall Street Journal then the transaction would be legal whereas if they had relied on insider information it would be illegal.

493. According to Goode it would depend on the applicable securities law. In general he thought that if people bought shares with a view to reselling later on at a profit, that was perfectly all right, while if they bought on a large scale with a view to manipulating the price of the shares on the market, that could be regarded as market manipulation and therefore improper trading.

494. Fontaine, like Gabriel, thought it all depended on the source of information.

495. Furmston specified that one of the shareholders got the information from an employee of the company thought to be about to launch a takeover bid with whom he was having an intimate relationship.

496. Bonell thought that if this was the case the three shareholders could not be accused of insider trading in a strict sense since they have not used information they had as insiders of their company.

497. Goode noted that the facts were still not sufficiently clear and different views had been expressed on the basis of different assumptions of facts. The case in question could be considered a case of insider trading or a case of improper trading because of market manipulation.

498. Date-Bah insisted that, at least as far as the latter assumption was concerned, it could hardly lead to illegality at an international level. Market manipulation might violate mandatory rules of one or another domestic law but cannot be considered contrary to international public policy since there are many countries in the world which have no securities laws at all.

499. Bonell noted that it was not even clear whether the company in question was listed on a stock exchange and consequently subject to the mandatory rules of the country(ies) where the stock exchange(s) was(were) located.

500. Also Zimmermann found that due to the few facts known it was almost impossible to give a clear answer. On the other hand he thought that to know these facts was after all not necessarily important because, like Date-Bah, he would have in any case excluded that the hypothetical transaction was contrary to “fundamental principles of human mankind that are recognised by all States”, while in order to see whether it violated any mandatory securities law(s), one would have first to determine which law(s) was(were) applicable and whether it(they) expressly declared the transaction illegal and provided for the effects of such illegality.

501. Crépeau agreed with Zimmermann and excluded that this case helped to define illegality at the international level.

502. Bonell, referring to the discussion the Group had concerning the basic approach to be adopted with respect to illegality, recalled that the majority had been in favour of a so-called two tier system. While most of the members seemed to exclude that in the example given by Furmston the transaction could be considered as contrary to internationally accepted principles and values (the so-called “black” contracts), he thought that the case was nonetheless useful since it provided an example of a contract violating mandatory rules (the so-called “grey” contracts).

503. According to Furmston the case was a borderline case. He expressed his surprise that, with the exception of Goode, everybody seemed to exclude that the sort of market manipulation indicated in the example could be considered null and void at an international level.

504. According to Widmer the example gave rise to a second important question which had not yet been discussed: whether the illegal purpose should make the transaction itself illegal with the result that X could not recover the million from B and C. To him this was not at all clear because ultimately all three shareholders had the same goal and he failed to see why X should not be able to collect the promised 2 million from his two accomplices.

505. Crépeau wanted to hear from Furmston what international principles and values he had in mind when affirming that the transaction indicated in the example was null and void at international level.

506. Goode thought that safeguarding the investing public against deception could be the internationally accepted principle.

507. While Garro agreed with Goode, Perales Viscasillas thought that the case involved a so-called “grey” contract, the exact effects of which a judge or arbitrator would have to determine on the basis of criteria of the kind set out in Article 15:102 PECL.

508. Finn sounded a note of caution on relying on general standards such as safeguarding against deception. He recalled that according to the Australian Trade Practices Act companies engaging in conduct that misleads or deceives consumers are subject to all sorts of civil sanctions but nobody would suggest that any contract affected by breach of that Trade Practices Act was illegal.

509. Fontaine, like others, thought that at present at least the example given by Furmston only involved the violation of mandatory securities rules but he did not exclude that in the near future this kind of behaviour could be considered as being contrary even to the international *ordre public*.

510. Date-Bah once more warned against generalising at an international level principles and standards at present accepted only in developed countries but virtually unknown in the rest of the world where financial markets were either completely lacking or in the early stages of development.

511. According to Bonell the discussion had shown basically two things: first, the need to be cautious as to the general formula in the sense that one should not assume that values and standards upheld in some countries are universal; second, that values and standards are evolving not only in the sense that what was acceptable years ago is unacceptable today, but also in the sense that what at present is upheld only in some countries may well become in the future universally upheld.

512. Widmer was still interested in hearing from Furmston what in his opinion the answer to the question posed in Case 1 was.

513. Furmston repeated that in his view the transaction was contrary to widespread international standards and therefore fell within the category of the so-called “black” contracts. He admitted at the same time however that other members were of a different opinion, i.e. that it was only a so-called “grey” contract violating the applicable securities laws. He concluded that the one thing which was clear was that it was unclear.

514. Moving on to Cases 3 and 6, Furmston pointed out that both dealt with mandatory rules. In his view in Case 3 the Hague-Visby Rules ought to apply to the contract even though the parties have made it subject to the UNIDROIT Principles, while Case 6 was more difficult because the dispute was to be decided by arbitration outside the European Union so that it was not at all certain whether the arbitral tribunal would apply European competition law on its own motion.

