

# A DEMANDEUR-CENTRIC APPROACH TO REGIME DESIGN IN TRANSNATIONAL COMMERCIAL LAW

Sandeep Gopalan\*

## INTRODUCTION

Recent scholarship on international agreement design has almost exclusively focused on the *public* international law area.<sup>1</sup> The literature on regime design in the area of international *private* law<sup>2</sup> lacks a solid theoretical foundation. Academic writing on *public* international law's state-centric approach is only amenable to crude transplantation and poses several puzzles in the international *private* law context. Resolving these puzzles is important because of the proliferation of transnational commercial agreements in areas that were traditionally the province of domestic law.<sup>3</sup> This paper attempts to provide a starting point to address the theoretical vacuum. Part I argues that functionalist, liberal, and realist theories cannot fully explain transnational commercial law agreement design. Part II puts forth a demandeur-centric approach with the aid of examples that span the spectrum from hard law to soft law. Part III concludes that agreement design in transnational commercial law is premised on demandeur preferences and relative power. Ultimately, the choice of structure boils down to which parties are the demandeurs of the agreement.<sup>4</sup> All else being equal, when the demandeurs are confident in their ability to achieve agreement and enforcement requires

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\* Associate Professor of Law, Sandra Day O'Connor College of Law, Arizona State University. The author wishes to thank participants of a faculty presentation at the University of Denver for assistance in refining some ideas expressed in this article. The standard disclaimers about errors and omissions apply.

<sup>1</sup> See, Kal Raustiala, Form and Substance in International Agreements, 99 AM. J. INT'L L. 581 (2005); Jack Goldsmith & Eric Posner, International Agreements: A Rational Choice Approach, 44 VA. J. INT'L L. 113 (2003); Andrew Guzman, The Design of International Agreements, 16 EUR. J. INT'L L. 579 (2005); Kenneth Abbott & Duncan Snidal, Hard Law and Soft Law in International Governance, INT'L ORG. 421 (2000); Hartmut Hillgenberg, A Fresh Look at Soft Law, 10 EUR. J. INT'L L. 499 (1999); and Anne-Marie Slaughter, International Law in a World of Liberal States, 6 EUR. J. INT'L L. 503 (1995).

<sup>2</sup> The pioneering scholarship of scholars like Sir Roy Goode opened up many avenues for further research, but theoretical work continues to languish. See, Roy Goode, Usage and its Reception in Transnational Commercial Law, 46 Int'l & Comp. L.Q. 1, 2 (1997); Roy Goode, Reflections on the Harmonization of Commercial Law, in Commercial and Consumer Law: National and International Dimensions 1-27 (Ross Cranston & Roy Goode eds., 1993).

<sup>3</sup> Sandeep Gopalan, The creation of International Commercial Law: Sovereignty Felled?, 5 SAN DIEGO J. INT'L J. 267 (2004); The American Law Institute and UNIDROIT are working on drafting procedural rules that a country may adopt for the adjudication of disputes stemming from international commercial transactions, available at [www.unidroit.org](http://www.unidroit.org); See, UNCITRAL Convention on the Assignment of Receivables in International Trade, <http://www.uncitral.org/stable/res5681-e.pdf>; UNIDROIT is currently in the advanced stages of transmitting a draft Space Protocol to the Cape Town Convention of 2001, available at [www.unidroit.org](http://www.unidroit.org); See, UNCITRAL Model Law on Cross Border Insolvency, 1997.

<sup>4</sup> When demandeurs need state involvement, primarily in terms of recognition, or enforcement assistance, they are likely to structure agreements as conventions provided that they possess sufficient political influence to attain ratification.

minimal state involvement, they will opt for non-convention vehicles.<sup>5</sup> The choice of the convention form is predicated on their ability to co-opt states, when enforcement power is necessary.

If, as contended, regime design is a function of demandeur preference, states have to be aware that they are ceding legislative power in significant areas to organizations that are not democratically elected, and difficult to access. Consultation in the agreement design process is frequently restricted to the membership, and even copies of the agreements are not available without paying a cost – a feature that sits uncomfortably with modern notions of participatory legislation and accessibility. It is not uncommon for some organizations to act like regulatory monopolies.<sup>6</sup> There are serious consequences for states – legal business is monopolized by those with greater access to the demandeur, dispute resolution is often taken away from the jurisdiction of otherwise appropriate state courts or tribunals, state legislative power is eroded, the legal system might, after a time, possess very little expertise in an area because of a complete absence of relevant work for the local bar, and citizens are deprived of participation.

## I. THE INAPPROPRIATENESS OF THE PUBLIC INTERNATIONAL LAW LENS

Institutions in the private law area traditionally favored international conventions, assuming that because international conventions are binding, they are the strongest vehicle available.<sup>7</sup> The use of conventions has been intrinsically linked to the emphasis on the bindingness of the obligations undertaken. In contrast, non-convention vehicles have been employed when the progenitors did not intend the agreement to be legally binding.<sup>8</sup> Non-convention vehicles have also been chosen when there was little need for state involvement.<sup>9</sup>

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<sup>5</sup> This is particularly exemplified by the behaviour of highly integrated commercial actors like the International Chamber of Commerce demanding transnational agreements and embodying them in non-convention forms with great success.

<sup>6</sup> One might contend that these laws only apply in commercial transactions where the parties have the benefit of legal counsel, and that there is no element of coercion. Allowing sophisticated commercial parties to act in ways that maximise joint gains is in conformity with autonomy. To the extent that there are no externalities on third parties, these arguments might have some merit. However, it is disingenuous to believe that there are no externalities to parties subjecting themselves to agreements structured by demandeurs outside the pale of state regulation.

<sup>7</sup> This view is embodied in article 26 of the Vienna Convention on the law of treaties. Vienna Convention on the Law of Treaties, article 26: “Every treaty in force is binding upon the parties to it and must be performed by them in good faith.”

<sup>8</sup> An example of such intention is the UNIDROIT Principles of International Commercial Contracts, 1980, available at [www.unidroit.org](http://www.unidroit.org). For scholarly commentary on the Principles, see M.J. Bonnell, *Do We Need a Global Commercial Code?*, 106 DICK. L. R. 87-100 (2001).

<sup>9</sup> An example is the ICC’s Incoterms, available at <http://www.iccwbo.org/policy/law/id315/index.html>.

Accordingly, the scholarly treatment of the subject of the desirability of conventions as vehicles of international legislation has inextricably been linked to the question of compliance.<sup>10</sup> While this focus may make sense in the public international law context, compliance has very little meaning in the private law area given the fact that many of these so-called *binding* conventions are dispositive.<sup>11</sup> Dispositive means that an actor's subsequent actions can render a convention non-binding. Parties are free to exclude the *binding* convention entirely or in part. Thus, while the traditional international law scholar would have concluded that the choice of a convention would enhance the "normative strength of the agreement and ...a state's sense of obligation",<sup>12</sup> reality does not support such a conclusion.

For example, the Vienna Convention on Contracts for the International Sale of Goods (CISG)<sup>13</sup> has been the law of the United States since 1988.<sup>14</sup> Yet, it has had very little impact because most international contracts routinely exclude the convention's application.<sup>15</sup> The conventional explanation advanced for failed binding conventions, that states violate agreements when their interests conflict with the obligations embodied in the agreement, has no explanatory power for the failure of the CISG: few state interests of the United States conflict with CISG obligations, and the state plays little role in the success of such conventions. One might argue, however, that the United States has an interest in preserving the application of its own law to international contracts that would be subjected to the CISG, and that interest would conflict with the interest to ratify the CISG. This argument overlooks the role of party choice. Even if the United States has an interest in the application of its own domestic contracts law, there is no guarantee that its forbearance from ratifying the CISG would ensure that its domestic law would be applied to international contracts. The matter rests entirely in the hands of the contracting parties. Subject to minor limitations they are free to choose the law that governs their contracts, and they are not bound to apply the law of the

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<sup>10</sup> Jack Goldsmith and Eric Posner, *International Agreements: A Rational Choice Approach*, 44 VA. J. Int'l L. 113, 115 (2003).

<sup>11</sup> See for example, the Vienna Convention on Contracts for the International Sale of Goods, 1980, article 6: "The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions."

<sup>12</sup> Goldsmith and Posner, *supra* note 10, at \_\_.

<sup>13</sup> See United Nations Conference on Contracts for the International Sale of Goods, Apr. 11, 1980, U.N. Doc. A/CONF.97/18, 19 I.L.M. 668 (entered into force Jan. 1, 1988) [hereinafter CISG] (including sixty-six contracting states as of 2007, such as Argentina, Australia, Canada, China, France, Germany, Israel, Iraq, Italy, Mexico, Russia, and Spain), available at <http://www.uncitral.org/en-index.htm> (last visited --). The CISG is the culmination of over fifty years worth of work and was ratified in December 1986 by the United States. *Id.*

<sup>14</sup> [http://www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods/1980CISG\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html)

<sup>15</sup> Michael W. Gordon, *Some Thoughts on the Receptiveness of Contract Rules in the CISG and UNIDROIT Principles as Reflected in One State's (Florida) Experience of Law School Faculty, Members of the Bar with an International Practice, and Judges*, 46 Am. J. Comp. L. 361 (1998).

United States. Contractual choice, which is common across transnational commercial law, renders extremely problematic the applicability of conventional arguments from the field of public international law.<sup>16</sup>

The application of rational choice theory to contracting parties, rather than states, explains why conventions succeed or fail. If the convention is precise in its terms on the ambits of cooperative action, contracting parties will find it hard to behave opportunistically and then turn around and claim that the opportunistic conduct did not violate the requirements of a cooperative game.<sup>17</sup> The conclusion is similar in the context of coordination. Contracting parties subject themselves to a convention not because of the *binding* nature, but *inter alia* to assuage another party's fear of being subject to a foreign legal system, because their interests might be better protected by the convention, and to reduce transaction costs. The *binding* nature does not add much value to either party, except insofar as it imposes some obligations on courts if a dispute arises.<sup>18</sup> Routine exclusions of instruments like the CISG might be explained by path dependence<sup>19</sup> and network externalities. Thus, although the CISG might be a better solution, a suboptimal uniformity continues to persist because contracting parties are reluctant to change their existing practices.<sup>20</sup>

Public international law scholars argue that when structuring international agreements, states seek to enhance the credibility and enforceability of their agreements.<sup>21</sup> These scholars analogize states to private contracting parties: states structure their agreements as contracts because they desire to make their promises binding. Thus compliance is crucial.<sup>22</sup> This compliance is ensured by providing mechanisms that measure adherence and deviation. The

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<sup>16</sup> The situation becomes somewhat clearer if one shifts focus from compliance to subjection. Unlike compliance, which focuses on state action both at the ratification and implementation stages, subjection refers to the deployment of the convention as a source of authority by the parties to a legal relationship to which the convention applies. There has been little or no scholarly treatment of this concept and it is unclear why parties subject their agreements to transnational agreements.

<sup>17</sup> Goldsmith and Posner, *id.*

<sup>18</sup> This might be of limited utility if, as is common, the contract contains an arbitration clause. Even where the dispute is before a court, the binding nature of a convention can be stymied by interpretative devices aimed at applying domestic law.

<sup>19</sup> Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L.Q. 347 (1996). Kahan and Klausner have suggested: "that corporate contract terms can frequently offer 'increasing returns' as more firms employ the same contract term. Value arises from the common use of a contract term . . . as the use of a term increases, it becomes significantly more attractive (at least up to a critical point), and its attraction becomes self-perpetuating." *Id.* at 348. This results in standardization which is "a form of path dependence." *Id.*

<sup>20</sup> Kahan & Klausner, *supra* note 19, at 349. Kahan and Klausner have suggested "that corporate contract terms can frequently offer "increasing returns" as more firms employ the same contract term. Value arises from the common use of a contract term . . . as the use of a term increases, it becomes significantly more attractive (at least up to a critical point), and its attraction becomes self-perpetuating."

<sup>21</sup> Andrew Guzman, *The Design of International Agreements*, *supra* note 6, 581.

<sup>22</sup> Andrew T. Guzman, *A Compliance-Based Theory of International Law*, CALIF. L. REV. 1823 (2002).

conventional view argues that, unlike private parties in the contractual context, states do not pay damages for breaches of contract, but rather suffer reputational sanctions.<sup>23</sup> The private contract analogy crumbles because of the absence of symmetry between the breaching party's sanction and the non-breaching party's loss.

Despite this problem, scholars have focused extensively on monitoring mechanisms, sanctions, and sanction inflicting bodies. They have assumed that the dominant players are rational states who act to maximize contractual surplus.<sup>24</sup> In structuring international agreements, states are most concerned about the *impact* that the agreement will have in changing state conduct. It is this concern about impact that will influence whether a state chooses *hard* or *soft* law. If states desire to have low impact, then they are more likely to choose soft law. Conversely, if they desire a high impact, then they will elect hard law. However, the correlation between impact and form of several international agreements is not positive.<sup>25</sup>

The structuring of transnational commercial law agreements runs contrary to the assumptions of public international law scholars. To begin with, states are not the dominant actors in transnational commercial law. Even when states are significant actors, they worry less about compliance and monitoring than public international law scholars would admit. Indeed, most transnational commercial law conventions have no monitoring mechanisms whatsoever, and do not have unified dispute resolution mechanisms or tribunals. If states were interested in compliance, why would they desist from creating such mechanisms? The CISG's drafters, for example, could have provided for the constitution of an international tribunal for the disposition of CISG cases. However, the drafters left the task of dispute resolution to domestic courts. Three current theories attempt to explain regime design: functionalism, liberalism, and realism.

#### A. FUNCTIONALISM

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<sup>23</sup> See George W. Downs & Michael A. Jones, Reputation, Compliance, and International Law, 31 J. LEG. STUD. 95 (2002).

<sup>24</sup> Kenneth W. Abbott, Modern International Relations Theory: A Prospectus for International Lawyers, 14 YALE J. INT'L L. 335 (1989); Robert O. Keohane, After Hegemony: Cooperation and Discord in the World Political Economy 27 (1984).

<sup>25</sup> Thomas M. Franck, Legitimacy in the International System, 82 AM. J. INT'L L. 705.

Scholars in the functionalist tradition have argued that drafters choose form based on desired results.<sup>26</sup> Thus, drafters choose soft law because of its greater flexibility, conduciveness to incrementalism, non-state party participation, and lack of need for ratification.<sup>27</sup> Some scholars assume that hard law impacts state behavior more than soft law.<sup>28</sup> States prefer soft law when uncertainty is high, states' interests diverge greatly, informational costs are low, and, consequently, reputational sanctions are low.<sup>29</sup> Soft law also offers flexibility, which is valuable in areas where states are strongly wedded to their preferences. For example, Abbott and Snidal argue that states choose soft law as a "way station" to hard law; it is preferred when the subject challenges state sovereignty.<sup>30</sup>

Functionalists argue that legalization is a means to increase the credibility of state commitments. States choose hard law when there are low domestic political costs, they desire to bind successive governments, and they need to modify the practices of their residents.<sup>31</sup> Legalization enhances credibility by limiting "self-serving auto-interpretation."<sup>32</sup> In the international system, the consequences of bad conduct within a particular convention or treaty regime can have negative consequences for the bad actor in other areas.<sup>33</sup> "Auto-interpretation" is limited by arbitral tribunals interpreting and applying hard-legal commitments, which is one reason to create or designate institutions that have the authority to bind the parties.<sup>34</sup> Abbott and Snidal espouse a narrow role for tribunals: to apply and interpret hard law. This does not account for the ability of these tribunals to apply soft law. The tremendous success of soft law agreements like the UNIDROIT Principles and the Principles of European Contract Law (PECL) is attributable to their application by tribunals and courts. Abbott and Snidal hypothesize that hard law would result where "the benefits of cooperation are great but the potential for opportunism and its costs are high, where noncompliance is not easy to detect, where states want to form clubs of very committed states, and where executive agencies within a state want to commit other domestic actors such as the legislature to the international agreement."<sup>35</sup>

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<sup>26</sup> Kenneth Abbott & Duncan Snidal, *Hard and Soft Law in International Governance*, 54 INT'L ORG. 421 (2000).

<sup>27</sup> *Id.*

<sup>28</sup> Andrew Guzman, *The Design of International Agreements*, 16 EJIL 579 (2005).

<sup>29</sup> Raustiala, *Form and Substance*, supra note 6, 591.

<sup>30</sup> Abbott & Snidal, supra note 6, 423.

<sup>31</sup> *Id.* 426.

<sup>32</sup> *Id.* 427.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> Abbott & Snidal, supra note 6, 429-430.

While functionalism has some explanatory power, it fails to explain fully why actors choose to structure a transnational commercial law agreement as either hard law or soft law. Consider, for example, the Vienna Convention on Contracts for the International Sale of Goods, 1980. If Abbott and Snidal are right, the drafters should have chosen to embody their agreement in a convention rather than soft law because the benefits of cooperation are great but the potential for opportunism is high. A convention that provides a unified system of law for contracts for the sale of goods between parties in two different countries would provide cooperative benefits.<sup>36</sup> Arguably, differences in national laws may cause “legal risk,”<sup>37</sup> and stand in the way of cooperative interactions.<sup>38</sup> Legal risk can encourage opportunism by contracting parties who may, for instance, race to litigate in a forum that will suit their interests in appropriate cases.<sup>39</sup> Such opportunism can arouse fear and cause businesses to shy away from potentially profitable contracts, or to factor in additional costs to cover such risks.<sup>40</sup> Assuming opportunism could be significant, eliminating or minimizing legal risk would play a salutary role in promoting contracts across national borders.<sup>41</sup> In addition to legal risk, the differences in national laws impose transaction costs on contracting parties, ranging from the cost of obtaining legal opinions, fulfilling formal requirements, and translations, to the varying court costs of different legal systems. While large businesses might be able to absorb these costs, they can be prohibitive to small enterprises.

Although the benefits of cooperation are clear, it is less clear if the risk of opportunistic conduct explains choice of structure when drafting the CISG.<sup>42</sup> In theory,

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<sup>36</sup> This point is valid even after the adoption of the CISG. The joint response prepared by the Commission on European Contract Law (CECL), (hereinafter referred to as the “Joint Response”), Para 9. “it is difficult and often impractical for parties entering into agreements or already bound by contracts to obtain cost-effective information about foreign law relevant to rights and liabilities under transactions they are contemplating or have entered into. The problems are particularly acute in the area of the law of obligations and property law because even in many of the legal systems where this area of the law has been codified the legislation is relatively old and its meaning cannot be established without grasping the significance of much judicial interpretation of its provisions. In relative terms the law is less apparent and more difficult to ascertain with assurance of its correctness.”

<sup>37</sup> The Joint Response stated that “[c]ontract laws across the EU show significant diversity on many fundamental points. Businesses cannot safely trade under the private law of another Member State in the supposition that it will be similarly to their own. The impossibility within reasonable conditions for participants in the internal market to acquire essential knowledge about foreign law always entails the danger of substantial loss of claims or unsuspected liabilities.” Joint Response of the Commission on European Contract Law and Study Group on European Civil Code’s response to the Communication on European Contract Law, 21.10.01

<sup>38</sup> Paul Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 Va. J. Int’l L. 743, 746 (1999).

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> What kind of opportunistic conduct would the delegates worry about? Would it be that parties in some states would not be subject to the agreement? Would it be that courts in some states would not apply the agreement? Would it be that parties could act opportunistically and pick and choose the instrument or its component parts depending on their interests? These don’t appear to be prevented by the CISG.

opportunism could be prevented or, at the very least, minimized, by the drafters choosing convention over soft law. However, parties are just as free to exclude the law in whole or in part regardless of the fact that it is a convention.<sup>43</sup> The principal benefit from choosing a convention is that courts in contracting states are bound to apply it unless the parties have excluded it by contract.<sup>44</sup> However, most commercial parties exclude the CISG; thus, the binding nature is of limited utility. A study on the CISG conducted by Professor Michael Gordon in Florida showed that it was “largely unknown to crucial legal audiences in Florida.”<sup>45</sup> A simple questionnaire study of the Maricopa County Bar association yielded similar results. The state of affairs documented by Gordon is not unique to Florida.<sup>46</sup> It is an international phenomenon and may be because lawyers do not study the CISG in relevant courses.<sup>47</sup> Many judges who responded seemed to think that the CISG only applied to federal courts.<sup>48</sup> Several commodities business sectors routinely exclude the CISG’s application altogether.<sup>49</sup> Even in cases where the CISG has been applied, it has come as a surprise to

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<sup>43</sup> Article 6 of the CISG provides that “[t]he parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions.” Available at <http://www.uncitral.org/pdf/english/texts/sales/cisg/CISG.pdf>

<sup>44</sup> This can be of dubious utility. See, *Delchi v. Rotorex*; *MCC Marble v. Augustino*; *Zapata v. Hermanios*.

<sup>45</sup> Michael Gordon, *Some Thoughts on the Receptiveness of Contract Rules in the CISG and UNIDROIT Principles as Reflected in One State’s (Florida) Experience of (1) Law School Faculty, (2) Members of the Bar with an International Practice, and (3) Judges*, 46 AM. J. COMP. L. 361 (1998). Prof. Gordon prepared a questionnaire and sent it to a random selection of 100 members of the Florida Bar Section on International Law and 100 judges, in addition to law professors in Florida. Most practitioners had no knowledge of the CISG, while approximately 30 percent had “reasonable knowledge” and only two a “fairly strong” knowledge. In contrast, only 15 percent had a “reasonable knowledge” of the UNIDROIT Principles while one had “fairly strong” knowledge. *Id.* 368. See also Arthur Rosett, *The UNIDROIT Principles of International Commercial Contracts: A New Approach to International Commercial Contracts*, 46 AM. J. COMP. L. 347, 357 (1998).

<sup>46</sup> *Id.* 348.

<sup>47</sup> According to Gordon, “[m]ost responses disclosed the adoption of casebooks which made no reference to either the CISG or the UNIDROIT Principles. In no cases did faculty indicate they included CISG or the UNIDROIT Principles where they were not included in their casebook. No response indicated any reference to the UNIDROIT Principles in adopted casebooks. Even when the CISG was included in the casebook, it was not always assigned for class.”

<sup>48</sup> *Id.* This is clearly wrong. As held by the court in *BP Oil International, Ltd., and BP Exploration & Oil, Inc., v. Empresa Estatal Petroleos De Ecuador (Petroecuador), et al.*, 332 F.3d 333 (2003): “A signatory’s assent to the CISG necessarily incorporates the treaty as part of that nation’s domestic law. Where parties seek to apply a signatory’s domestic law in lieu of the CISG, they must affirmatively opt-out of the CISG. In *Asante Techs., Inc. v. PMC-Sierra, Inc.*, 164 F. Supp. 2d 1142, 1150 (N.D. Cal. 2001), the court held that a choice-of-law provision selecting British Columbia law did not, without more, “evinced a clear intent to opt out of the CISG . . . . Defendant’s choice of applicable law adopts the law of British Columbia, and it is undisputed that the CISG is the law of British Columbia” (internal citations omitted). Similarly in *Usinor Indusreel v. Leeco Steel Products Inc.*, 209 F. Supp. 2d 880, 884 (N.D. Ill. 2002), “when the CISG applies, it pre-empts domestic sales law that otherwise would govern the contract, such as Article 2 of the UCC.” *Id.* The court held that “at the time of contracting, the parties have the opportunity to opt-out, and decide that the UCC, or other domestic law, applies.” *Id.*

<sup>49</sup> Jan Smits, *Law Making In The European Union: On Globalization And Contract Law In Divergent Legal Cultures*, 67 La. L. Rev. 1181, 1187 (2007) (“...many general conditions set by ... Federation of Oils, Seeds, and Fats (“FOSFA”) and the Grain and Feed Trade Association (“GAFTA”)[exclude the CISG]. A survey among some large Dutch companies showed that most of them exclude the applicability of the CISG ... Smaller Dutch companies often do not exclude the CISG, unless legal advice was sought by one of the companies involved.”); GAFTA contract 100, clause 33 is an example: “International Conventions[:] The following shall not apply to this contract:--(a) the Uniform Law on Sales and the Uniform Law on Formation to which effect is given by the

parties.<sup>50</sup> Lawyers either do not know of the application of the convention or choose to apply domestic law instead. This suggests that learning externalities are a key contributor to the lack of impact. Unless lawyers become comfortable with applying the convention and move away from an impulsive exclusion of its operation, the CISG will never play a significant role.<sup>51</sup> Adopting it as a convention did little to reduce opportunistic conduct based on this evidence.

Abbott and Snidal also claim that some international law commitments can be enforced by domestic law, primarily as customary international law. However, it is unclear if they limit their arguments to hard law. The examples provided, the torture convention and the Whaling convention, suggest that they are only contemplating hard law.<sup>52</sup> It is not clear that the restriction to hard law is fully accurate: courts have frequently referred to soft law instruments like the UNIDROIT Principles as evidence of custom and accordingly applied them when deciding cases.

Functionalists argue that soft law is advantageous because of lower contracting costs: less expenditure in terms of drafting time, negotiation, ratification, etc.<sup>53</sup> Abbott and Snidal argue that hard law is more costly because states are more careful in “negotiating and drafting

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Uniform Laws on International Sales Act 1967; (b) the United Nations Convention on Contracts for the International Sale of Goods of 1980; and (c) the United Nations Convention on Prescription (Limitation) in the International Sale of Goods of 1974 and the amending Protocol of 1980.” See, Michael Bridge, *The International Sale of Goods: Law and Practice*, appendix (1999).

<sup>50</sup> Volker Behr, *The Sales Convention in Europe: From Problems in Drafting to Problems in Practice*, 17 J. L. & COM. 263–99 (1998).

<sup>51</sup> As one scholar notes in the U.S. context, “The difficulties and potential additional expense created by the fact that foreign cases construing the CISG are relevant, even critical, to a proper interpretation of the Convention is undoubtedly one reason that U.S. practitioners continue to advise clients engaged in international sales transaction to avoid the application of the CISG in favor of U.S. domestic sales law.” See, Harry M. Flechtner, *Recovering Attorneys’ Fees as Damages under the U.N. Sales Convention (CISG): The Role Of Case Law in the New International Commercial Practice, With Comments on Zapata Hermanos v. Hearthside Baking*, 22 NW. J. INT’L L. & BUS. 121, 133–34 (2002); One author wrote that despite several years of CISG practice, it is “still regarded by U.S. courts as somewhat of an interloper. Most U.S. judges since its 1988 ratification have either applied the Convention superficially or ignored it outright. Though some courts have engaged in valiant efforts to interpret the Convention autonomously, most have been coy with its pesky mandates, merely flirting with generally accepted methods of CISG interpretation only to make ultimate decisions through the lens of domestic law.” Jeffrey R. Hartwig, *Schmitz-Werke GmbH & Co. v. Rockland Industries Inc. and the United Nations Convention on Contracts for the International Sale of Goods (CISG): Diffidence and Developing International Legal Norms*, 22 J.L. & COM. 77 (2003) (internal citations omitted); Mathias Reimann, *The CISG in the United States: Why It Has Been Neglected and Why Europeans Should Care*, <http://cisgw3.law.pace.edu/cisg/biblio/reimann.html> (“A closer look at the U.S. data reveals that the number of truly relevant cases is even lower than 87. Whoever reads the reported decisions will quickly notice that in approximately half of them, CISG is neither applied nor interpreted. ... the number of cases reported in the United States is merely an indication of the Convention's small practical relevance.”); One practitioner writes that the “slow acceptance” by lawyers in the U.S. should not be mistaken for rejection. See, Susanne Cook, *CISG from the Perspective of the Practitioner*, 17 J.L. & COM. 343, 349–52 (1998).

<sup>52</sup> Principle of *pacta sunt servanda*, a concept based on contracts.

<sup>53</sup> By which is meant the expenditure in terms of drafting time, negotiation, ratification

legal agreements, since the costs of violation are higher.”<sup>54</sup> The argument with regard to hard law being more costly than soft law is only true on one front: ratification. All the other costs are incurred in the case of soft law too. Experts will still have to be consulted. Differences between legal families and systems must still be resolved. Negotiation is still contentious as proponents of various interests argue just as vigorously.<sup>55</sup> Drafting soft transnational commercial law agreements takes just as long as conventions. The UNIDROIT Principles have been a work in progress for over 20 years.<sup>56</sup> In contrast, the Hague Convention on Certain Rights with respect to Securities held with Intermediaries took about two years from start to finish.<sup>57</sup>

Abbott and Snidal’s examples distinguishing hard and soft law focus on ratification costs. However, soft law instruments cannot be created and placed on library shelves for free; effective dissemination requires marketing to the relevant constituencies. Notwithstanding these criticisms, it is true that agencies creating transnational commercial law exhibit weariness regarding the cost of ratification. A perception exists that the labor expended in creating the instrument is largely wasted if the instrument does not achieve the minimum number of ratifications necessary for the convention to enter into force.

An illustration of this trend is work of the Interamerican Conference on Private International Law (CIDIP), an organ of the OAS.<sup>58</sup> CIDIP instruments have been bedeviled by the vexing problem of low ratifications despite the expenditure of considerable time and resources.<sup>59</sup> The organization undertook a study to address this issue and made changes to its working methods, recognizing the opportunities presented by non-convention instruments.<sup>60</sup>

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<sup>54</sup> Abbott & Snidal, *Hard and Soft Law*, supra note 6, 434. They write that “Legal specialists must be consulted; bureaucratic reviews are often lengthy. Different legal traditions across states complicate the exercise. Approval and ratification processes, typically involving legislative authorization, are more complex than for purely political agreements.”

<sup>55</sup> If it were otherwise, it might suggest that the parties do not intend that the instrument be of much use!

<sup>56</sup> [www.unidroit.org](http://www.unidroit.org)

<sup>57</sup> Sandeep Gopalan, *New Trends in the Making of International Commercial Law*, J. L. & COM. 117 (2004). See also, Conclusions of the Special Commission held from 1–3 April 2003 on General Affairs and Policy of the Conference, available at <[http://www.hcch.net/doc/genaff\\_concl2003.pdf](http://www.hcch.net/doc/genaff_concl2003.pdf)>, noting that “[t]he Commission welcomed the flexibility and innovative character of the working methods used for this project and the speed at which the project has been completed without a vote being cast.”

<sup>58</sup> There have been six CIDIP conferences. The first was held in Panama in 1975. See Carlos Vazquez, *Regionalism Versus Globalism: A View from the Americas*, UNIFORM. L. REV. 2003-1/2, 62. CIDIP has crafted conventions on bills of exchange and checks, commercial arbitration, letters rogatory, foreign evidence, the legal regime governing powers of attorney, and model laws on secured transactions, and negotiable instruments.

<sup>59</sup> See an introduction to CIDIP-VII authored by Carlos Vazquez and Joao Rodas at <<http://www.oas.org/main/main.asp?sLang=E&sLink=. / . / documents/ eng/oasinbrief.asp>>

<sup>60</sup> See introduction to CIDIP-VII authored by Carlos Vazquez and Joao Rodas at <http://www.oas.org/main/main.asp?sLang=E&sLink=. / . / documents/eng/oasinbrief.asp> (“The problem of

This example supports the ILO case that Abbott and Snidal provide.<sup>61</sup> However, neither case proves that hard law costs more than soft law. At best, they support the view that the declining number of ratifications is deterring international agencies. However, this decline in ratifications may be attributed to any number of reasons: the instrument is inadequate in comparison to domestic law,<sup>62</sup> legislatures do not care about the subject matter, international law is not needed, the state hardly participated in the drafting process,<sup>63</sup> the perception that the instrument panders to powerful interest groups,<sup>64</sup> and pressure from conflicting interest groups.<sup>65</sup> These alternative explanations call into question Abbott & Snidal's claim that "softer forms of legalization will be more attractive to states as contracting costs increase."<sup>66</sup> Rather than the increased cost, in many instances, what seems to be motivating the choice against hard law is the realization that the cost of ratification is only worthwhile in some instances because of the dispositive nature of conventions. Ratification may not add much by way of bindingness or, more importantly, impact. Thus, it is unclear if the trade-offs between contracting costs and the choice between hard law and soft law occurs, except for the aforementioned point about ratification costs.

Raustiala argues that the risk of opportunistic conduct "suggests that pledges will be observed only when the risk of opportunism is low and uncertainty is high."<sup>67</sup> However, he does concede that "the choice to negotiate a pledge" is not the "product of a preference for flexibility on the part of negotiators."<sup>68</sup> However, opportunism lacks traction in the context of dispositive law. Opportunism has explanatory power when one is talking about public goods. However, private law arguably does not engender opportunistic conduct in the same way. Commercial parties likely do not value their legal systems beyond a bare minimum, and would be satisfied by any substitute sophisticated and predictable legal system.

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decreasing ratifications may well already have been addressed through a change implemented in CIDIP VI. In contrast to previous CIDIPs, which have elaborated draft conventions on traditional subjects of private intentional law, such as jurisdiction, choice of law, and enforcement of judgments, CIDIP VI has focused on producing model laws on substantive topics of private (commercial) law. CIDIP VI will consider for adoption a model law on secured financing as well as a model law on draft bill of lading for the carriage of goods by road. Some respondents praised this recent focus on model laws, while other respondents lamented it.")