515. Zhang first of all reiterated his reservation concerning the use of general formulations such as “violation of internationally recognised fundamental principles” or the like. He thought that they were too vague and could dissuade prospective users of the Principles from actually using them. Even if such formulations were followed by a list of examples such as corruption, restrictive trade practices, violation of human rights, etc., the outcome would still remain very uncertain. Indeed, where could one find an internationally accepted definition of corruption, restrictive trade practices or violation of human rights? In his view the formulation used in PECL was much better since it referred specifically to the fundamental principles within the European Union. However, since at international level there was no possibility of a similar framework, he saw no other alternative than to restrict the fundamental principles in question to those recognised by the domestic law applicable in each given case. Turning to Cases 3 and 6, he felt that Case 3 had nothing to do with

illegality and that also in Case 3 he would conclude that the arbitral tribunal should not apply European competition law since it had not been invoked by either party.

516. Goode, though admitting that formulations such as “violation of internationally recognised fundamental principles” or the like were rather vague, thought that this was not sufficient reason for not adopting them. The Principles clearly could not regulate everything but he was confident that it was possible to identify at least some internationally recognised fundamental principles on which to agree. However he did agree with Zhang in his conclusions concerning Case 6. In other words also in his view, and this was based on current English law, an arbitral tribunal cannot actually raise an issue of illegality on its own motion because in this way the parties would not have an opportunity to challenge the allegation.

517. Fontaine objected that at least in Belgium arbitrators can take up *ex officio* a cartel issue even if the parties have not raised it provided that the parties are then given the opportunity to argue against it or in favour of it.

518. Goode pointed out that this was also the position of English law. In other words he agreed that an arbitral tribunal can raise on its own motion for instance a violation of competition law if it appears *prima facie*. All that he wanted to say was that the arbitral tribunal cannot reach a conclusion on the issue without giving the parties an opportunity to present their case.

519. Fauvarque-Cosson thought that Cases 3 and 6 did not involve questions of illegality and that they dealt rather with sensitive conflict of laws problems which were already addressed in the second sentence of the Preamble stating “The Principles shall be applied when the parties have agreed that their contract be governed by them” and in Article 1.4 on mandatory rules.

520. Garro agreed with Fauvarque-Cosson with respect to Case 3 which he too thought could be solved under the combined application of the second sentence of the Preamble and Article 1.4. He wondered however what the solution would be if one of the countries involved was not a signatory to the Hague-Visby Rules. In his view even in this case an arbitral tribunal should have regard to the Hague-Visby Rules since it is generally held that arbitrators should ensure that their awards are enforceable at least in those countries somehow related to the case at hand. *Mutatis mutandis* the same conclusion should be reached in Case 6 where for the same reasons the arbitral tribunal is certainly entitled to raise the issue of the violation of European competition law on its own motion.

521. Bonell understood Case 3 as concerning illegality provided that the parties not only have subjected their contract to the UNIDROIT Principles but also have included in their contract an exculpatory clause which contravenes the relevant provisions of the Hague-Visby Rules and would therefore be invalid due to the internationally mandatory nature of the Hague-Visby Rules. He asked Furmston whether his understanding of the facts was correct.

522. Furmston admitted that in the light of the discussion the example needed to be elaborated a bit in order to make it clear. The purpose of the example was to test what the solution would be where the regime for damage to the goods is governed by the Hague-Visby Rules which are mandatory in the relevant country or countries so that the parties could not sidestep their application by subjecting the contract to the UNIDROIT Principles.

523. Gabriel had considerable difficulty in accepting the view that the contract under Case 3 could be called illegal. If the parties draft a contract whose provisions are overridden by the applicable law, it would be just a question of conflicts, a matter already taken care of by Article 1.4. He would never have thought that this was a case of illegality in the sense of Article 15:102 PECL: at least in the United States nobody would call that contract illegal.

524. Asked by Bonell whether the single contract term violating the applicable mandatory provision and therefore being invalid would in Gabriel's view amount to a case of partial illegality or "ineffectiveness" according to Art 15:103 PECL, Gabriel replied that it definitely did not. He gave the example of a sales contract governed by the Uniform Commercial Code, a term of which violates the State's consumer protection laws: although the consumer protection laws prevail over the Uniform Commercial Code, nobody in the United States would call that an illegal contract. There is absolutely nothing illegal about it. It was just a situation where one series of laws trumps the law governing the contract.

525. Goode felt that it ultimately was a terminological issue. In other words at least in common law systems the mere fact that a contractual provision is of no effect does not mean that the provision or the contract is illegal. He therefore agreed with Gabriel with respect to Case 3. All that happens there is that the exemption clause is contrary to the Hague-Visby Rules and therefore is of no effect. The case has nothing to do with illegality. It is not unlawful to enter into that sort of contract. Not even the single contract provision is an illegal provision. It is simply a provision that is deprived of legal effect, which was not the same at all.

526. Bonell recalled that Article 15:102 PECL, placed in a chapter entitled "Illegality" and with respect to which it has never been questioned that it concerns cases of illegality, is entitled "Contracts infringing mandatory rules" and states in paragraph 1 that "Where a contract infringes a mandatory rule of law applicable under Article 1:103 PECL [which corresponds to Article 1.4 of the Principles] the effects of that infringement upon the contract are the effects if any prescribed by that mandatory rule". Everybody had agreed that Case 3 involved a contract containing a provision violating or – to use the terminology of Article 15:102 PECL – "infringing" the mandatory Hague-Visby Rules. So why now the objection to calling such a contract provision "illegal", always on the assumption that the Group agrees on the basic approach taken in Chapter 15 PECL?