<sup>61</sup> Abbott & Snidal, *Hard and Soft Law*, supra note...434.

<sup>62</sup> This explains the lack of ratification of the ULIS and ULIF conventions drafted by UNIDR/OIT.

<sup>63</sup> This explains the United States refusal to ratify ULIS and ULIF.

<sup>64</sup> This explains the reluctance of developing countries to ratify the Hague-Visby Rules.

<sup>65</sup> This explains the United States' refusal to ratify the United Nations Convention on the Law of the Sea. The last reason is the least powerful in the transnational commercial law context. None of these reasons pertain to cost or seriousness. Unless each instrument is evaluated based upon the reasons for the lack of ratifications, it is impossible to prove that the same instrument could have been more successful had the drafting agency chosen soft law as the vehicle. This is surely a mammoth task and is beyond the purview of this paper.

<sup>66</sup> Id. 436.

<sup>67</sup> Raustiala, supra note 6, 593. "...the risk of opportunism may be central to the choice between legal and nonlegal agreement." Id. 594.

<sup>68</sup> Id.

Raustiala writes that in “more technocratic and arcane areas, the available empirical evidence suggests that the prevalence of pledges roughly, if inconsistently, rises as uncertainty rises – as functional theory predicts.”<sup>69</sup> He provides examples to support both the functionalist claim that uncertainty influences the form of international agreement and the liberal claim that pledges are “most common in areas of low domestic salience.”<sup>70</sup> However, one example in the technocratic area directly contradicts this claim: the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (“Hague Convention”).<sup>71</sup> The Hague Convention creates a hard law agreement in the face of enormous uncertainty that was said to threaten the very survival of the global financial system.<sup>72</sup> The genesis of the Hague Convention was a joint proposal by Australia, the United Kingdom and the United States suggesting that a “short multilateral Convention clarifying applicable law rules for securities held through intermediaries” as “a basis for the world-wide adoption of consistent principles” was necessary because of the inadequacy of the present legal regime.<sup>73</sup> The proposal was based on the prevalence of transactions involving intermediaries between the issuer and the holder of securities, wherein the latter’s interest is only recorded by the intermediary on its books.<sup>74</sup>

Although the demandeurs appeared to be states, in reality, private actors drove the process.<sup>75</sup> The Hague Conference commissioned a feasibility study by Christophe Bernasconi

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<sup>69</sup> Id.

<sup>70</sup> Id.

<sup>71</sup> Available at [http://hcch.e-vision.nl/index\\_en.php?act=conventions.text&cid=72](http://hcch.e-vision.nl/index_en.php?act=conventions.text&cid=72).

<sup>72</sup> [http://hcch.e-vision.nl/index\\_en.php?act=conventions.text&cid=72](http://hcch.e-vision.nl/index_en.php?act=conventions.text&cid=72)

<sup>73</sup> Conclusions of the Special Commission of May 2000 on General Affairs and Policy of the Conference, Preliminary Document No. 10 of June 2000 for the attention of the Nineteenth Session, 25–26, available at <http://www.hcch.net/e/workprog/genaff.html>.

<sup>74</sup> See Proposal by the delegations of Australia, the United Kingdom, and the United States, Working Document No. 1 E, May 2000 available at <http://www.hcch.net/e/workprog/genaff.html>. The proposal argued that “The need for a Convention is urgent because of the systemic risk implications and because the existing legal uncertainty in the area has the potential to impede the growth internationally of financial services industry arrangements for the transfer of securities through multiple tiers of intermediaries.” Exposure is very high: European securitisation issuance alone was Eur. 157.8 billion for 2002 according to the European Securitisation Forum. See <http://www.europeansecuritisation.com/pubs/ESF2002ReportRelease.pdf>; See also, Klaus Lober, “The Harmonisation of the Legal Framework for Rights Evidenced by Book Entries—A Report by the European Financial Markets Lawyers’ Group,” J.I.B.L.R. 2003, 18 (10), 413; Philippe Dupont, Regulatory Aspects of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, 4, available at <http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/dupont.pdf> (“At present, it is very common to find a scenario where a collateral provider in country A provides to a bank, as collateral taker, in country B a pledge over securities issued by issuers of three different nationalities and booked to one account with a central securities depository (CSD) in country C and held physically in the vaults of a local depository or by nominee registration for this CSD in different countries.”)

<sup>75</sup> See Proposal, available at <http://www.hcch.net/e/workprog/genaff.html>. (The ICSA “committed its members to urging their governments to support the consideration of an international Convention on this topic by the Hague Conference on Private International Law at its meeting on general affairs and policy in May 2000.”)

of its Permanent Bureau prior to embarking on the project. The study found that the traditional direct holding system, which was characterized by a direct relationship between the issuer of the securities and the owner, was an anachronism in most modern legal systems.<sup>76</sup> The modern system consisted of tiered relationships between the securities issuer and owner. These tiers consisted of various intermediaries, who made entries on their books in respect of interests relating to themselves.<sup>77</sup> Thus, the law in most countries needed modification to address the range of problems associated with indirect holding systems.<sup>78</sup>

Another feature of the system is fungibility and commingling: the owner's securities were not uniquely identified, thus, owners frequently were only entitled to securities of equal value. This created problems for the property law concept of *lex situs*, which resolved conflicts of law,<sup>79</sup> because commingling effectively eliminates the owner's direct proprietary interest.<sup>80</sup>

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<sup>76</sup> Christophe Bernasconi, *The Law Applicable to Dispositions of Securities Held through Indirect Holding Systems*, Preliminary Document No. 1 of November 2000, available at <[http://www.hcch.net/e/workprog/sec\\_pd.html#pd](http://www.hcch.net/e/workprog/sec_pd.html#pd)> (hereinafter "the Bernasconi Report"). The reasons for moving away from the traditional direct holding systems according to Bernasconi are (1) The cost, human, temporal, and financial; (2) risk of loss and forgery; and (3) "pipeline liquidity (or illiquidity) risk," which was the unavailability of the securities as investment vehicles while the securities were in the postal pipeline. Dupont notes that "investors in securities realized quite some time ago that the transfer of certificated securities by way of physical transfer, which had been the method of transfer for centuries, carried substantial risks of loss, theft and liquidity costs which grew according to the distance between the buyer and the seller of a security. Disregarding existing legal frameworks that were still based on the existence and transfer of physical securities certificates, investors have set up a securities book-entry holding and transfer system that immensely facilitates the transfer of securities through a multi-tiered system of intermediaries without securities actually having to be physically moved." Philippe Dupont, *Regulatory Aspects of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary*, 1, available at <<http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/dupont.pdf>>.

<sup>77</sup> Such intermediaries may operate on several levels. As Potok points out, an example may be of an Australian Investor who holds securities of Illinois Corp, which are recorded by its intermediary, French Bank, which holds interests in respect of Illinois Corp., both for Australian Investor, and its other customers, which are recorded under its name in an omnibus account with a European International Central Securities Depository. The European CSD, in turn holds interests in respect of Illinois Corp., both for French Bank, and for other participants in the ICSD system in an omnibus account with its custodian in the United States, the Californian Sub-custodian. The last named also holds interests in respect of Illinois Corp., for the European ICSD and its other customers with the DTC. See Richard Potok, *CROSS BORDER COLLATERAL: LEGAL RISK AND THE CONFLICT OF LAWS* (London: 2002).

<sup>78</sup> The Bernasconi Report, 3. According to the study, this situation was common to both the substantive law as well as the conflict of law rules.

<sup>79</sup> In the fact situation outlined in n.97, if the Investor in Australia decides to pledge its security interests in respect of Illinois Corp. shares, the creditor must make sure that its interests trump those of third parties by fulfilling the legal formalities of the appropriate law from amongst a host of competing laws, viz., Illinois law, which may be the law of the place of incorporation, New Jersey law, which may be the law of the place of the register of the underlying securities, New York law, as the law of the DTC, California law, as the law of the Sub-custodian, the law of the European ICSD, French law, as the law of the place of French Bank, or Australian law, which is the law of the place of the debtor. In addition, the law, if any that the parties have chosen in their agreement, and the law of the place of the creditor may also be implicated.

<sup>80</sup> The Bernasconi Report, 19. Under traditional rules common to both the common law and civil law, depositors retain property rights in respect of property held by a depository so long as it has not been commingled. In the event that the property is commingled, the depositor may have a contractual claim for the same amount and type of property, or may have a common, co-ownership interest in the commingled pool along with other depositors.

Legal systems have adopted a variety of approaches to solve the resulting difficulties.<sup>81</sup> Some systems only recognized a contractual right when there was commingling; others conferred a co-proprietary right to the owner. These differences created serious uncertainties with regard to the applicable law.<sup>82</sup> The traditional approach was the *look through* approach: the law assumed that the intermediaries were transparent and looked through them to the ultimate issuer or registrar. The feasibility study found that this approach created “severe practical difficulties:”<sup>83</sup> serious transaction costs and systemic risk due to legal uncertainties.<sup>84</sup> The study concluded that the Hague Conference should create a uniform standard to determine the law applicable to proprietary aspects of intermediary transactions.<sup>85</sup> Most scholars assumed that the convention would embody the Place of the Relevant Intermediary Approach (PRIMA).<sup>86</sup> However, it became apparent quickly that the problem necessitated a new approach based on the reality that a record would only be maintained by the intermediary with whom the owner has a direct relationship. Thus, the solution was to look to the account agreement.

The conclusions of the feasibility study were buttressed by the views of experts and market participants.<sup>87</sup> The nature of the problem meant that national solutions would be inadequate. One expert noted: “only a multi-national law reform will help cure the problem as local initiatives would always be subject to the risk of being challenged abroad.”<sup>88</sup> The

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<sup>81</sup> These range from the antiquated no-commingling approach of some German intermediaries which hold certificates held together by a ribbon stating the name of the actual owner, to co-proprietary rights which may pertain to actual or notional pools of securities.

<sup>82</sup> The Bernasconi Report, 27–29. See Philippe Dupont, Regulatory Aspects of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, 5, available at <<http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/dupont.pdf>>.

<sup>83</sup> The “look through” approach refers to the process whereby the law looks through the levels of intermediaries until it reaches the issuer, register, or actual certificates. *Id.* 27. The problems that the “look through” approach runs into when confronted with fungible securities is obvious: it runs into a veritable brick wall, on account of the fact that there is no record on any interest of the investor, except with the intermediary with which it has a direct relationship. Thus, a movement through the levels of intermediaries will be frustrated. Further, the collateral taker may be forced to satisfy the perfection requirements of many jurisdictions. *Id.* 29. The study also found that “it is uncertain exactly what the legal rule is when applying the “look though approach”—is it the law of the place of the issuer, the place of the register or the place of the underlying securities?” *Id.*

<sup>84</sup> The Bernasconi Report, 29.

<sup>85</sup> *Id.* 29.

<sup>86</sup> *Id.* 29. This was to become known as the “place of the relevant intermediary approach” or “PRIMA” a term that was reportedly coined by Richard Potok. See Richard Potok, CROSS BORDER COLLATERAL: LEGAL RISK AND THE CONFLICT OF LAWS (London: 2002).

<sup>87</sup> See p.2 of Text of Letter from Richard Metcalfe, Co-Head of the European Office of ISDA to the Secretary General of UNIDROIT dated 6th September 2002, stating that “there are a number of weaknesses in the legal framework for indirectly held securities in many, if not most, jurisdictions around the world.”; Randall Guynn, Modernizing Securities Ownership, Transfer and Pledging Laws, A Discussion Paper published by the Capital Markets Forum of the International Bar Association, 1996, at 9; Klaus Lober, “The Harmonisation of the Legal Framework for Rights Evidenced by Book Entries—A Report by the European Financial Markets Lawyers’ Group,” J.I.B.L.R. 2003, 18 (10), 413.

<sup>88</sup> Dupont, *op. cit.*, at 8.

Securities Industry Association (SIA), a key market participant, also supported an international solution.<sup>89</sup> Some experts even suggested that the present situation “put[s] at risk the capital base of banks as well as payment systems and the central banks that run these systems.”<sup>90</sup>

The Hague Conference drafted a convention in a remarkably short time: two years. The convention looks to the account agreement to determine the applicable law. It contains several default rules where the account agreement does not determine the applicable law. It has been signed by the United States and Switzerland, and is awaiting ratification by major players like the European Union.<sup>91</sup>

This example calls into question both the functional and liberal claims that soft law preference is tied to uncertainty and low domestic salience. It also casts doubt upon Raustiala’s claim that legality and depth have a negative correlation.<sup>92</sup> More specifically, Raustiala argues that pledges are deeper than contracts because they do not raise compliance worries. Hence states prefer pledges if they want to make deep commitments rather than shallow ones. Conversely, states will prefer hard law when they are making shallow commitments. Thus, hard law is likely to exhibit higher levels of compliance. However, even assuming that ratification is a proxy for compliance, empirical evidence reveals low levels of ratification for conventions. Accordingly, other factors affect ratification beyond the depth of commitments. Based on the empirical evidence, one could even argue that compliance has little or no meaning in the transnational commercial law context because of its dispositive nature.

Raustiala then advances a seemingly contradictory functionalist argument: legality correlates positively with depth. Thus, states embody their agreements in hard law when they are making deep commitments.<sup>93</sup> Both explanations can be understood by addressing the risk of compliance: a negative correlation exists when a state may not want to comply, and a

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<sup>89</sup> The Securities Industry Association in its comments on the (then) proposed Hague Convention, noted that “[p]ublic trust and confidence in the capital markets, as well as market efficiency, are enhanced when national laws are harmonized to ensure legal certainty and predictability, so that parties’ expectations as to the applicable law governing their transactions are not frustrated. The Committee believes that the work on the Convention by the delegates to the Hague Conference will substantially advance these policy goals regarding transactions where securities are held as collateral.” Text of letter from Michael Viviano, Chairman, SIA Operations Committee, to Christophe Bernasconi, dated 7th December 2001, on file with the author. The SIA, according to the letter, represents the interests of about 700 securities firms.

<sup>90</sup> Philippe Dupont, *supra* note 78, at 7.

<sup>91</sup> [www.hcch.net](http://www.hcch.net)

<sup>92</sup> Raustiala, *supra* note 6, 601.

<sup>93</sup> *Id.* 602.

positive correlation exists when a state wants other states to comply.<sup>94</sup> Also, the correlation between legality and depth will be positive when powerful domestic constituencies push for the agreement and will be negative when the domestic constituencies demanding agreement lack political power.<sup>95</sup>

Despite their explanatory power in public law, these correlations do not translate to transnational commercial law. The ICC and its constituents possess significant political power but still chose to draft the UCP 600 and the Incoterms as non-convention law. Conversely, the aircraft manufacturing and leasing industries also possess enormous political clout, and, unlike the ICC, chose to structure their agreement as a convention.<sup>96</sup> One could reasonably conclude that political clout can be employed to choose both hard law and soft law, thus diluting its explanatory power. For example, consider a segment of the economy that does not have much political power: small businesses that enter into international contracts on a daily basis. If Raustiala is right, the CISG should have been designed as soft law rather than a convention. The same is the case with the UNIDROIT Conventions on International Financial Leasing, and International Factoring.<sup>97</sup> However, contrary to the correlation thesis, both international commercial agreements took the form of hard law.

## B. LIBERAL THEORIES

Liberal theorists, such as Moravcsik, place non-state actors at the center of international politics.<sup>98</sup> They argue that non-state actors influence both the behavior and preferences of governments.<sup>99</sup> These non-state actors, whom Moravcsik calls *societal actors*, “are on the average rational and risk-averse and ... organize exchange and collective action to promote differentiated interests under constraints.”<sup>100</sup> Liberal theory is premised on a *bottom-up* approach: the preferences of non-state actors “are treated as exogenous causes of the interests underlying state behavior.”<sup>101</sup> One interest group or another captures a state, which

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<sup>94</sup> *Id.*

<sup>95</sup> *Id.* This might explain the deep commitments in the WTO agreements.

<sup>96</sup> See, Sandeep Gopalan, *Securing Mobile Assets: The Convention on International Interests in Mobile Equipment*, 29 N.CAROLINA J. INT'L L. 59 (2003).

<sup>97</sup> [www.unidroit.org](http://www.unidroit.org)

<sup>98</sup> Andrew Moravcsik, *Taking Preferences Seriously: A Liberal Theory of International Politics*, 51 INT'L ORD. 513, 523 (1997).

<sup>99</sup> Governments behave in ways that are determined by the bargains struck by these non-state actors, and state behavior is determined by state preferences as articulated by these actors.

<sup>100</sup> Andrew Moravcsik, *Taking Preferences Seriously: A Liberal Theory of International Politics*, 51 INT'L ORD. 513, 516 (1997).