527. Finn confessed that he had understood Article 15:102 PECL as referring not to all cases of conflicts between a contract provision and the applicable mandatory rules but only to cases where a contract provision infringed an international norm of a character the violation of which one would categorise as illegal because of the value system it was supporting.

528. Fauvarque-Cosson insisted that Case 3 as drafted did not involve the infringement of a mandatory rule but concerned an attempt to escape a mandatory rule by a choice of law device. Indeed, the mere fact that the parties have chosen the UNIDROIT Principles in order to escape the mandatory rule of the Hague-Visby Rules does not mean that they have directly infringed a mandatory rule.

529. Bonell agreed but recalled that Furmston himself had admitted that what he had in mind was a contract containing a provision contrary to the relevant provision of the Hague-Visby Rules.

530. Furmston pointed out that the case he had in mind was one in which the damage to goods regime of the contract would be governed by the Hague-Visby Rules and not by the parties' own provisions since the parties cannot evade the Hague-Visby Rules by choosing the Principles as the law governing their contract. This being so, he did not actually care whether one called this illegality or not.

531. Gabriel strongly objected and insisted that the case at hand was covered by Article 1.4 and had nothing to do with illegality. He began to doubt whether the Principles should adopt the same approach taken by PECL in Article 15:102.

532. In view of the fact that in common law systems the notion of illegality was restricted to what in civil law jurisdictions was known as contracts *contra bonos mores*, Garro too wondered whether the Group should reconsider the advisability of following the model of Article 15:102 PECL and rely only on Article 1.4.

533. Goode agreed. In other words, if the question at stake was only that mandatory rules cannot be displaced by individual provisions of a contract which might otherwise be fully effective, was there still a need for a provision along the lines of 15:102 PECL? Would Article 1.4 not be sufficient?

534. Fontaine confessed that as a civil lawyer he had no difficulty labelling Case 3 as a case of illegality. However since, as it now appeared, the notion of illegality has different meanings in the different jurisdictions, he wondered whether it was advisable to have a specific chapter on illegality at all. After all the Principles in Chapter I already contained a rule on mandatory provisions: why not think of adding in that same chapter a rule on contracts contrary to fundamental principles and then combine the present Article 1.4 with a provision similar to Article 15:102 PECL.

535. Furmston first of all pointed out that even within the common law systems the meaning of illegality differed widely. He recalled that the American Restatement contains in the chapter on illegality a provision (§ 195 (1)) stating: "A term exempting a party from tort liability for harm caused intentionally or recklessly is unenforceable on grounds of public policy." Leaving aside whether this was the rule also in England or in Australia, certainly nobody in those countries would ever explain such a rule on the grounds of public policy and discusses it in the chapter on illegality. It was therefore fair to say that the scope of illegality is different in the United States and in the other common law countries, no doubt for good historical reasons. But he did not think that this really mattered at all. Concerning Cases 3 and 6, he did not care where to deal with them – either in a special chapter on illegality or in the context of Article 1.4 – provided that there was agreement as to the solution to be adopted, i.e. that the mandatory rules would prevail over the conflicting contract provisions.

536. Zimmermann pointed out that PECL adopt an autonomous terminology, i.e. the notion of illegality is used neither in accordance with civil law nor with common law, but as an overarching concept comprising two different levels of "illegality": one defined as "contracts contrary to fundamental principles", the other as "contracts infringing mandatory rules". The two levels of illegality differ mainly as to the effects: contracts infringing fundamental principles are null and void while contracts infringing mandatory rules may have no effect, some effects, full effect depending on what the infringed mandatory rules provide or, if nothing is said by the infringed mandatory rules, on an assessment of the circumstances of the case.

537. Gabriel recalled that § 195 of the Restatement 2nd of Contracts does not define terms that invalidate tortious liability as illegal but merely provides that those terms are unenforceable. He therefore suggested not speaking any longer of “illegal” contracts or “illegal” contract provisions but rather of contracts that are wholly or partly “unenforceable”. This would after all be very much in line with the neutral approach taken by PECL which uses the term “illegality” only in the title of Chapter 15.

538. Bonell thanked Gabriel for his constructive intervention and agreed that it would be wise not to use the concept of illegality any longer.

539. Crépeau first of all thought that to reduce illegality to immorality as suggested by some members would be contrary to general legal traditions. He then urged that a distinction be made between definition and effects. Illegality in his view was in all legal systems something which is against a rule of law whereas as far as the effects were concerned there has been considerable development over the last decades or so. In former times nullity was nullity and that was the end of it. But the laws have evolved and the effects of the nullity nowadays tend to differ depending on the circumstances.