<sup>101</sup> *Id.*

then expresses those preferences in international politics.<sup>102</sup> Thus, non-state actors prefer contracts to pledges,<sup>103</sup> as exemplified by the land mines convention, TRIPS, and agreements on environmental protection.<sup>104</sup>

However, this preference for hard law can also be explained by the fact that these subject areas are not dispositive. These agreements have aspects of the mandatory laws of nation states because non-state actors had little choice other than conventions if they aimed to design a successful agreement. Accordingly, the choice of hard law is determined by the extent to which the subject matter is amenable to self regulation. If state assistance is needed for regulation, hard law will result and vice versa. Nevertheless, in the transnational commercial law area, the perception of compliance does not motivate non-state actors to choose hard law. This is because non-state actors are likely to be highly integrated and thus possess sanctioning mechanisms that stem from membership. For example, the International Chamber of Commerce, which has crafted international agreements in several areas, has favored non-convention law, as in the UCP 600 where banks and financial institutions being members facilitated enforcement without state involvement.<sup>105</sup>

Some have argued that domestic political pressures play a role in the choice between pledges and contracts.<sup>106</sup> This is certainly true in hotly-contested areas. However, political pressure is unlikely to be a factor in transnational commercial law. By definition, international agreements are restricted to commercial transactions and almost invariably exclude consumer transactions,<sup>107</sup> thus insulating transnational commercial law from political pressures. The insulation is so powerful that political apathy is more visible than political interest. This is partly to blame for the low rate of ratification of transnational commercial law conventions: they are almost never interesting enough for politicians to prioritize.<sup>108</sup> Therefore, the desire

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<sup>102</sup> Id. 518.

<sup>103</sup> Raustiala, supra note ...596.

<sup>104</sup> Id.

<sup>105</sup> ICC's most well known instruments include the Incoterms, which are standard international trade definitions used in international contracts, the Uniform Customs and Practice for Documentary Credits (UCP 600), which are the rules that are applied by financial institutions to finance world trade, and international commercial arbitration under the ICC Rules. See, <http://www.iccwbo.org/id93/index.html>. The ICC's website echoes the point made above: "The conviction that business operates most effectively with a minimum of government intervention inspired ICC's voluntary codes."

<sup>106</sup> Raustiala, supra note 6, 598.

<sup>107</sup> One example of this is CISG Article 2: "This Convention does not apply to sales:

(a) of goods bought for personal, family or household use, unless the seller, at any time before or at the conclusion of the contract, neither knew nor ought to have known that the goods were bought for any such use..."

<sup>108</sup> Roy Goode, *Contract and Commercial Law: The Logic and Limits of Harmonisation*, vol. 7.4 Electronic Journal of Comparative Law (November 2003) <<http://law.kub.nl/ejcl/74/art74-1.html>.

to insulate governments from domestic political pressure is unlikely to motivate the choice of soft law versus convention law under the theory that the former is less likely to be brought up for legislative scrutiny.

Liberal theorists also argue that actors consider credibility when choosing between soft law and hard law. When credibility depends on legislative approval, states prefer hard law unless the state possesses other mechanisms to ensure and enhance credibility.<sup>109</sup> However, state credibility is largely irrelevant in the transnational commercial law area: it is the credibility of the parties who enter into contracts that is the relevant consideration. This is unaffected by the law's character being hard or soft.

### C. REALISM

Realists argue that the powerful states's preferences dominate the choice between soft law and hard law.<sup>110</sup> The principal players, states, seek power in a zero sum world.<sup>111</sup> International law is merely an instrument in the hands of powerful states. States choose hard law when they wish to convey the "seriousness" of their "intent to be bound."<sup>112</sup> States will also choose hard law when the other state "demands a strong or lasting commitment," when there is domestic legislative support, and when there is no urgency.<sup>113</sup> Given that realism is predicated on states being the primary players, transnational commercial law's emphasis on non-state actors poses serious problems. If realists are correct, powerful states should have little incentive in entering into transnational commercial law agreements because the advantage that they enjoy in the absence of such agreements would be lost. This advantage is primarily from contracting parties choosing the laws of powerful states to govern their contracts, and to subject dispute to resolution before their courts. Such advantages are enjoyed by the U.S., U.K., and France, and yet these states are frequently at the forefront of drafting transnational commercial law agreements. The U.S. should not have ratified the CISG as early as 1986 because it differs significantly from article 2 of the Uniform Commercial Code. Under the realist view, dominant states should only pursue transnational commercial law agreements to the extent that they can export their own laws to the rest of the world. Given the

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<sup>109</sup> Id. 600.

<sup>110</sup> Jack Goldsmith & Eric Posner, *International Agreements: A Rational Choice Approach*, 44 VA. J. INT'L L. 113 (2003).

<sup>111</sup> See, Gilpin, *The Richness of the Tradition of Political Realism*, 38 INTL. ORG. 290 (1984).

<sup>112</sup> Jack Goldsmith & Eric Posner, *International Agreements: A Rational Choice Approach*, 44 Va. J. Int'l L. 113, 131 (2003).

<sup>113</sup> Id. at 126.

balance of power, such agreements should in most cases be heavily based on the domestic laws of dominant states. Yet, it is invariably the case that these agreements are the results of compromises between the laws of many states. This has not been cited as a reason for states to refuse to ratify the instrument. Realists might point to one example - the U.K.'s reluctance to ratify the CISG is because of its self interest in preserving the dominance of English law. This is facilitated by the fact that the demandeurs of the CISG are weak and diffused, undermining the ability to draw conclusions that might support the realist view. Realism has some traction if the focus is shifted to the relative power of demandeurs who are more important than states in designing transnational commercial law agreements. This might explain why the Cape Town convention was structured as hard law with many mandatory provisions. The demandeurs in that case - Boeing and Airbus were powerful actors and their preferences are reflected in the convention's form, substance, and structure. A hybrid approach that combines the insights from realism with the focus on the role of non-state actors from liberal theory would offer explanatory power. This approach can be labeled *demandeur-centric*.

## II. A DEMANDEUR-CENTRIC APPROACH

An alternative approach to the structuring of international agreements is to look at design and structure from the perspective of those commercial parties demanding agreements. Thus, demandeurs, rather than states, play the central role in the design and structure of international commercial agreements. According to Abbott and Snidal,

demandeurs should seek hard legalization (1) when the likelihood of opportunism and its costs are high, and noncompliance is difficult to detect; (2) when they wish to limit participation to those strongly committed to an agreement; and (3) when executive officials in other states have preferences compatible with those of the demandeurs, but other elites within those states have divergent preferences.<sup>114</sup>

However, functionalist claims do not explain completely the instruments already considered. Opportunism and compliance play a very limited role in transnational commercial law due to its dispositive nature. Functionalists claim that hard law will be preferred when participation is limited to those seeking strong commitments. However, that is rebutted by the existence of the ICC's UCP 600 and the Incoterms. The modified-functionalist claim that soft law will result when demandeurs confront stunted opposition is rebutted by the existence of soft law in

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<sup>114</sup> Abbott & Snidal, *Hard and Soft Law*, supra note 6, 431.

cases where there is no opposition, such as the UNIDROIT Principles, and by the existence of hard law despite opposition, like the Hamburg Convention on Carriage of Goods by Sea.<sup>115</sup>

How, then, does the demandeur-centric approach offer greater explanatory power? Demandeurs will be primarily motivated by the extent to which a transnational agreement necessitates state involvement. Accordingly, there is no tradeoff between form and depth in this calculation. Deep agreements can result if the demandeurs believe that state involvement can be minimal or nonexistent, and equally if they decide that state involvement is essential. Depth is thus not tied to determinations as to form, but rather connected to the degree of demandeur integration. The more diffuse the demandeurs, the shallower the agreement, regardless of whether the agreement is a convention or a non-convention.

Conversely, if demandeurs are tightly integrated and capable of self-policing, then they exhibit a preference for non-convention law because of minimal reliance on state intervention. The demandeurs in this scenario are confident in their ability to get the agreement to work without state support. Integration confers on demandeurs state-like police powers and they serve as enforcers outside the state system. In this case, the choice of convention law would be inimical to their interests because of the need to co-opt state actors who may lack technical expertise. It may also signal a low level of integration.

One could argue that, even rejecting the depth-hard law correlation, bindingness is still a variable in agreement design. However, the UNIDROIT Principles and the UCP 600 contradict Raustiala's claim that "there is a dearth of state practice in support of the idea that formally nonlegal agreements are actually quasi-legal."<sup>116</sup> Courts and arbitral tribunals in several countries have referred to the UNIDROIT Principles in deciding cases, which is puzzling because several of the disputed contracts do not refer to the UNIDROIT Principles. This suggests that, although the Principles do not bind states, in practice they perform the function of binding law. Conversely, so-called binding laws, such as the CISG, are not so binding because of provisions which allow parties to exclude the convention in whole or in part.<sup>117</sup> Deference to the law that the parties have created, i.e., the contract, is almost universal

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<sup>115</sup> This UN convention was adopted despite opposition from the major shipping nations and industry groups because of the alleged bias in the previous regime in favor of shipping interests. See, [http://www.oecd.org/document/32/0,3343,fr\\_2649\\_34337\\_1866253\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/32/0,3343,fr_2649_34337_1866253_1_1_1_1,00.html).

<sup>116</sup> Raustiala, *Form and Substance*, supra note 6, 590.

<sup>117</sup> CISG article 6: "The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions"; Article 6 of the UN Convention on the Assignment of Receivables in International Trade: "Subject to article 19, the assignor, the assignee and the debtor may derogate from or vary by agreement provisions of this Convention relating to their respective rights and obligations. Such

in transnational commercial law, and severely undermines the claim that demandeurs desire binding law. The deference also does not support a distinction between hard law, like a contract, and soft law, like a pledge: the UNIDROIT Principles are not a pledge in any sense of the word. The hard law versus soft law distinction means little in the transnational commercial law setting: soft law often includes a sense of obligation derived either from membership in the organization that promulgated the law or incorporation of the law into a contract. It is not *soft* in any meaningful sense of the term because it contains obligations just as deep as those embodied in state law.<sup>118</sup>

#### A. CHOICE OF FORM DEPENDS ON DEMANDEURS

Demandeurs choose form and structure based on relative power. An example is the drafting history of the Cape Town Convention.<sup>119</sup> At the outset, UNIDROIT distributed a questionnaire to business and financial circles with the goal of empirically establishing the need for an agreement.<sup>120</sup> About one thousand copies of the questionnaire and an explanatory report were sent to banks, financial institutions, confederations of industry, major industrial bodies, and airlines. The response rate was very low: only ninety-three entities replied. The respondents were primarily from the lending side: fifty-two lenders, eight sellers, ten buyers, one foreign trade corporation, two governmental agencies, ten law teachers, and twelve practicing lawyers.<sup>121</sup> Despite the low response rate, UNIDROIT was satisfied that there was sufficient support and determined that a convention was appropriate. The aircraft industry was involved from the early drafting stages and slowly became the engine of progress. Airbus

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an agreement does not affect the rights of any person who is not a party to the agreement.” Available at <http://www.uncitral.org/pdf/english/texts/payments/receivables/ctc-assignment-convention-e.pdf>.

<sup>118</sup> I make no claims about the functionalist claim that soft law, characterized as non-state law in my scheme, is a way station to hard law. It could serve as a way station because integration collapses or because demandeurs realize that state sanctions are needed to recognize private agreements. I provide several examples of state and non-state law in the following pages to test the demandeur-centric hypothesis.

<sup>119</sup> See Convention on International Interests in Mobile Equipment (adopted on Nov. 16, 2001) (noting that sixty-four nations attended the diplomatic conference in Cape Town, South Africa and fifty-three nations signed the final act); see also Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, at <http://www.unidroit.org/english/conventions/c-main.htm>. The Convention and its Protocol have been ratified by nineteen nations to date. Id.

<sup>120</sup> See UNIDROIT, International Regulation of Aspects of Security Interests in Mobile Equipment: Questionnaire, Study LXXII-Doc. 2 (1989) (noting the need to test five assumptions before proceeding with the preparation of the convention). The assumptions are that (1) valuable mobile equipment is moved across national frontiers; (2) the laws of most nations that deal with security interests are inadequate, (3) the UNIDROIT Convention can address the inadequacies, (4) international experts in the field support the initiatives of the UNIDROIT Convention, and (5) that financing organizations will be more willing to provide financing for high cost mobile equipment if there were accepted international standards regarding the matter. See id.

<sup>121</sup> See UNIDROIT, Analysis of the Replies to the Questionnaire on an International Regulation of Aspects of Security Interests in Mobile Equipment, Study LXXII-Doc. 3 (1991) (concluding that “the types of legal problems arising in the context of the international recognition of security interests in mobile equipment could be adequately addressed through an international convention containing a mix of choice of law and substantive rules the implementation of which would not require sweeping changes in the municipal law of most States”).

Industry and Boeing, the forces behind the aviation working group, wanted an asset-based financing regime.<sup>122</sup>

Not every participant agreed with the aircraft lobby. Some nations claimed that commercially oriented remedies would offend national sovereignty. For example, the Government of Japan in 1999, stated that “imposing under [A]rticle X (1) a 30 day deadline (or any deadline) for obtaining judicial relief would be inconsistent with concepts of civil procedure in Japan and, therefore, unacceptable.”<sup>123</sup> Rather than getting bogged down in ideological debates, the aircraft working group worked around such objections by drafting opt-in rules that states could accept based on their comfort level with asset-based financing principles.<sup>124</sup> Also, in order to quash sovereignty concerns, the aircraft group commissioned an economic impact assessment to demonstrate the need for a convention and the potential benefits of ratification.<sup>125</sup> The EIA concluded that greater reliance on asset-backed aircraft finance instruments would divert financing that would otherwise require sovereign bank credits or sovereign international bond issues into the private sector.<sup>126</sup> Thus, the proposed convention would improve access of developing and emerging country airlines to secured loans and leases on a commercial basis. Following the adoption of the convention, the Export

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<sup>122</sup> For example, one such memorandum stated “To be materially beneficial, the basic (non-exclusive) remedies under the proposed convention of possession/repossession/seizure, judicially supervised sale and judicial sale set forth in the summary report need to be available within an expedited time frame, and notwithstanding any contrary provisions of national law. We recommend, therefore, that the proposed convention provide a mandatory timetable in which courts having jurisdiction under the proposed convention would be required to determine issues brought before them relating to these basic remedies. In particular, we recommend that such courts be required to issue non-appealable, final decisions in respect of the availability of (a) the grounding of the aircraft (pending further litigation procedures) no later than five days, and (b) the right of the financier/lessor to repossession/seizure, or to a judicially supervised sale/judicial sale, of the aircraft no later than thirty days, in each case of the date on which the application is made to the court with in rem jurisdiction over the aircraft.” See UNIDROIT, Study Group for the Preparation of Uniform Rules on International Interests in Mobile Equipment: Subcommittee for the Preparation of First Draft, Study LXXII-Doc. 16 (1995) 16-17 (suggesting changes and additions to the remedies section of the Convention). The Airbus Industry and Boeing Company continue that ‘for commercial reasons, these remedies must be non-exclusive’ in that ‘additional remedies available under the selected law... or under the private international law rules of the forum...must also be available to the transaction parties.’ *Id.* at 16.

<sup>123</sup> UNIDROIT, Committee of Governmental Experts for the Preparation of a Draft Convention on International Interests in Mobile Equipment and a Draft Protocol on Matters Specific to Aircraft Equipment, Study LX11-Doc.49 / (1999) 3.

<sup>124</sup> The AWG wrote that “[o]ur highest priority in participating in the proposed convention is to ensure that contracting states have the option of selecting rules which embody this fundamental principle, thereby permitting transaction parties in their countries to take greater advantage of international asset-based financing in connection with the acquisition of unprecedented amounts of required aircraft equipment . . . . This fundamental principle is but abstract rhetoric if the actual timing element is undefined and potentially open-ended. In direct terms, if this timing element is not addressed, both inside and outside the insolvency contexts, the proposed convention will have a marginal impact on credit, leasing and lending decisions and will thus be of marginal benefit to the air transport industry.” See UNIDROIT, Study Group for the Preparation of Uniform Rules on International Interests in Mobile Equipment, Study LXII- Doc. 32, Add. 2, 3 (1996).

<sup>125</sup> Anthony Saunders & Ingo Walters, Proposed UNIDROIT Convention on International Interests in Mobile Equipment as Applicable to Aircraft Equipment Through the Aircraft Equipment Protocol: Economic Impact Assessment, reprinted in 23 *Air & Space L.* 339 (1998) (hereinafter EIA).

<sup>126</sup> EIA, at xiii.

Import Bank of the United States reduced its exposure fee on financing of U.S. commercial aircraft by one-third for foreign buyers from countries that have ratified and implemented the Cape Town Convention.<sup>127</sup>

Demandeurs, with their dominant position in the market and enormous economic clout, used their leverage to convince states to ratify the convention. Demandeur clout also explains the relatively large number of mandatory provisions<sup>128</sup> in contrast to the CISG. The drafting of controversial provisions as opt-in or opt-out clauses also allowed the industry to bargain more strategically. But for the demandeurs' economic clout, the convention likely would not have included many of these provisions. Even if they had been included, they would have been watered down versions. Because Airbus and Boeing, the two dominant aircraft companies, worked together, the agreement effectuated their preferences. Airbus and Boeing desired a binding convention that created an "international interest," provided expeditious recourse to the asset in case of default, established an international registry, and made available self help remedies. These could only be achieved with state involvement, and, because their market power secured state approval, they chose to embody the agreement in convention form.

The Cape Town convention calls into question Raustiala's depth-legality correlation.<sup>129</sup> One could conclude that the political privilege of the international demandeurs is more important than those of the domestic demandeurs. In the Cape Town convention, the largest number of domestic demandeurs should have been from developing countries, a group that consists of more borrowers than lenders. One would assume that actors from developing countries would prefer less depth: as borrowers, they run the risk of default and could take advantage of delays provided by the domestic legal system. However, their interests yielded to the more powerful international demandeurs. Lenders and aircraft manufacturers carried the day and did not want to take any chances with the borrowers' legal systems.

## B. DEMANDEURS CHOOSE NON-LEGAL AGREEMENTS WHEN THEY DO NOT NEED STATE INVOLVEMENT

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127 Press Release, Export-Import Bank of the United States, Ex-Im Bank Offers One-Third Reduction of Exposure Fee on Export Financing for U.S. Large Commercial Aircraft, at <http://www.exim.gov/pressrelease.cfm/6F76B4BA-1032-5B0F-BDC2F28463DF4239/>.

<sup>128</sup> These provisions cannot be modified or excluded by contract.

<sup>129</sup> Raustiala, *supra* note \_\_, 603. (there will be "a positive correlation between depth and legality when the domestic demandeurs of cooperation are politically privileged, and a negative correlation when they are not.")

The international law literature contains several definitions of “soft law.” This presents a serious conundrum because the definitions contradict. One view holds that “soft laws” are pledges and are not laws at all.<sup>130</sup> Other scholars define soft law as incorporating legal obligations enshrined in “hard law” in a weak form. According to these scholars, if a treaty is worded in a manner that demonstrates no substantive requirements but instead consists of largely hortative generalities, then, regardless of the formal nature of the treaty, the instrument is “soft law”.<sup>131</sup> Under this conception, “hard law” can be “soft” in whole or in part. It is unclear if these scholars apply the same standards to “soft law” to determine if the obligations therein are actually of a substantive nature and hence more appropriately labeled “hard law.” As this description shows, there is very little clarity that appears from this taxonomical nightmare.

#### i. LEGALITY AND *SOFT LAW*

Raustiala, while stating that “soft law” is not a coherent concept, argues that states “carefully choose the legal nature of their agreements dichotomously.”<sup>132</sup> According to him, states focus on the binding nature of an agreement as an ex ante certainty when deciding whether to enter into an international agreement.<sup>133</sup> Thus, a state, when participating in international agreement design, will ask itself if it wants to be bound by the agreement in question. If the answer is yes, it will be in favor of structuring the agreement in the form of “hard law.” If the answer is no, it will be in favor of structuring the agreement in the form of “soft law.” This argument does not address the intentions of non-state actors – do non-state actors structure agreements in the form of soft law when they do not want to be bound by the agreement?

#### ii. *FLEXIBILITY AND SOFT LAW*

A key attribute of “soft law” is perceived flexibility.<sup>134</sup> Soft law is flexible in terms of substantive provisions, party applicability, the absence ratification requisites, and ultimately

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<sup>130</sup> Kal Raustiala, *Form and Substance*, supra note 6, 586.

<sup>131</sup> See R.R. Baxter, *International Law in "Her Infinite Variety"*, 29 *Int'l & Comp. L.Q.* 549, 554 (1980); Christine Chinkin, *The Challenge of Soft Law: Development and Change in International Law*, 38 *I.C.L.Q.* 850, 851 (1989).

<sup>132</sup> Raustiala, supra note 6.

<sup>133</sup> *Id.*

<sup>134</sup> Abbott & Snidal, supra note 6, at 445; Charles Lipson, *Why are Some International Agreements Informal?*, 45 *International Org.* 495, 500 (1991) (“[I]nformal bargains are more flexible than treaties. They are willows not oaks.”); Raustiala, *Form and Substance*, supra note 6, 18.

bindingness or *impact*. Flexibility also pertains to the relevant actors. This is particularly important in the transnational commercial law area and seems to have greater explanatory power than the other kinds of flexibility discussed by public international law theorists. Flexibility in terms of implementation, by executive action rather than ratification, is important in the transnational commercial law area because of legislative disinterest and apathy.<sup>135</sup> Given the rather technical nature of transnational commercial law instruments, legislators rarely place them at the top of the legislative agenda. Despite their great importance for the economy, they may be trumped on the legislative calendar by the *hot* issues of the day. Legislators worry more about re-election than passing significant commercial legislation.

Flexibility, one scholar argues, is important because of opposing interest group pressure.<sup>136</sup> Guzman writes that when domestic interest groups are championing international agreements they are likely to favor binding conventions because they prefer the most binding form possible.<sup>137</sup> Accordingly, when competing interest groups collide, states are likely to adopt “soft law.” In fact, the evidence in the transnational commercial law area does not support this view. International agreements appear to be concluded almost entirely in the absence of colliding interest group pressure of any significance. Agreements result almost exclusively when dominant interest groups push for them, and in the few instances where opposition has materialized, the proposed agreement has been dropped from the legislative agenda of the law-making agency.<sup>138</sup>

### iii. NON-ENFORCEABILITY AND SOFT LAW

Scholars have argued that, by definition, an international law lacking enforceability is soft law.<sup>139</sup> However, this view is too simplistic. In the context of international private law, agreements lacking direct enforcement nevertheless can become binding in some form. One example is the UNIDROIT Principles of International Commercial Contracts which were drafted almost entirely at the instance of academics without any state involvement

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<sup>135</sup> Scholars have argued that implementation flexibility is important when speed is of the essence and/or when legislative support is doubtful because of the hostility of legislators to the substantive commitments in the international instrument. While this can be a powerful motivation in controversial areas like nuclear weapons control, or antiterror activities, legislative boredom is more plausible in the case of franchising conventions and conventions on international receivable financing!

<sup>136</sup> Guzman, *The Design of International Agreements*, supra note 6.

<sup>137</sup> *Id.*

<sup>138</sup> The Hoteliers liability convention that was dropped by UNIDROIT is a classic example.

<sup>139</sup> R.R. Baxter, *International Law in “Her infinite Variety,”* 29 INT’L & COMP. L. Q 549 (1980).

(“UNIDROIT Principles”).<sup>140</sup> Guided in spirit by the American experience with restatements, the drafters of the UNIDROIT Principles drafted default rules that could apply when parties had not specified in a contract the applicable national law. They were the product of wide-ranging comparative law study and created new rules for international contracts. A major criticism of the drafting effort is a lack of significant involvement by industry groups.

Given that the UNIDROIT Principles are expressly nonbinding, there was no need to worry about obtaining ratifications from states. This probably contributed to the willingness of the drafters to look beyond existing national approaches.<sup>141</sup> The success of the Principles must give pause for thought to the drafting agencies whose thinking is convention-centered, and there is some evidence that UNIDROIT Principles-like vehicles are being considered more seriously than before.<sup>142</sup> This is so even where the objective is to reduce great divergences in national laws, as in Europe, contradicting the argument that binding conventions will be favored in such cases.<sup>143</sup> The success of the UNIDROIT Principles suggests the merits of incrementalism in agreement design. Demandeurs can employ such vehicles to create a favorable climate for a convention in areas that are more amenable. Because ratification is unnecessary, these vehicles can be modified readily and parties have more choices with regard to substantive provisions.<sup>144</sup> They serve educational functions for national legislative bodies, and many provisions might become part of national law and hence become binding.<sup>145</sup> Both the UNIDROIT Principles and the Principles of European Contract

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<sup>140</sup> See, Response submitted on behalf of the Society of Public Teachers of Law in Great Britain and Northern Ireland (SPTL) to the European Commission’s Communication on Contract Law. The response further states that the UNIDROIT Principles could form the basis of a legal “restatement” of contract principles to which contracting parties could subscribe on a voluntary basis on a European level. According to them, an English court would give effect to a contractual agreement to apply the UNIDROIT Principles in place of the general rules of English law.

<sup>141</sup> UNIDROIT, *Principles of International Commercial Contracts*, Introduction, vii (1994). (“[e]fforts towards the international unification of law have hitherto essentially taken the form of binding instruments, such as supranational legislation or international conventions, or of model laws. Since these instruments often risk remaining little more than a dead letter and tend to be rather fragmentary in character, calls are increasingly being made for recourse to non-legislative means of unification or harmonization of law.”)

<sup>142</sup> The Joint Response of the Commission on European Contract Law and Study Group on European Civil Code to the Communication on European Contract Law, states the authors’ belief that this is their preferred vehicle for European integration. Joint Response, paragraph 33, noting that “[t]he preparation of a restatement of European private law is an indispensable foundation for further European legal integration.”

<sup>143</sup> Abbott and Snidal, *supra* note 6, 423, 438.

<sup>144</sup> See, ICC Response: “Although ICC would like to express concerns as to whether non-binding principles are sufficient, it would like to also emphasize that such principles are an effective first step towards harmonization. Important attempts already exist, such as the UNIDROIT Principles of International Commercial Transactions, which are increasingly referred to in international contracts and in arbitration. Another example is the Principles of European Contract Law, which ICC considers could serve as an excellent starting point for the harmonization of European contract law.”

<sup>145</sup> See, COMBAR Response: “In our view, the work of the Commission on European Contract Law, and the Study Group on a European Civil Code is valuable, and should be supported. A “Restatement” of contract law, which is what we would expect to be the end result, though not in itself binding, may be expected to “harden” into law, for example, by influencing the judicial process. At the least, where a provision of national contract law

Law (PECL) have been consulted extensively by national legislators, including sophisticated jurisdictions like Germany, Scotland, and Spain.<sup>146</sup> Flexibility can also benefit contracting parties to the extent that courts and arbitral tribunals are willing to recognize party autonomy to choose non-state law to govern their contracts.<sup>147</sup> In the European Union, efforts to increase party autonomy to facilitate the choice of the UNIDROIT Principles and the PECL reached a crescendo in calls for amendments to the Rome Convention on the Law Applicable to Contracts.<sup>148</sup> This is truly remarkable, because a piece of binding law is sought to be amended to allow resort to non-binding law that can displace the national laws of the contracting states. In addition to legislative efforts, the receptivity of national courts to international restatements can play a major role in their bindingness.<sup>149</sup>

#### iv. THE UNIDROIT PRINCIPLES

The UNIDROIT Principles were drafted by a group of leading experts on commercial law.<sup>150</sup> These experts included academics, judges, and civil servants, but not industry actors. The members of the drafting group had no affiliations with states and were appointed entirely for

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diverges from those as stated in principles, courts may be encouraged to consider whether such divergence is in fact justified by reference to conditions obtaining in the country concerned.”

<sup>146</sup> Joint Response, paragraph 37.

<sup>147</sup> In Professor Goode’s view the PECL and the UNIDROIT Principles have been successful “precisely because they are not binding, have not been influenced by governments and do not pose any threat to national legal systems. Like the UNCITRAL Model Law on Arbitration they are designed to be a unifying influence and a resource, but it is left to legislatures, courts and arbitral tribunals to decide to what extent they assist in the solution of problems.” See, Prof. Goode’s Response to the European Commission’s Communication on a European Civil Code. He also notes that the UNIDROIT Principles have been “widely applied by arbitral tribunals, and even by some courts, and have influenced national legislation in a number of countries.” Id.

<sup>148</sup> The Joint Response notes that party autonomy can be facilitated even more if the Rome Convention were to allow the application of restatements. (“[o]ffering an additional legal system to choose as the governing law for a contract would go a long way beyond merely offering terms that can be incorporated into an agreement. It would represent a very substantial and effective enhancement of the parties’ autonomy because the law at their disposal would be one which is pan-European and non-partisan in nature and which will therefore have immediate appeal as an escape from the battle of choosing one or other of the parties’ national laws.”) Id. Paragraph. 36. The European Commission submitted a draft in December 2005 to amend Article 3 to provide: “[t]he parties may also choose as the applicable law the principles and rules of the substantive law of contract recognised internationally or in the Community [ . . .].” See, Proposal for a Regulation of the European Parliament and the Council on the Law Applicable to Contractual Obligations (Rome I), COM (2005) 650 final (Dec. 15, 2005).

<sup>149</sup> See, Opinion of the Economic and Social Committee on the ‘Communication from the Commission to the Council and the European Parliament on European contract law’ writing that, “in Europe recognition of these private ‘codes’ by national judges when interpreting contract clauses, clarifying the intention of the parties or settling disputes is a problem, while elsewhere, non-State law can be taken into account, as is the case, for example, under the Mexico Convention.” OJ C 241, dated 7.10.2002.

<sup>150</sup> The members of the working group (part II) included Bonell (Italy), Baptista (Brazil), Crepeau (Canada), Date Bah (Ghana), Di Majo (Italy), El Kholi (Egypt), Farnsworth (United States), Finn (Australia), Fontaine (Belgium), Furmston (U.K.), Hartkamp (Netherlands), Huang (China), Jauffret-Spinosi (France), Komarov (Russia), Lando (Denmark), Schlectreim (Germany), and Uchida (Japan).

their expertise.<sup>151</sup> This enabled a more ecumenical approach to drafting and did not foreclose the possibility of inventing solutions that were foreign to national legal systems.<sup>152</sup>

In less than two decades the Principles have attained a modicum of success in attracting the attention of courts, arbitral tribunals, and national legislatures. Its status as the embodiment of the current state of the art of international contract law motivated national legislators to refer to it in the process of enacting new legislation.<sup>153</sup> For example, the drafting of the Russian Civil Code, the Estonian Law of Obligations, and the Civil Code of the Republic of Lithuania, all witnessed resort to the Principles.<sup>154</sup>

The demandeurs expressly decided against structuring the UNIDROIT Principles as a convention. However, that has not prevented the UNIDROIT Principles from being enforceable either by contractual incorporation or by tribunals even in cases where contracts made no reference to them. Such use will likely grow if Article 3 of the proposed Rome I Regulation<sup>155</sup> of the EU is issued allowing contracting parties to choose non-state contract law to govern their contract.<sup>156</sup>

Courts have referred to the Principles in several countries, including the U.S. In *Ministry Of Defense and Support for the Armed Forces of the Islamic Republic of Iran v. Cubic Defense Systems, Inc.*,<sup>157</sup> one of the questions before the court was whether the arbitral tribunal's application of the UNIDROIT Principles was a ground for vacatur of the award

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<sup>151</sup> Gesa Baron, *Do the UNIDROIT Principles of International Commercial Contracts form a new lex mercatoria?*

<sup>152</sup> Inevitably, instruments such as the American Uniform Commercial Code, the Restatement (Second) of the Law of Contracts, the draft of the new Dutch Civil Code and the new Civil Code of Québec, which were more current embodiments of the law, came in for more detailed consideration. The drafters also resorted to the 1980 Vienna Sales Convention as it reflected international consensus, at least on the law of sales.

<sup>153</sup> Arthur Rosett, *The UNIDROIT Principles of International Commercial Contracts: A New Approach to International Commercial Contracts*, 46 AM. J. COMP. L. 347, 348 (1998). ("immensely valuable to those who seek a structure to commercial contract law that can provide predictable and harmonious outcomes everywhere.")

<sup>154</sup> M. J. Bonell, "An International Restatement of Contract Law", (2<sup>nd</sup> ed., 1997) 236 et seq; M. Williams, 'An Introduction to General Principles and Formation of Contracts in the New Chinese Contract Law,' 17 Journal of Contract Law 13, 20 (2001).

<sup>155</sup> The proposed Regulation would allow parties to choose "the principles and rules of the substantive law of contract recognised internationally or in the community". For articles stating that the new Austrian Arbitration Act would allow parties to choose the Unidroit Principles, See, Christoph Liebscher & Florian Haugeneder, Looking At The New Austrian Arbitration Law Through The Spectacles Of The English Arbitration Act 1996, 9 (4) Int. A.L.R. 109 (2006); Stefan Riegler, Is Austria Any Different? The New Austrian Arbitration Law in Comparison with the UNCITRAL Model Law and the German Arbitration Law, 9(3) Int. A.L.R. 69 (2006).