540. Widmer agreed with Crépeau.

541. Brödermann, speaking from the viewpoint of a practitioner, urged the Group to be as transparent as possible in this field. Perhaps the most important general principle underlying the Principles was freedom of contract though within the limits of Articles 1.3 and 1.4, the latter declaring the pre-eminence of the applicable mandatory rules of national, supranational or international origin. If the intention was to add to those external limits new limits consisting in substantial principles and values laid down by the Principles themselves, this should be made very clear so as to permit potential users to know exactly where they are when referring to the Principles as the applicable law just as they would know it when choosing for instance Swiss law or Swedish law. Also PECL were much clearer in this respect since they refer to fundamental principles accepted within the European Union.

542. Moving on to Cases 7 and 8, Furmston pointed out that they both involved illegality in the performance of the contract. In Case 7, B has paid in cash with money obtained from drug smuggling and it is clearly a money laundering manoeuvre which in most countries would nowadays probably be contrary to both specific statutory rules and also general policy considerations. Therefore, if A refuses to deliver the cars it may be presumed that no court would ever sanction the action and the contract would not be enforceable. Case 8 was more controversial. It was a variation of a famous English decision concerning the case of an overloaded ship, the difference being that in his example the lorry used to perform the contract was known by the carrier from the outset to be unsafe for that purpose and the question was whether this was sufficient reason for the sender not to pay the price.

543. Goode agreed with Furmston concerning Case 7. As to Case 8, he would have thought that the carrier may perhaps be entitled to some payment but certainly not to payment of the entire price.

544. Gabriel took it for granted that even assuming that as a matter of contract law in both cases the contracts were deemed unenforceable, the restitutionary remedies would remain valid, i.e. in Case 7 the prospective buyer would be entitled to recover the cash paid and in Case 8 the carrier would be entitled to recover the restitutionary interest because it had in fact performed. In his view it was important to make this clear because, provided the

restitutionary remedies were not affected, the question as to whether or not the contracts in question were to be considered as illegal or unenforceable became rather secondary.

545. With respect to the restitutionary question, Goode confirmed that under English law if one party refuses to perform or invokes unenforceability, normally the other party is entitled to recover in restitution; at the same time however illegality may come in as a barrier to the restitutionary remedy. His personal view was that the Principles could well take a more flexible approach in this respect.

546. Finn agreed with Goode's last remark and invoked as a model for such flexibility Article 15:102 PECL.

547. Also Crépeau felt that in Case 7, notwithstanding the illegal nature of the transaction, the seller had to return to the buyer the cash paid by the latter. Otherwise immorality would be added to illegality, something which is prevented also under Article 1699 of the Civil Code of Québec.

548. According to Bonell the example showed that even a contract infringing internationally accepted principles and values may exceptionally, according to certain criteria, produce some effects.

549. Komarov pointed out that in formulating the envisaged provisions on illegality, regard should be had to their pedagogical function: indeed once the parties have actually committed a violation of fundamental principles and values, they are unlikely to submit their disputes if any to a court or arbitral tribunal, while the mere fact that the Principles contain provisions sanctioning immoral or illegal contracts may dissuade parties from making such immoral or illegal contracts.

550. In the light of the discussion Furmston felt that there was sufficient agreement concerning Case 8 where of course it has first of all to be seen whether the contract of carriage was invalid and the answer depended on the purpose of the administrative rules violated, i.e. whether they are intended to protect the owners of the goods entrusted to a carrier or some other interests such road safety. If the contract turns out to be invalid there seemed to be general agreement that nonetheless the carrier should be given some restitutionary remedy. On the contrary, he had considerable difficulty with Case 7: indeed, if the majority of the Group felt the money launderer should get the money back, he preferred deleting any reference to such a case as in his view the Principles should not give the impression that they are indifferent to money laundering.

551. Garro first of all agreed with Komarov that at least Case 7 was rather academic, it being unlikely that a money launderer would ever sue the prospective seller for restitution of the cash paid since in so doing it would alert the authorities. More in general he felt that what was at stake was the extent to which courts or arbitrators are bound to uphold the public policy values at stake in the examples under consideration by not helping the parties to get anything out of the immoral transaction. He wondered whether the discussion should focus on the definition of immorality and, for the time being, leave aside the issue of the effects of an immoral contract.

552. Zimmermann thought that in Case 7, if the assumption was that both parties knew it to be an immoral transaction, i.e. are *in pari turpitudine*, there should be no restitutionary remedy and the money launderer/prospective buyer should not be able to recover the one million.

553. Hartkamp objected that under Dutch law the solution would be exactly the opposite, i.e. the money launderer would be able to get the money back. In view of these sharp differences among legal systems, he doubted that the Group would ever be able to agree on a particular solution. He therefore suggested focusing on a rule on the effects that would permit a maximum degree of flexibility and go no further.

554. Goode pointed out that no English court would ever order the return of laundered money if both parties knew from the beginning that the money was tainted.

555. Crépeau reiterated that under the Civil Code of Québec the solution would be the same as under Dutch law, i.e. the opposite.

556. Zimmermann agreed with Hartkamp urging the Group to focus on immorality and illegality and their effects.

557. Concerning Case 7, Zhang felt that it all depended on whether the prospective seller knew of the illegal origin of the money it had received. If it did not know, he thought that there was no legal basis for undoing the deal.

558. Furmston thought that, though not expressly stated in the example, the prospective seller could not have been aware of the illegal origin of the money since, at least in England, nobody would ever show up with such an amount of cash in hand if it was clean money.

559. Gabriel and Date-Bah disagreed, pointing out that at least in some regions of the world even large payments were frequently made in cash.

560. Passing on to Case 2, Furmston said that as everybody would have perceived it raises questions about corruption. The amount of money being paid to B to facilitate the conclusion of the contracts is so enormously large that it must surely be a corrupt payment. This gives rise to a whole series of questions which include whether B, who has been paid a fee in respect of the first 20 planes, can sue to recover the unpaid fee in relation to the remaining 10 planes which have been delivered, whether A can sue to get back the payment which has been made and whether the Utopian Government is bound by the contract either in terms of paying for the planes which have been delivered or in relation to the planes which have not been delivered. The very helpful paper on corruption submitted by Raeschke-Kessler suggested that the answer to all these questions is probably not the same, but he would be very interested to hear the other member's views on Case 2.

561. Finn thought that corruption, which is unfortunately widespread in international contract practice, should definitely be addressed in the Principles if for no other reasons than for symbolic reasons. In general however he warned against being too ambitious and urged the Group seriously to consider the extent to which, if at all, generalised statements about international standards should be made. After all, most of the primary forms of illegality will be covered by Article 1.4, and the only addition to be made was in his opinion a provision along the lines of Article 15:102 PECL because many mandatory laws do not provide sufficient indication of the effect of the violation of a mandatory norm on a contract. To go much beyond that would in his view seriously compromise the utility of the Principles in international commercial transactions.

562. Also according to Date-Ban corruption should be expressly addressed in the Principles, and since corruption had a particular moral turpitude in it in his view a contract involving corruption should be of no effect whatsoever.

563. On a more general level Goode suggested distinguishing between mandatory rules, i.e. positive requirements imposed by the applicable law to do certain things, and rules of public policy or *loi de police*, i.e. prohibitions of certain kinds of conduct. In his view otherwise there was a risk of mixing up two entirely different kinds of rules, one of which denies legal effect to things offensive to public policy (e.g. corruption) and the other one which requires things to be done in the public interest but is not necessarily concerned with objectionable behaviour as such (e.g. a rule that says all food products must carry with them a statement of the ingredients).

564. Bonell noted that even with respect to corruption for example the distinction between the two kinds of rules might not always be easy to make as shown by the Algerian legislation on intermediaries which, clearly for the purpose of preventing corruption, prohibits such kind of contracts unless some positive requirements are met (e.g. a particular professional qualification of the intermediaries and their being registered in a public register).

565. Furmston added that, while in all or perhaps nearly all countries there are local laws which prohibit corruption of local officials in relation to local transactions, the situation might be different with respect to bribing people in other countries. In England, for instance, the Prime Minister recently appeared to regard with equanimity bribing people in Saudi Arabia.

566. Widmer first of all wanted to reply to Finn's last intervention. In his view nobody in the Group had ever advocated stating in the Principles new international principles and values: reference was made only to those principles and values already generally accepted and even with respect to them it has been suggested that the Principles should make it clear that they may evolve over the years and in different parts of the world.

567. Zhang thought that Raeschke-Kessler's paper provided an excellent basis for the discussion concerning corruption. However in his view the problem of corruption did not arise only in the context of government procurement contracts but concerned all kinds of international commercial transactions, including those between two private parties. He gave the example of joint ventures between a Chinese and a foreign company which in China are subject to governmental approval: the foreign company, eager to prevail over other foreign prospective investors, bribes an official of the Chinese government in order to get the approval, but when subsequently the corruption is discovered the Chinese company claims to have been totally unaware of it. He wondered whether in such a case the contract of joint venture should be declared null and void and added that at least under Chinese law this would not be the effect: the persons responsible for the corruption would be punished under criminal law but the contract as such would be kept alive also in consideration of the serious social and economic consequences deriving from the dissolution of a fully operative joint venture. One may criticise this approach but this was what would happen under Chinese law. He acknowledged that other jurisdictions might take the opposite stand and declare the joint venture null and void but precisely because of that he thought that the Principles should not adopt a solution in one or the other direction but leave it to the applicable domestic law to handle such situations.

568. Gabriel to a certain extent shared Zhang's concern. In other words he too felt that the Principles could hardly go further than stating in general terms that contracts that violate

internationally accepted fundamental principles and values will be invalid, leaving it to the applicable law to determine the effects of a possible violation.

569. With reference to Case 2 Furmston thought that there could hardly be any doubt that the arrangement between A and B is null and void (a “black” contract” and that as a consequence B has no action against A for the unpaid commission nor could A get back the money it has paid to B. As to the contract between A and the Utopian government for the supply of the Eurobombers, there were a number of questions involved. One is whether the incoming government is entitled to say that it did not want to have any more planes, i.e. whether a contract procured by corruption is non-binding as to any future performance, and he felt that the answer should be in the affirmative. Another question was whether the incoming government has to pay for the five planes delivered but not yet paid for, and he thought this would be the case unless the government decides to return the planes.