<sup>156</sup> See, Stuart Dutton, A Dangerous Proposal - The European Commission's Attempt To Amend The Law Applicable To Contractual Obligations, J.Bus.L. 608-618 (2006).

<sup>157</sup> 29 F.Supp.2d 1168, 1999 Daily Journal D.A.R. 2924 (1998).

under article V (1)(c) of the New York Convention on the recognition and enforcement of foreign arbitral awards. The defendant argued that such use of the Principles exceeded the scope of the Terms of Reference. The court was unimpressed: “[t]he reference to the UNIDROIT Principles does not exceed the scope of the Terms of Reference....The Tribunal's reference to and application of the UNIDROIT Principles and principles such as good faith and fair dealing do not violate Article V(1)(c).”<sup>158</sup>

In *Great Hill Equity Partners II LP v. Novator One LP*,<sup>159</sup> the question was whether certain statements made during pre-contractual negotiations could be used to construe the agreement.<sup>160</sup> The court referred to the UNIDROIT Principles alongside the CISG for the proposition that all relevant circumstances must be considered in construing the intention of the parties.<sup>161</sup> A similar question arose in *The Square Mile Partnership Limited v. Fitzmaurice McCall Limited*,<sup>162</sup> and the court once again referred to article 4.3 of the Principles in addition to scholarly commentary.<sup>163</sup> In *Econet Satellite Services Ltd v. Vee Networks Ltd*,<sup>164</sup> the parties had a clause in the contract stating that it shall be “interpreted in accordance with the UNIDROIT Principles of International Commercial Contracts of the International Institute for the Unification of Private Laws [1994] as then in force, applied *mutatis mutandis* to the extent not inconsistent therewith.” There was no objection to this by the Queen’s Bench.

In an Argentinean case in 2004,<sup>165</sup> despite no reference to the UNIDROIT Principles in the contract, which was between a bank and its customer concerning a credit card issued by the former, the court explicitly referred to article 2.4 of the Principles as an exemplar of “modern law.”<sup>166</sup> There are six Australian cases listed on the Unilex database that have referred to the Principles. In *Hughes Aircraft Systems International v. Airservices*

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<sup>158</sup> Id. at 1173.

<sup>159</sup> [2007] EWHC 1210 (Comm) (2007).

<sup>160</sup> A similar point arose in *Proforce Recruit Limited v. The Rugby Group Limited*, [2006] EWCA Civ 69. See also, *Svenska Petroleum Exploration Ab v. Government Of The Republic Of Lithuania (No 2)*, [2005] EWHC 2437 (Comm).

<sup>161</sup> “The UNIDROIT Principles of International Commercial Contracts give primacy to the common intention of the parties and on questions of interpretation requires regard to be had to all the circumstances, including the pre-contractual negotiations of the parties ( article 4.3 ).” Id. at paragraph 57.

<sup>162</sup> [2006] EWCA Civ 1690 (2006). See, Anna Rogowska, CISG in UK: How Does The CISG Govern The Contractual Relations Of English Businessmen, I.C.C.L.R. 2007, 18(7), 226-230 (“the decisions are particularly important for the future development of English law; they raise the status of the two international instruments in the English courts, granting them a greater level of acceptance and popularity.”)

<sup>163</sup> Id. at paragraph 62.

<sup>164</sup> [2006] 2 Lloyd's Rep. 423.

<sup>165</sup> Case dated 10.6.2004, decision of the Cámara Nacional de Apelaciones en lo Comercial de la Capital Federal (CNCom Sala B), available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13619&x=1>.

<sup>166</sup> Id.

*Australia*,<sup>167</sup> the court noted that the Anglo-Australian law on the duty of fair dealing was indecisive, but that “[i]t has been propounded as a fundamental principle to be honoured in international commercial contracts” by the UNIDROIT Principles of International Commercial Contracts in Article 1.7,<sup>168</sup> and held that “recognition [of the duty] in our own contract law is now warranted.” This decision was cited with approval by the Supreme Court of New South Wales in *Alcatel Australia Ltd. v. Scarcella & Ors.*<sup>169</sup> In *Aiton v. Transfield*,<sup>170</sup> the dispute was about the proper construction of a clause in the agreement which provided that “[t]he Purchaser [Transfield] and Supplier [Aiton] shall make diligent and good faith efforts to resolve all [d]isputes.” The court noted the “interest generated by international instruments such as the UNIDROIT Principles of International Commercial Contracts ...which specifically refer to a requirement of "good faith" in contracts” and held that the clause was enforceable.<sup>171</sup>

A similar question arose before the Supreme Court of Western Australia in *Central Exchange Ltd v Anaconda Nickel Ltd.*<sup>172</sup> The court referred to *Hughes Aircraft Systems* and seemed inclined to imply a duty of good faith. A more significant decision for the authority of the Principles is *GEC Marconi Systems Pty Ltd. v BHP Information Technology Pty Ltd.*<sup>173</sup> Despite the contract being subject to the domestic law of Australia, the court referred to articles 1.7, 2.1.8,<sup>174</sup> and 6.14<sup>175</sup> of the UNIDROIT Principles. In *Tan Hung Nguyen v Luxury Design Homes*,<sup>176</sup> also a case involving the application of domestic law, the court referred to article 6.14, comment 2, to find that complete performance was not a condition for the payment obligation. The Principles were recently cited by the High Court of Delhi in a purely domestic dispute between two parties over the consummation of a sale agreement for an apartment despite the fact that the circumstances would ordinarily not have led to them being

<sup>167</sup> Federal Court of Australia, 30.6.1997, available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13619&x=1>.

<sup>168</sup> Article 1.7: “(1) Each party must act in accordance with good faith and fair dealing in international Trade; (2) The parties may not exclude or limit this duty.”

<sup>169</sup> Available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13619&x=1>.

<sup>170</sup> [1999] NSWSC 996, available at [http://www.austlii.edu.au/au/cases/nsw/supreme\\_ct/1999/996.html](http://www.austlii.edu.au/au/cases/nsw/supreme_ct/1999/996.html).

<sup>171</sup> Supreme Court of NSW, 01.10.1999, Available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13619&x=1>.

<sup>172</sup> Available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13619&x=1>.

<sup>173</sup> *Id.*

<sup>174</sup> “ARTICLE 2.1.8 (*Acceptance within a fixed period of time*): A period of acceptance fixed by the offeror begins to run from the time that the offer is dispatched. A time indicated in the offer is deemed to be the time of dispatch unless the circumstances indicate otherwise.”

<sup>175</sup> ARTICLE 6.1.4 (*Order of performance*): (1) 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; (2) To the extent that the performance of only one party requires a period of time, that party is bound to render its performance first, unless the circumstances indicate otherwise.”

<sup>176</sup> [2004] NSWCA 178 (11 June 2004), available at <http://unilex.info/dynasite.cfm?dssid=2377&dsmid=13619&x=1>.

applicable.<sup>177</sup> This is the only court decision from India citing the Principles on the Unilex database.

Courts have rejected arguments against application of the UNIDROIT Principles in arbitration because they are beyond the submission to arbitration. In a recent French case, *Société FORASOL v. Société mixte Franco-Kazakh CISTM*,<sup>178</sup> where French law governed the contract and the arbitrator had referenced the UNIDROIT Principles as a “codification of trade usages”, the court apparently approved of such reference when the chosen law was unclear on the particular topic and held that it was not beyond the terms of arbitration. A similar challenge, albeit where a court applied the UNIDROIT Principles notwithstanding the fact that domestic law governed the contract, is on appeal in the Chinese case of *Hengxing Company v. Guangdong Petrochemical Subsidiary Company*.<sup>179</sup> In a Russian arbitration, the claimant objected to the respondent’s invocation of the UNIDROIT Principles when Russian law was the governing law, and the tribunal refused to apply the Principles due to the objection.<sup>180</sup>

Some courts have made it clear that the Principles are not binding, but cited them as confirming international consensus on a particular issue.<sup>181</sup> A Swiss court indicated that the UNIDROIT Principles could be chosen by the parties to apply to their contract despite being “anational law” because they are “transnational in character and sufficiently coherent.”<sup>182</sup> The judgment of this court was reversed on appeal, but the Supreme Court endorsed the lower court with regard to the parties’ ability to choose the Principles to govern their contract.<sup>183</sup> Arbitral tribunals have been favorable to parties choosing the Principles despite the existence of domestic law. In a recent award rendered by the *Centro de Arbitraje de México (CAM)* where the parties were Mexican and American, but had chosen the UNIDROIT Principles to

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<sup>177</sup> Sandvik Asia Pvt. Ltd. v. Vardhman Promoters Pvt. Ltd., <http://unilex.info/dynasite.cfm?dssid=2377&dsmid=13617> (“UNIDROIT Principles, Article 4.4. All terms in the contract must be given effect rather than deprive some of them of the effect.”).

<sup>178</sup> Cour d’appel de Paris (1er Ch.C.), available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13619&x=1>.

<sup>179</sup> The appeal is from the decision of the Guangdong Intermediate People’s Court, available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13619&x=1>.

<sup>180</sup> International Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation, No. 174/2003, 12.11.2004, available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13620&x=1>.

<sup>181</sup> See, Tribunale Padova - Sez. Este decision dated 10.1.2006, where the court held that unless otherwise agreed to by the parties, the place of delivery was the place where the seller handed over the goods to the first carrier stating that “this solution is confirmed by two other equally autonomous, though not binding, instruments such as the UNIDROIT Principles of International Commercial Contracts (Art. 6.1.6(1)) and the Principles of European Contract Law (Art. 7:101(1)(b))”.

<sup>182</sup> Decision of the Bundesgericht, dated 20.12.2005.

<sup>183</sup> Decision of the Handelsgericht St.Gallen, dated 12.11.2004 available at unilex.info.

govern the contract, the Tribunal resorted to Article 1445 of the Mexican Commercial Code which allowed it to decide the dispute according to the “rules of law” chosen by the parties.<sup>184</sup> In the Tribunal’s view, the status of the UNIDROIT Principles and its application in many international arbitral proceedings gave it the status of “rules of law.”

One Italian court refused to resort to the Principles when the contract was governed by English law.<sup>185</sup> A more friendly attitude was adopted by the Court of Appeal of New Zealand which, despite the fact that domestic New Zealand law was applicable to the contract, desired to make

[r]eference ... to the Unidroit Principles of International Commercial Contracts published in 1994. This document, which is in the nature of a restatement of the commercial contract law of the world, refines and expands the principles contained in the United Nations Convention. Particularly relevant for present purposes is Article 4.3. Having stipulated that a contract is to be interpreted according to the common intention of the parties (4.1), and that the statements and other conduct of a party shall be interpreted according to that party's intention if the other party knew or could not have been unaware of that intention (4.2), Article 4.3 provides that, in applying these general principles, regard should be had to all the circumstances including "preliminary negotiations between the parties". Clearly, it is desirable that the approach of the Courts in this country to the interpretation of statutes should be consistent with the best international practice. (internal citations omitted).<sup>186</sup>

Similarly, the Supreme Court of Poland, in concluding that penalty clauses are valid despite the nonbreaching party suffering no damage, said that “the view expressed in this resolution is supported by legal solutions found in regulations of international contract law pertaining to the institution of contractual penalties,” specifically “[i]n Art. 7.4.13 [of the] UNIDROIT Principles ... [which] state[s] that if a contract provides for the payment of penalty in case of default, then the other party shall have the right to claim the agreed amount, regardless of the scope of the incurred damage.”<sup>187</sup> A novel approach to the application of the Principles can be

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<sup>184</sup> Centro de Arbitraje de México (CAM), 30.11.2006.

<sup>185</sup> Universal Pictures International No 2 BV v. Curatela Del Fallimento Academy Pictures S.R.L, Tribunale Rovereto, 15.03.2007, available at <http://unilex.info/dynasite.cfm?dssid=2377&dsmid=13617>.

<sup>186</sup> Hideo Yoshimoto v Canterbury Golf International Limited, (2000) NZCA 350, Available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13619&x=1>.

<sup>187</sup> Case no. III CZP 61/03, Supreme Court of Poland, available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13619&x=1>.

found in the decision of a Costa Rican arbitral tribunal concluding that there was a duty of good faith:

Without applying them as a source of law not agreed upon or invoked by the parties, but instead for their doctrinal value, it is relevant to recall that the [Principles] were repeatedly applied in several awards of the I.C.C. International Court of Arbitration up until 1998 and also in domestic arbitration. These Principles are the result of years of intensive comparative investigation and deliberation carried out by a group of selected legal experts from the most diverse legal systems ....<sup>188</sup>

In another Costa Rican arbitration, the tribunal applied the Principles because they were the “central component” of the rules governing international contracts.<sup>189</sup>

The Principles have found application even in a public international law dispute between sovereign states before a UN forum. The United Nations Compensation Commission, in determining whether Iraq was liable to pay compensation for its illegal invasion of Kuwait, expressly referred to the Principles for the proposition that a court has discretion in determining the amount of compensation, and for the proposition that a party has the duty to mitigate damages.<sup>190</sup> The Supreme Court of Venezuela, in coming to the

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<sup>188</sup> Arbitration Centre of the Costa Rican Chamber of Commerce, 01.06.2003, available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13620&x=1>.

<sup>189</sup> Ad hoc arbitration (San José, Costa Rica), 30.04.2001, available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13620&x=1>. The Tribunal said: “The reasons why this Tribunal considers the UNIDROIT Principles of International Commercial Contracts to be the central component of the general rules and principles regulating international contractual obligations and enjoying wide international consensus, which constitute the proper law of the contracts, are manifold: (1) the UNIDROIT Principles of International Commercial Contracts are a restatement of international legal principles applicable to international commercial contracts prepared by a distinguished group of international experts coming from all prevailing legal systems of the world, without the intervention of States or governments, both circumstances contributing to the high quality and neutrality of the product and its ability to reflect the present state of consensus on international legal rules and principles governing international contractual obligations in the world, primarily on the basis of their fairness and appropriateness for international commercial transactions falling within their purview; (2) at the same time, the UNIDROIT Principles of International Commercial Contracts are largely inspired by an international uniform law text already enjoying wide international recognition and generally considered as reflecting international trade usages and practice in the field of the international sale of goods, which has already been ratified by almost 40 countries, namely CISG; (3) the UNIDROIT Principles of International Commercial Contracts are specially adapted to the contracts subject of this arbitration, since they cover both the international sale of goods and supply of services; (4) the UNIDROIT Principles of International Commercial Contracts have been specifically conceived to apply to international contracts in instances in which, as is the case in these proceedings, it has been found that the parties have agreed that their transactions shall be governed by general legal rules and principles; (5) rather than vague principles or general guidelines, the UNIDROIT Principles of International Commercial Contracts are mostly constituted by clearly enunciated and specific rules coherently organized in a systematic way.”

<sup>190</sup> Panel of the Commissioners, Panel F1, Recommendation S/AC.26, dated 23.09.1997, available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13619&x=1>. The panel referred to arts. 7.1.7, 7.3.5, 7.3.6, 7.4.3(3), 7.4.8(1),(2) and 7.4.9. The panel stated in a footnote: “This [duty of mitigation] is a general principle of law. Compare UNIDROIT Principles, art. 7.4.8(1). (“The non performing party is not liable for harm

conclusion that a contract was international for the purposes of upholding the validity of an arbitration clause for arbitration in New York when both parties were Venezuelan, expressly referred to the comment to the preamble of the UNIDROIT Principles which provides that "[...] the concept of 'international' contracts should be given the broadest possible interpretation, so as to ultimately exclude only those situations where no international element at all is involved, i.e. where all the relevant elements of the contract in question are connected with one country only."<sup>191</sup>

The growing use of the Principles by courts and arbitral tribunals suggests that demandeurs can be successful in creating legal agreements even when they possess no direct mechanisms for legalization. This success must be qualified by the fact that the Principles have usually only be used by courts in a supportive capacity rather than to determine the dispute. Despite this caution, the cases illustrate that if key constituencies like arbitrators and judges can be co-opted, non-legal agreements can attain legal significance by reference and incorporation. Similarly, lawyers can foster bindingness by incorporating non-legal agreements into private contracts. These strategies are vital if the demandeurs are academics and not industry groups because they do not possess much economic or political clout. There is some evidence that the UNIDROIT Principles have become successful because the demandeurs have been successful in selling the product to key constituencies.<sup>192</sup>

## C. DEMANDEURS CHOOSE DEEP NON-LEGAL AGREEMENTS WHEN THEY ARE INTEGRATED

### i. THE WORK OF THE ICC

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suffered by the aggrieved party to the extent that the harm could have been reduced by the latter party's taking reasonable steps.")