570. Bonell thought that Furmston’s example represented a very useful contribution to the discussion on the effects of contracts procured by corruption. However he wondered whether the suggested answers would be different in case of a construction contract where e.g. the construction of the airport or the electricity plant was almost completed.

571. Zimmermann wanted to put a question to Finn. In his view the discussion showed a wide consensus on adopting a so-called two tier system along the lines of Articles 15:101 and 15:102 PECL, on the assumption that the general formula – however phrased – would not prescribe new standards but be restricted to standards of behaviour at present generally accepted at international level, and that the envisaged provision on contracts infringing mandatory rules should be a sort of combination of Article 1.4 and a provision dealing with the effects of such contracts in a very flexible or open-ended manner. This being so, he wondered whether he had understood Finn correctly in the sense that Finn was proposing to add to these two provisions one specifically dealing with corruption.

572. Finn replied that, at the risk of saying something shocking, the provision corresponding to Article 15:101 PECL he had in mind would be restricted to corruption since in his view all the other matters mentioned such as human rights, money laundering, child labour, etc. were to a large extent already covered under Article 1.4 as they were regulated – though in a different way and with different effects – by mandatory domestic rules. He admitted that such an approach might appear rather minimalist as compared to Article 15:101 PECL, but it was one thing to draft in an exclusively European context and another to draft for the whole world. He repeated his fear that going beyond such minimalist approach could seriously compromise the attractiveness of the Principles.

573. Bonell thought that the last two interventions had made it very clear that the Group had to choose between two quite different approaches, i.e. the maximal approach favoured by Zimmermann and the minimalist approach suggested by Finn. He thought that at this point of the discussion it was very important that all the other members of the Group express their preference for one or the other.

574. Uchida strongly supported Finn’s approach.

575. Akhlaghi too felt that corruption was a particularly important issue which should definitely be addressed in the Principles.

576. Date-Bah, though not being against a general formula on immoral contracts provided that it was sufficiently narrow so as to be acceptable not only in Europe but also on other continents, supported the idea of giving prominence to corruption.

577. Komarov supported Zimmermann's approach. He did not think that the adoption of a general formula could compromise the acceptability of the Principles in practice: after all, at present business people have to live with the application of different domestic laws which normally also contain rather vague formulations on immoral or illegal contracts. Moreover, if – as he hoped would be the case – the Principles were to become a self-contained legal system capable of being chosen as an alternative to domestic laws as the law governing international commercial contracts – it was essential that they positively state some fundamental principles and values rather than merely referring for this purpose to the applicable domestic laws.

578. Crépeau too was in favour of the Zimmermann approach: undoubtedly some fundamental principles and values generally accepted not only within the European Union but also at universal level existed, and the Principles should expressly require their observance in international commercial contracting.

579. Widmer agreed with Crépeau and mentioned as examples of internationally accepted principles and values human rights and the protection of the environment, though admitting that especially the latter might at present not yet be sufficiently defined.

580. Garro thought it was somehow arrogant to think that regions of the world other than Europe have no fundamental principles to which they attach their public policy interest and was therefore in favour of a general statement on immorality. As to the wording he recommended an open-ended formula that would take into account the evolving standards of what is called *jus cogens* in public international law.

581. Gama too felt that there certainly were values and rights common to humankind which should be referred to in the Principles by a sufficiently broad formula.

582. Goode supported the idea of a general formulation on immorality and suggested using the notion of "international *ordre public*". He was not too much concerned about the risk that such notion might be understood and applied differently in the different parts of the world. Like Komarov he felt that this was already the case when applying domestic laws. Moreover he insisted that immorality should be detached from Article 1.4 because mandatory rules deal with something different.

583. Chappuis said that instead of choosing between the Zimmermann approach and the Finn approach she preferred to combine the two to the effect that the black letter rules should contain a general formula on immorality and the comments should restrict the scope of immorality by indicating a number of topics that do not fall under the general formula because not yet sufficiently accepted at international level or differently understood in the various parts of the world. As examples of such excluded areas she indicated competition law and human rights pointing out that the latter did not after all really concern international commercial contracts. On the contrary she favoured an express reference to corruption, maybe even in the black letter rules, as corruption was clearly the paramount example of immoral commercial contracts. She recalled that also in Switzerland as in other countries special legislation existed dealing with corruption but was concerned only with corruption committed in Switzerland while leaving open the question if and to what extent also corruption committed in foreign countries was punishable. She thought that by equalling the

infringement of foreign anti-corruption rules with the infringement of national rules the Principles could make an important contribution to the establishment of a corruptionless international commercial order.

584. Gabriel supported the idea of a general statement prohibiting immoral contracts. However he was not be in favour of referring only to corruption and pointed out that there were a number of other fundamental principles and values that could play a role in the context of international commercial contracts including human rights. He insisted that the Principles should not attempt to define further the parameters of the fundamental principles in question and in this context quoted Potter Stewart who with respect to obscenity said “I can’t define it but I know it when I see it”.

585. Fauvarque-Cosson first of all expressed her support for the idea of having a general formula on immorality and found Goode’s suggestion to use the notion of international *ordre public* or - maybe even better – transnational *ordre public* very appealing. However, like Finn, she recommended greatest caution and restraint since there were only a few fundamental principles and values generally accepted worldwide. In this context she gave the example of human rights pointing out that for instance equality between men and women was a fundamental human right only in certain parts of the world while in many countries it was not at all accepted as such. She also favoured an express reference to corruption and, since she too was of the opinion that contracts procured by corruption may under special circumstances still produce some effects, thought it preferable to deal with corruption in a separate article so as to make it clear there is this important difference as compared to the other cases of immorality. On a different point she again expressed some reservations as to the approach taken by Article 15:102 PECL with respect to contracts infringing mandatory provisions: more precisely she questioned the advisability of distinguishing between the cases where the effects of such infringements are laid down by the mandatory rules themselves and the cases where nothing is said by the mandatory rules in this respect. She preferred that the Principles provide for a flexible approach in all cases.

586. With reference to human rights, Kronke pointed out that in the context of international commercial contracts their violation could become relevant in two different ways. One case had already been indicated by Gama and concerned an international joint venture set up in Ruritania to produce ethanol and employing local workers on terms which, though legal according to Ruritanian law, were contrary to internationally accepted labour standards. The other was a case he himself had been confronted with in arbitration proceedings where the international joint venture agreement itself provided for the production of certain goods in a manner that would violate the fundamental rights of the employees and severely harm the environment of the region. Were the Principles intended to address such a scenario and what would the position taken with respect to a joint venture agreement of this kind be?

587. Zhang confessed that he had difficulty taking a precise stand on this as well as on other issues raised during the discussion, such as competition law, corruption, money laundering, environmental protection, etc., without adequate information concerning the way in which they are dealt with at comparative level. Recalling a similar request made by the Secretary General at the beginning of the session, he thought it indispensable that the Rapporteurs, when submitting their preliminary draft chapters for examination by the Group at its next session, provide also such basic information so as to permit the Group to take its decisions based on a full knowledge of existing laws.

588. Bonell fully supported this request and was confident that the Rapporteurs would respond to it. At the same time however he reminded that the preparation of the Principles had always been a collective exercise involving all members of the Group who were therefore likewise invited to provide the necessary input at least as far as their own legal system was concerned.

589. Date-Bah felt that at least as far as immorality and illegality were concerned, the Principles should restrict themselves to a broad formulation leaving it to courts and arbitral tribunals to find out in each given case whether or not certain behaviour constitutes a violation of internationally accepted fundamental principles. After all, as already pointed out in the course of the discussion, such principles were subject to evolution over the years so that it would not only be impossible but even useless to try to define them here and now in the Principles.

590. Fontaine reiterated his support for a general formula and recommended further defining it by way of examples in the comments. Reference should be made not only to corruption but also to human rights, including the prohibition of discrimination on the ground of sex, race, age, etc., as well as protection of privacy, topics that were all becoming more and more relevant also in the context of private contracting.

591. Furmston agreed in principle with Fontaine but at the same time pointed out that the Group should bear in mind exactly what its task was, i.e. not to produce a contract code for the world but just to lay down principles of international commercial contracts. As a consequence there was little if any sense in stating for example that slavery is immoral or that family life has to be promoted - these and other examples one finds in the comments of PECL - and the focus should be on examples relevant in the context of international commercial contracts.

592. Crépeau, like Fontaine, felt that the Principles should mention also human rights as one of the fundamental principles to be respected in international contracting. He had just recently read a book by a French scholar dealing with discrimination and the problems of competition in international contracts dealing with the industrial cotton trade around the world. It referred to number of cases where the Principles could be of great help.

593. Also Schiavoni was in favour of mentioning human rights in the Principles even though in his view it would not make a great difference if there was no such mention. Indeed the fact that human rights is a very sensitive subject does not mean that it should be excluded from the appreciation of an arbitrator. Human rights is a subject of such great axiological power and of such paramount of importance that it cannot be left to the discretion of a legislative or semi-legislative instrument. To make an express reference to it or not, was only a question of style.

594. Brödermann, offering another example of how the notion of immorality and illegality may vary in the different parts of the world or even from country to country, referred to the case of the government of Country X, which when leasing to a private Company A access to a telecommunication satellite, included in the leasing agreement a provision according to which A undertook not to use the telecommunications network for illegal purposes. Company A sub-leased its rights to foreign Company B which used the network to distribute pornography which was prohibited by law in Country X. When the government of Country X became aware of how B was using the network, it invoked the contract provision in question in order to terminate the leasing agreement with A. A dispute arose because B, when accepting a similar contract provision as agreed between the

government of Country X and A (the undertaking not to use the telecommunication network for illegal purposes), was unaware that distributing pornography was illegal in Country X. On a general level he felt that a distinction should be made between looking at the Principles from an arbitrator's viewpoint and a lawyer's. For an arbitrator it may be important to be given some guidance as to what are to be considered immoral and illegal contracts and what their effects will be: even a generic statement in the Principles in this respect would be useful provided that it leaves the arbitrator sufficient discretion in deciding a given case. Quite different would the impact of such statement be on practising lawyers when negotiating international commercial contracts. Already now they face considerable difficulties in taking account of the mandatory rules of the various jurisdictions which in one way or another may become relevant for the transaction at stake. If by using the Principles they have to take into account yet another limitation to the freedom of contract, this would certainly not increase the popularity of the Principles. He was not against the inclusion in the Principles of a general statement concerning immoral and illegal contracts but urged the adoption of a very short formula.