<sup>191</sup> *Bottling Companies v. Pepsi Cola Panamericana*, 09.10.1997, available at <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13619&x=1>.

<sup>192</sup> Klaus Peter Berger, 'The Central Enquiry On The Use Of Transnational Law In International Contract Law And Arbitration: Background, Procedure And Selected Results', *Int. A.L.R.* 2000 3 (5), 145-156. It confirmed many of the findings of UNIDROIT, which had conducted a study of about 1000 users of the UNIDROIT Principles to obtain information about the practical application of the Principles. Although the response rates are very low, and may be skewed by the fact that many of the uses have been in the context of arbitration, it is definitely indicative of the fact that the sheer quality of the Principles are causing commercial players to resort to them.

Arguably the most successful example of *demandeurs* from industry creating international agreements is the work of the International Chamber of Commerce (ICC).<sup>193</sup> Two of its most successful agreements are the Uniform Customs and Practice for Documentary Credits (UCP 600),<sup>194</sup> the rules that banks apply to finance billions of dollars worth of world trade, and the ICC Incoterms, the standard international trade definitions used in thousands of contracts.<sup>195</sup> The Uniform Customs and Practice for Documentary Credits (UCP) were introduced in 1933, and the area has been surprisingly immune from intervention by states.<sup>196</sup> Banks in over 145 nations use the UCP, which has been revised in 1951, 1974, 1983, 1993, and 2006.<sup>197</sup> It is estimated that the UCP governs ninety-five percent of all international letters of credit.<sup>198</sup> The UCP are not binding *ipso facto*, and depend on the parties incorporating them through the contract.<sup>199</sup> The lack of a need for state involvement and ratification facilitated this process of amendment and clarification. Amendments were preceded by studies showing that letters of credit were being rejected in significant numbers.<sup>200</sup> Prior to the commencement of most recent revision in 2003, “global surveys indicated that, because of discrepancies, approximately 70% of documents presented under letters of credit were being rejected on first presentation.”<sup>201</sup>

A similar reason had motivated the adoption of the International Standard Banking Practice for the Examination of Documents under Documentary Credits (the "ISBP") in

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<sup>193</sup> The ICC was founded in 1919 “to further the development of an open world economy with the firm conviction that international commercial exchanges are conducive to both greater global prosperity and peace among nations.” See, Preamble to ICC Constitution, available at [http://www.iccwbo.org/uploadedFiles/ICC/ICC\\_Home\\_Page/pages/Constitution8101907E.pdf](http://www.iccwbo.org/uploadedFiles/ICC/ICC_Home_Page/pages/Constitution8101907E.pdf). The ICC International Court of Arbitration was set up in 1923, and is the leading center for the resolution of international commercial disputes. See, <http://www.iccwbo.org/id93/index.html>.

<sup>194</sup> See, Foreword to the UCP600: “The UCP remain the most successful set of private rules for trade ever developed.”

<sup>195</sup> The Incoterms were originally published in 1936 following a study conducted in a decade earlier showing that trade terms were understood and applied differently by different legal systems. In the case of a dispute between the parties to a contract, the result could depend on the *lex fori* and on the law governing the contract. See, Charles del Busto, ICC Guide to Documentary Credit Operations, ICC Pub. No. 515 (1994), 13.

<sup>196</sup> See, Robert Bradgate & Fidelma White, ‘Into the 21<sup>st</sup> Century’, *Law Society’s Gazette*, Vol. 89 No. 41 p 19.

<sup>197</sup> *Id.*

<sup>198</sup> See, <http://www.ucp600.tk/index.html>; See, E. P. Ellinger, “The UCP-500: Considering a New Revision” [2004] *L.M.C.L.Q.* 30; Ross P. Buckley, ‘The 1993 Revision of the Uniform Customs and Practice For Documentary Credits’, 28 *Geo. Wash. J. Int’l L. & Econ.* 265, 266 (1995).

<sup>199</sup> Article 1 of the UCP 600 states that they “are rules that apply to any documentary credit (“credit”) (including, to the extent to which they may be applicable, any standby letter of credit) when the text of the credit expressly indicates that it is subject to these rules. They are binding on all parties thereto unless expressly modified or excluded by the credit.”

<sup>200</sup> Gao Xiang & Ross Buckley, ‘The Unique Jurisprudence of Letters of Credit: Its Origin and Sources’, 4 *San Diego Int’l L.J.* 91 (2003).

<sup>201</sup> UCP600, Introduction, at 2. (“This [has] a negative effect on the letter of credit being seen as a means of payment and, if unchecked, could have serious implications for maintaining or increasing its market share as a recognized means of settlement in international trade. The introduction by banks of a discrepancy fee has highlighted the importance of this issue, especially when the underlying discrepancies have been found to be dubious or unsound.”)

2002.<sup>202</sup> Highlighting the rapidity of agreement design without state involvement, the ISBP were completed in just two years. The UCP 600 revision process took about three years.<sup>203</sup> While there was extensive consultation within the organization, the lack of meaningful access to outsiders is a cause for concern. The predominance of demandeurs – in this case, the banking sector—in the drafting process explains the success of the instrument, but the possibility of negative externalities has to be considered by state actors.<sup>204</sup> If the UCP 600 imposes significant externalities, one might expect regulatory competition to ensue to the extent that it can withstand the objections of the banking industry.

## ii. AGREEMENTS IN COMMODITIES MARKETS

There are several examples of demandeur-centric agreement design in the commodities sector, typically characterized by integrated industry groups, which are examined below. One example is the Refined Sugar Association (RSA), which was founded in 1891. One of its objectives is to draft rules and regulations “required for the proper conduct of the white sugar trade in the United Kingdom and international markets.”<sup>205</sup> The RSA has over one-hundred members representing about 40 states. The council of the association is the organ responsible for drafting rules for the international white sugar trade. These rules are used by the majority of international companies trading white sugar.<sup>206</sup> The Association provides for arbitration of disputes and has detailed rules for its arbitration procedure when the contract includes a clause subjecting it to arbitration before the association.<sup>207</sup> A key rule provides that parties may not approach the courts until the tribunal issues an award.<sup>208</sup>

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<sup>202</sup> Id. Prof. Rosett commends the ICC: “The ability of the International Chamber of Commerce to regularly review and revise these definitions is impressive.” Arthur Rosett, ‘The UNIDROIT Principles of International Commercial Contracts: A New Approach to International Commercial Contracts’, 46 Am. J. Comp. L. 347, 353 (1998). The UCP600 Introduction notes that “[the ISBP] has evolved into a necessary companion to the UCP for determining compliance of documents with the terms of letters of credit.” UCP600, Introduction, *supra* note \_\_\_, at 3.

<sup>203</sup> Id.

<sup>204</sup> Arthur Rosett, ‘The UNIDROIT Principles of International Commercial Contracts: A New Approach to International Commercial Contracts’, 46 Am. J. Comp. L. 347, 353 (1998).

<sup>205</sup> <http://www.sugarassociation.co.uk/rsa/index.htm>

<sup>206</sup> Id.

<sup>207</sup> The association recommends that parties to White Sugar contracts include the following clause in their agreement: “*Any disputes arising out of or in connection with this Contract shall be referred to arbitration before The Refined Sugar Association for settlement in accordance with the Rules Relating to Arbitration. Such arbitration shall be conducted in accordance with English Law. This contract shall be governed by and construed in accordance with English Law.*”

<sup>208</sup> Section 6: “Unless the Council shall as hereinbefore provided have refused to arbitrate, neither the Buyer, Seller, Trustee in Bankruptcy, liquidator nor any other person claiming under any of them, shall bring any action against any party to the contract in respect of any dispute arising out of such contract, until such dispute shall have been adjudicated upon in arbitration under these Rules; and the obtaining of an award under these Rules shall be a condition precedent to the right of either contracting party to sue the other in respect of any claim arising out of the contract.”

Further, in another example of externalities being imposed on third parties, the rules provide that the contract shall be deemed to have been made in England, and that England shall be deemed to be the place of performance notwithstanding any provision to the contrary.<sup>209</sup> The rules also exclude the CISG unless there is an express statement to the contrary in the contract.<sup>210</sup> The seat of the arbitration is England.<sup>211</sup> Parties are not entitled to a hearing before the tribunal, which may make a determination purely based on written submissions at its discretion.<sup>212</sup> Central to the success of the arbitration system are the deployment of reputational sanctions by the association. The rules expressly provide that the association can publicize the names of parties who do not adhere to arbitral awards.<sup>213</sup> This is likely to ensure that parties do not challenge arbitral awards in courts and fosters finality.

\_\_\_\_\_The Sugar Association of London was established in 1882 to provide rules for the conduct of the raw sugar trade.<sup>214</sup> The association has over eighty members from over forty countries comprising trading houses, refiners, and producers.<sup>215</sup> It also provides for arbitration of disputes which include a clause in the agreement providing for such arbitration, and the rules contain a provision embargoing resort to the courts pending issuance of the award.<sup>216</sup> The CISG is similarly excluded unless a specific incorporating provision is contained in the contract.<sup>217</sup> The rules also provide for “circularizing” details about parties who do not abide by arbitral awards.<sup>218</sup>

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<sup>209</sup> Section 8 provides that “For the purpose of all proceedings in arbitration, the contract shall be deemed to have been made in England, any correspondence in reference to the offer, the acceptance, the place of payment or otherwise, notwithstanding, and England shall be regarded as the place of performance. Disputes shall be settled according to the law of England wherever the domicile, residence or place of business of the parties to the contract may be or become.”

<sup>210</sup> “Unless the contract contains any statement expressly to the contrary, the provisions of neither the Convention relating to a Uniform Law on the International Sale of Goods, of 1964, nor the United Nations Convention on Contracts for the International Sale of Goods, of 1980, shall apply thereto.”

<sup>211</sup> *Id.*

<sup>212</sup> “The Council may in its discretion decide the case on the written statements and documents submitted to it without an oral hearing (without the attendance of the parties or their representatives and witnesses). The Council may however, call the parties before it, and request the attendance of witnesses, or the provision of further documents, or information in written form.”

<sup>213</sup> “In the event of a party to an arbitration neglecting or refusing to carry out or abide by any award or order made under Arbitration Rule 14, the Secretary on behalf of the Council may circularise to Members of the Association in any way thought fit a notification to that effect. The parties to any such arbitration shall be deemed to have consented to the Council taking such action as aforesaid. The information contained in any such notice shall be issued to a member only on the understanding that neither the member nor any of its employees or any authorised representative of it shall use such information for anything other than the members own commercial knowledge and purposes and that it shall remain privy to that member, its employees or any authorised representative of it at all times. Any member failing to adhere to this Rule shall immediately cease to receive the aforesaid notice and Constitution Rules 7 and 8 may be invoked by the Council.”

<sup>214</sup> <http://www.sugarassociation.co.uk/sal/index.htm>

<sup>215</sup> <http://www.sugarassociation.co.uk/sal/members.htm>

<sup>216</sup> Section 406, available at <http://www.sugarassociation.co.uk/sal/arbitrationrules.htm>.

<sup>217</sup> Section 408.

<sup>218</sup> Section 416.

The Federation of Oils, Seeds and Fats Associations (FOSFA) puts forth contracts and conducts arbitration for the world trade in oilseeds, oils and fats.<sup>219</sup> It has over 830 members in 76 countries, comprising producers, processors, shippers, dealers, traders, brokers and agents in oilseeds, oils, and fats.<sup>220</sup> Its clout is demonstrated by the fact that 85% of the world trade in these commodities is conducted under its contracts.<sup>221</sup> These contracts contain arbitration clauses that subject disputes to FOSFA arbitration.<sup>222</sup> Parties are barred from approaching the courts until the tribunal has issued an award.<sup>223</sup> Surprisingly, parties cannot be represented by legal counsel.<sup>224</sup> Parties have a right to appeal to the Federation, again without representation at the hearing by legal counsel.<sup>225</sup> The Federation also deploys reputational sanctions against parties who do not comply with awards: “the Council of the Federation may post on the Federation's notice Board and/or circularise to members in any way thought fit notification to that effect.”<sup>226</sup> The Guide notes that “[j]ust to be told of the possible consequences of his neglect or refusal is often enough to cause a party to honour the award.”<sup>227</sup> Clearly, this sanctioning power allows agreements that lack the traditional features of law to perform similar functions.

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<sup>219</sup> <http://www.fosfa.org/?pgc=1&mod=5&mnu=>

<sup>220</sup> <http://www.fosfa.org/?pgc=39&mod=5&mnu=>

<sup>221</sup> <http://www.fosfa.org/?pgc=1&mod=5&mnu=>

<sup>222</sup> The contract provides that “‘ARBITRATION: Any dispute arising out of this contract, including any question of law arising in connection therewith, shall be referred to arbitration in London (or elsewhere if so agreed) in accordance with the Rules of Arbitration and Appeal of the Federation of Oils, Seeds and Fats Associations Limited in force at the date of this contract and of which both parties hereto shall be deemed to be cognizant.” Available at

<http://www.fosfa.org/?newpath=LINKED.FOSFA.DOCUMENT&filename=101901018810228104331038610177101961020010180103701026610231102261026910288102411035910435104061030510288102591027510312103161035310438102921032610291104541035310342103491033510372103191037410384103551033810390104211050610393104121051810375103761039510435104751062910459104031042574&mthd=0&pgc=99&mod=21&mnu=>.

<sup>223</sup> “Neither party hereto, nor any persons claiming under either of them, shall bring any action or other legal proceedings against the other of them in respect of any such dispute until such dispute shall first have been heard and determined by the arbitrators, umpire or Board of Appeal (as the case may be) in accordance with the Rules of Arbitration and Appeal of the Federation and it is hereby expressly agreed and declared that the obtaining of any award from the arbitrators, umpire or Board of Appeal (as the case may be), shall be a condition precedent to the right of either party hereto or of any person claiming under either of them to bring any action or other legal proceedings against the other of them in respect of any such dispute.”

<sup>224</sup> FOSFA GUIDE TO ARBITRATIONS AND APPEALS: “Either party has the right either to present their own case or to be represented at the hearing, but may not have present or be represented by any member of the legal profession wholly or principally engaged in legal practice (Rule 4(g)).”

<sup>225</sup> Guide: “parties to an appeal may not be represented by or have present at the hearing, counsel or solicitor or any member of the legal profession wholly or principally engaged in legal practice unless, in response to a request for legal representation by either party, the Board of Appeal decides in its sole discretion that the case is of special importance.”

<sup>226</sup> Id.

<sup>227</sup> Id.

The American Cotton Shipper's Association's member firms handle over 80% of the U.S. cotton sold in domestic and foreign markets.<sup>228</sup> The Association requires its "members ... to honor all contracts, to attempt to resolve quality and technical disputes through amicable settlement, to submit disputes incapable of settlement to binding arbitration, and to honor the arbitration award."<sup>229</sup> The Association has detailed arbitration rules which apply to arbitrations between members, and between members and nonmembers with their consent.<sup>230</sup> The association's arbitration process is not available to members in default.<sup>231</sup> Upon institution of a complaint, the association submits a contract to both parties providing that they shall abide by the award.<sup>232</sup> However, this seems to be a contract without much choice because section 5(b) provides that

[s]hould either party refuse to sign the contract for arbitration or agree to the arbitration then the Executive Vice President shall pursuant to Article 12 of the By-Laws appoint an Arbitration Committee who shall proceed with the arbitration "ex parte." In such event, the parties shall be deemed to have agreed to the provisions of the contract described in this subsection, and the decision of the Arbitration Committee shall be binding on both parties to the controversy, subject to the right of appeal.

The element of pressure to arbitrate is also found in section 5(d) whereby members have a duty to sign the contract within fifteen days.<sup>233</sup> Oral arguments come at a price—the party requesting it has to pay for the expense of the hearing.<sup>234</sup>

Many commodities business associations resort to reputational sanctions to give teeth to their agreements. Significant obstacles to their effective deployment have been reduced by

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<sup>228</sup> It was formed in 1924.

<sup>229</sup> <http://www.acsa-cotton.org/acsa/acsalive.nsf/pages/2F9A7EC1AEF7F615862570FA0059B9F7?OpenDocument>.

<sup>230</sup> <http://www.acsa-cotton.org/acsa/acsalive.nsf/pages/100D3A47E22CAFE0862570FB0046469D?OpenDocument>.

<sup>231</sup> Section 3(a)(3): "(3) The Arbitration Committee will not consider a dispute of a member or a non-member of this Association pursuant to these rules if either the member or non-member or the other party to the dispute is listed in default by any member organization of the Committee for International Cooperation between Cotton Associations (CICCA) for failing to honor a contract, arbitrations award, or court ruling. (*Revised 2/6/03*)"

<sup>232</sup> *Id.* The contract provides includes the following language: "...we will abide by the decision of said committee, and that its decision shall be final, subject to the Association Arbitration Rules." <http://www.acsa-cotton.org/acsa/acsalive.nsf/pages/306474C84F9FAC89862571BD0073820D?OpenDocument>.