595. Widmer reiterated the importance of considering the effects of immoral and illegal contracts, all the more so since as the discussion had shown also with respect to human rights, there are fundamental principles which really are universal and others which are not. Under these circumstances it was essential to provide a maximum of flexibility with respect to the effects of their violation, and he felt that the approach adopted in Article 15:103 (2) PECL was very appropriate and could be taken as a model also for the Principles.

596. With reference to corruption, Al Mulla pointed out that it was nowadays increasingly influenced by politics as shown by the recent case of the corruption of a Saudi governmental official perpetrated by an English company to procure a contract for the sale of military equipment. If the English judiciary had been reluctant, as it appeared to be, to prosecute the English company this was likely to have been for political reasons.

597. Summing up, Furmston confessed that he now had a much clearer idea of the problems involved. He thought that some kind of general formula was necessary but it needed to be carefully explained in the comments and illustrated by examples. He agreed that the definition of immorality and illegality was heavily entangled with the rules concerning the effects but there seemed to be general consensus that maximum flexibility should be provided in this respect. Finally he wondered whether the distinction drawn between Articles 15:101 and 15:102 PECL was actually all that appropriate, but he would give the matter further consideration.

598. Bonell first of all thanked, also on behalf of the Group, Furmston for the excellent work he had done. He was confident that Furmston would be able to prepare for the Group's next session a draft chapter on illegality including comments and illustrations which would permit the Group to discuss the various problems involved in a more systematic and comprehensive manner.

VI. EXAMINATION OF THE POSITION PAPER ON TERMINATION OF LONG-TERM CONTRACTS FOR JUST CAUSE (UNIDROIT 2007 – Study L – Doc. 104)

599. Bonell informed the Group that much to his regret Dessemontet had not been able for health reasons to attend the session but that his substitute Stefan Eberhard had kindly offered to present the position paper in his place.

600. Chappuis, while very much appreciating Eberhard's offer, thought that, as was the case with the other chapters, also with respect to this topic presentation by the Rapporteur was essential and would in any case require much more time for discussion than was left. She therefore suggested that the examination of the position paper be postponed to the Group's next session. Also in view of the fact that at the last session the very idea of dealing with the topic of termination of long-term contracts for just cause had met with some rather strong reservations, she offered to consult in the meantime her colleagues from the *Group de travail contrats internationaux* - an international group of corporate lawyers, professors and members of the bar, founded by Marcel Fontaine some twenty-five years ago, whose task was to analyse critically contract clauses members take from their own professional experience - to see how they feel about a rule on termination for good cause in the UNIDROIT Principles. Would they think it useful or would they share the concern that such a provision could result in an increase in litigation? If the Group so wished she would submit the results of such an enquiry to it at its next session.

601. Bonell first of all thanked Eberhard for replacing Dessemontet. He understood that Eberhard had made a substantial contribution to Dessemontet's position paper so that he would certainly have been in a position to introduce the paper with the necessary insight and expertise. At the same time however he saw the advantages of taking the course of action suggested by Chappuis: above all because of the lack of sufficient time left at this session for an exhaustive discussion on this very important topic, and secondly because the suggested consultation with such a qualified group of practitioners could but only be beneficial for an even better understanding of the various problems involved.

602. Goode entirely agreed but felt that it would be extremely useful if the group of experts in question was also asked to comment on the rules on the effects of termination contained in the Principles at present. He had already repeatedly pointed out that in his view they should be amended so as to attach to termination only prospective effects and not provide for restitution also of past performances thereby making the effects of termination equal to those of avoidance.

603. Bonell was confident that Chappuis would be prepared to take care of this additional request.

VII. DEVELOPMENTS CONCERNING THE OHADA PROJECT

604. Fontaine reported on the latest developments of the OHADA project. The draft he prepared had been submitted to OHADA in September 2004 but little had happened since then in terms of the advancement of the project. The National Commissions still had to give their opinions but, also due to some changes in the Permanent Secretariat of OHADA, the consultations had come to a standstill. To keep interest in the project alive a colloquium was being organised in Ouagadougou for November 2007 on which occasion the draft will be critically analysed from various aspects by the participants who hopefully will include many experts from African countries.

VIII. DATE OF THE GROUP'S NEXT SESSION

605. Bonell announced that, following consultation with the members of the Group and with the UNIDROIT Secretariat, the Group's next session would be held in Rome from Monday 26 May until Friday 30 May 2008.

606. In closing the session Bonell pointed out that, notwithstanding the extreme complexity of the topics addressed throughout the week, the session had been very successful. He wholeheartedly thanked all the Members and Observers of the Group for their constructive cooperation and outstanding contribution to the discussion and looked forward to welcoming them again in Rome in a year's time.

APPENDIX

**WORKING GROUP FOR THE PREPARATION OF
PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS (3RD)
2nd session, Rome, 4 – 8 June 2007**

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