<sup>233</sup> "(d) In the event of a complaint being submitted by an Active member against another Active member, or nonmember by consent of both parties, or by virtue of a court order, it shall be the duty of both parties to complete the contract for arbitration within fifteen (15) days from the date the party receives the contract from the Executive Vice President."

<sup>234</sup> Section 8 (f) "When either party to an arbitration requests an oral hearing, the same must be held, and shall take place in Memphis, Tennessee. Such written request must be made to the Executive Vice President on or before the filing of the defendant's surrebuttal;(g) The party requesting such an oral hearing must pay whatever amounts, in addition to 5(c), as shall be necessary to cover the additional expenses of the Committee for the hearing. The amount of such additional expenses shall be determined and fixed by the Committee."

the pervasiveness of the Internet in commercial transactions. Bad reputation was hard to convey because of the limitations of traditional media. Further, shunning businesses with bad reputations might have come at a cost because of informational costs associated with finding substitute partners. Both difficulties are solved by websites managed by industry associations. The American Cotton Exporters Association (ACEA), another industry body with a significant membership, publishes a default list on its website with a star indicating that the defaulter, in addition to defaulting on a contract, has also failed to comply with an arbitral award.<sup>235</sup> The most recent list of defaulters includes companies from countries including Bangladesh, China, India, Greece, El Salvador, Indonesia, Italy, Mexico, Philippines, and Turkey. The Committee for International Cooperation between Cotton Associations (CICCA),<sup>236</sup> based in Liverpool, England, publishes a list of defaulters on its website that names companies that failed to comply with arbitral awards issued by recognized arbitral bodies.<sup>237</sup> The largest number of defaulters appear to be from India, Bangladesh, and Pakistan.<sup>238</sup> At this time, there are a total of 263 defaulters.<sup>239</sup> The World Cotton Exporters Association (WCEA) also publishes a list of defaulters. It states that “the mere listing of a party in default is not to be construed as a prohibition against dealing with that party. Each participant should exercise his own business judgement as to the use of the list...”<sup>240</sup> The WCEA defines default for purposes of inclusion in the list.<sup>241</sup> The list has over 45

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<sup>235</sup> <http://www.acsa-cotton.org/acsa/acsalive.nsf/pages/8E2CD9C50E21DD93862571A90069A0AC?OpenDocument>.

<sup>236</sup> CICCA is comprised of the world’s fourteen leading cotton associations from Africa, Belgium, UK, China, France, India, Japan, Poland, Turkey, Australia, Brazil, Egypt, Germany, Italy, Pakistan, Spain, and the US. It was established in 1976. Its mission statement is to “provide a more representative and influential organisation through which members are able to unite behind the principal of the sanctity of contracts and good trading practice.” Three of its objectives bear listing: “uphold the standards of good trading practices and the ethic of the sanctity of contracts;” “help ensure that dispute resolution procedures are adhered to and any consequential award upheld;” and “circulate to Member-Organisations a consolidated list of firms reported to have failed to properly comply with valid arbitration awards made by Member-Organisations.” See, <http://www.cicca.info/>

<sup>237</sup> [http://www.cicca.info/pdf\\_files/open\\_default\\_list.pdf](http://www.cicca.info/pdf_files/open_default_list.pdf)

<sup>238</sup> Id.

<sup>239</sup> <http://www.cicca.info/>

<sup>240</sup> <http://www.acsa-cotton.org/acsa/acsalive.nsf/pages/5FD62FDB3B7B0F25862570F800578B52?OpenDocument>.

<sup>241</sup> “For the purpose of the operation of these procedures, a party shall be deemed to be in default when: (A) In the case of contracts calling for the opening of a letter or letters of credit for the benefit of the exporter, the purchaser has failed to open a letter of credit in accordance with the terms of the contract or other agreements on or prior to the last day of shipment month; or refused to extend an L/C if requested by the exporter; or opened the L/C with insufficient time to load; or added other clauses designed to make the L/C inoperable; (B) In the case of contracts made on CAD, COA, FOB, FAS, C & F, and CIF terms, payment has not been received by the exporter in the ordinary and usual course of business; (C) In the case of contracts calling for shipment to the exporter, the seller fails to make shipment according to the terms of the contract or other agreement on or prior to the last day of the shipment month; (D) In any case where the party has definitely notified the exporter of his intention not to honor the contract. (E) Notwithstanding the above, if the party has agreed to submit the dispute to arbitration, and to abide by the award, the exporter shall not add such party to the Default List.”

companies.<sup>242</sup> It is curious that defaulting companies appear to be principally from third-world countries.

The Grain and Feed Trade Association (GAFTA) has been at work since 1878 “to promote the international trade.”<sup>243</sup> Its members use its contracts, which contain arbitration rules. The rules provide detailed procedures for arbitration and review of awards.<sup>244</sup> One author notes that GAFTA is “able to provide disputants with an effective means for ensuring the issuance of accurate awards and to recognize parties' interests in designing an arbitration process to fit their needs.”<sup>245</sup> Like the sugar associations, GAFTA contracts also create the legal fiction that the contract was concluded in England and choose English law as the law governing the contract.<sup>246</sup> GAFTA arbitration awards have been enforced by courts in several countries.<sup>247</sup>

The above examples illustrate the complete absence of state involvement in areas where demandeurs are tightly integrated and possess enforcement power. A consultation process that focuses on the states which have the highest number of defaulters on the lists of these demandeurs might provide insights into the implications of states ceding regulatory authority over large areas of economic activity. If there are disproportionate burdens being placed on businesses from these countries, there might be the possibility for regulatory competition to redress the balance. There is room for competition because the procedures followed by many trade associations are designed to facilitate expeditious dispute resolution rather than to provide the kinds of checks and balances that characterize traditional state-based systems. If the systemic flaws are compromising due process requirements, other suppliers of better mechanisms might be able to compete effectively.

### iii. AIR TRANSPORT

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<sup>242</sup> [http://www.acsa-](http://www.acsa-cotton.org/acsa/acsalive.nsf/pages/73B0CE7BC3B3898A862571A9006AD76A?OpenDocument)

[cotton.org/acsa/acsalive.nsf/pages/73B0CE7BC3B3898A862571A9006AD76A?OpenDocument](http://www.acsa-cotton.org/acsa/acsalive.nsf/pages/73B0CE7BC3B3898A862571A9006AD76A?OpenDocument).

<sup>243</sup> [http://www.gafta.com/index.php?page=all\\_about\\_gafta](http://www.gafta.com/index.php?page=all_about_gafta).

<sup>244</sup> <http://www.medimedita.com/Contratti%20tipo/125.pdf>.

<sup>245</sup> Erin Gleason, *International Arbitral Appeals: What Are We So Afraid Of?*, 7 *Pepp. Disp. Resol. L.J.* 269, 277 (2007).

<sup>246</sup> Contract for Shipment of Feedingstuffs in Bulk No.100, cl. 31 (The Grain and Feed Trade Ass'n): “Buyers and Sellers agree that, for the purpose of proceedings either legal or by arbitration, this contract shall be deemed to have been made in England, and to be performed there . . . and the Courts of England or Arbitrators appointed in England . . . shall . . . have exclusive jurisdiction over all disputes which may arise under this contract. Such disputes shall be settled according to the law of England, whatever the domicile, residence or place of business of the parties to this contract may be or become . . .”

<sup>247</sup> See, *S & DAVIS INTERNATIONAL, INC. v. The Republic of Yemen*, 218 F.3d 1292 (2000), 13 Fla. L. Weekly Fed. C 888; For contra see, *Amrapali Choudhury, Turkey: Refusal To Enforce An Arbitral Award*, Int. A.L.R. 2001, 4(5), N33-34.

The International Air Transport Association (IATA), founded in 1945, is comprised of over 270 member airlines from over 140 nations.<sup>248</sup> It serves as a link between the world's air carriers and develops commercial standards. IATA arbitration rules provide that parties waive their right to judicial relief by submission to arbitration.<sup>249</sup> It also commits the parties to enforcing the award within thirty days.<sup>250</sup> Recognizing that the limits on liability provided in the Warsaw Convention have not been amended in several decades, the IATA crafted an agreement amongst carriers to waive the limits of liability.<sup>251</sup> The Agreement requires the parties to waive limits on liability for compensation in respect of "claims for death, wounding or other bodily injury of a passenger within the meaning of Article 17 of the Convention."<sup>252</sup> Under the agreement, the limits on liability will be determined by the law of the domicile of the passenger.<sup>253</sup> Thereafter, IATA drafted an Agreement on Measures to Implement the Intercarrier Agreement.<sup>254</sup> This Agreement had 95 signatories as of 2005.<sup>255</sup> The Intercarrier Agreement had 131 signatories as of the same date.<sup>256</sup> The IATA is also a highly integrated demandeur and its agreements support the view that conventions are sought only when state involvement is necessary.

#### D. DEMOCRATIC DEFICIT

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<sup>248</sup> <http://www.iata.org/about/history>.

<sup>249</sup> Article 25 provides that the parties "subject to Article 26... have specifically waived their right to any form of judicial recourse against the same insofar as such waiver can validly be made." Available at [http://www.iata.org/NR/ContentConnector/CS2000/Siteinterface/sites/legal/file/legal\\_arbitration\\_rules.pdf](http://www.iata.org/NR/ContentConnector/CS2000/Siteinterface/sites/legal/file/legal_arbitration_rules.pdf).

<sup>250</sup> Article 25: "By submitting the dispute to arbitration pursuant to these Rules, the parties shall be deemed to have undertaken to comply with an award within thirty (30) days..."

<sup>251</sup> Intercarrier Agreement on Passenger Liability, Explanatory Note: "The carriers signatory to the Agreement undertake to waive such limitations of liability as are set out in the Warsaw Convention (1929), The Hague Protocol (1955), the Montreal Agreement of 1966, and/or limits they may have previously agreed to implement or were required by Governments to implement." Available at <http://www.iata.org/NR/ContentConnector/CS2000/Siteinterface/sites/legal/file/iaa.pdf>. The Preamble to the Agreement notes that "The Convention's limits of liability, which have not been amended since 1955, are now grossly inadequate in most countries and that international airlines have previously acted together to increase them to the benefit of passengers..."

<sup>252</sup> Article 1.

<sup>253</sup> Id.

<sup>254</sup> "I. Pursuant to the IATA Intercarrier Agreement of 31 October 1995, the undersigned carriers agree to implement said Agreement by incorporating in their conditions of carriage and tariffs, where necessary, the following:

1. **{CARRIER}** shall not invoke the limitation of liability in Article 22(1) of the Convention as to any claim for recoverable compensatory damages arising under Article 17 of the Convention.

2. **{CARRIER}** shall not avail itself of any defence under Article 20(1) of the Convention with respect to that portion of such claim which does not exceed 100,000 SDRs\* [unless option II(2) is used]." Available at <http://www.iata.org/NR/ContentConnector/CS2000/Siteinterface/sites/legal/file/mia.pdf>.

<sup>255</sup> <http://www.iata.org/NR/rdonlyres/ECB93C8B-190A-4022-8C96-D885EF32DD8E/0/MIASignatoryList2005.pdf>.

<sup>256</sup> <http://www.iata.org/NR/rdonlyres/2942AF85-526D-41B9-8015-CF6F6B54AAFC/0/IIASignatoryList2005.pdf>

Some may criticize demandeur-centric agreement design because it supplants states, which supposedly are democratic entities, with private entities. However, this claim is dubious given that democratic participation is lacking even when states are the driving forces. Also, the bulk of the work in drafting international commercial agreements has been done by technical experts from the major developed countries with minimal participation from third-world countries.<sup>257</sup> These experts are not elected and are not democratically accountable. For example, although the Governing Council of UNIDROIT included persons nominated by member states, these experts are not bound to follow any instructions issued by their nominating states.<sup>258</sup> This might have its advantages if the expert acts perfectly, but if he does not, the agency cost can be significant. Frequently, work continues for several years before the wider community is aware of the substantive content of any instrument that is being drafted. It is unclear if the consultation processes that exist in many organizations are meaningfully applicable to nonmembers. Drafts are not always available in a timely manner on public databases. In this context, the choice of a convention as the vehicle ushers in the possibility of some (minimal) democratic oversight at the ratification stage.

Inevitably, the democratic nature of an international commercial agreement will depend on the constitutional structure of states and their ratification process. Not every state conducts hearings and consultations on international agreements; thus, in such states, the democratic deficit persists. One could argue that, even in cases with a democratic ratification process, legislatures are only presented with a binary take-it-or-leave-it choice, subject to the possibility of declarations and reservations. Also, regardless of ratification, international commercial conventions are created by experts who do not face the same scrutiny as elected representatives. Demandeurs may perceive insulation from political battles as an advantage: they may be unwilling to pay the costs of delay in ratification when the subject matter of the agreement is a matter of immediate concern. The demandeurs might be fearful of opposition from contrary interest groups who could use the legislative process to derail the agreement. These are just a few of the possibilities that suggest themselves.

## E. REGULATORY COMPETITION

The demandeur-centric approach recognizes the competition between state and non-state actors, political institutions intra-state, and among international organizations.

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<sup>257</sup> See for example the list of participants of the Working Group for the Hague Convention at [http://hcch.e-vision.nl/upload/sec\\_pd02e.pdf](http://hcch.e-vision.nl/upload/sec_pd02e.pdf).

<sup>258</sup> Charter of UNIDROIT, available at [www.unidroit.org](http://www.unidroit.org).

Traditional theories have ignored this competition and assume that their objectives are largely complementary. They also presume that states possess the power to subsume and subdue non-state entities. This explains their understanding of how the states are mediating demandeurs and designing agreements considering the preferences of these groups. However, the reality may frequently be the opposite. Non-state actors compete with state actors and frequently dominate them in certain areas of international law – the work of the ICC in occupying the field of documentary credits has particular salience here. Non-state entities dominate these fields because of technical expertise and policing mechanisms. In the demandeur-centric approach, the non-state demandeur mediates state preferences, not vice versa.

Competition can also exist at an intra-state level between various political institutions. Demandeur preferences are also at play in mediating this competition. All other things being equal, a legislature ought to prefer a convention rather than a non-legal agreement as it has the opportunity to participate in the former whereas it would be completely excluded in the latter. In terms of institutional competition, the legislature comes off second-best when non-legal agreements are chosen as both the other institutions, the executive and the judiciary have a role to play. The executive branch can sign non-legal agreements and courts may be able to leave their stamp on non-legal agreements which have been contractually incorporated and which are the subject of disputes before them. Thus the choice of legal versus non-legal is frequently a choice of legislative versus non-legislative participation.

Institutional competition can stymie effectiveness because of concerns about demandeurs playing too powerful a role in the drafting of an agreement. This may be behind concerns expressed by the European Parliament in its analysis of the Hague Securities Convention, “[r]eiterat[ing] the need for democratic checks on the negotiations carried on in the context of the Hague Conference on Private International Law.”<sup>259</sup> The Parliament called for an impact study even though the European Commission had been involved in the drafting of the convention, and was party to the abandonment of the PRIMA principle. Regardless of the relative merits of the competing positions, the delay in ratification caused by the stance of the Parliament illustrates the need for demandeurs to be cautious in their co-opting of international organizations, and to pay heed to intra-state and intra-organization competition.

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<sup>259</sup> European Parliament resolution on the implications of signing the Hague Securities Convention, 14 December 2006, available at <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2006-0608+0+DOC+XML+V0//EN>.

### III. CONCLUSION

Functionalism, liberal theories, and realism have serious limitations in explaining the design of international commercial agreements. These theories assume that states are the primary actors, that law is binding and non-excludable, and that soft law is inferior to hard law.<sup>260</sup> None of these assumptions appear to be central in the transnational commercial law area. The correlation between legality and depth predicted by functionalism is rebutted by the experience with the CISG where the choice of the convention form yields little benefit because of its dispositive nature. The prediction that soft law will be more common in arcane areas is rebutted by the adoption of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary.

The liberal claim that state preferences are shaped by those of non-state actors, and that non-state actors will exhibit a preference for hard law does not explain the existence of instruments adopted by the ICC. On the contrary, the choice of hard law seems to be a function of the extent to which the area is conducive to self regulation. If state assistance is needed for regulation, hard law will result, if not, non-convention law is likely to be adopted. Further, demandeurs are often highly integrated and thus possess sanctioning mechanisms that stem from membership, negating the need for state-preference capture. Realism's exclusive focus on states only offers crude explanations in the transnational commercial law context.

The demandeur-centric approach offers significant explanatory advantages over other theories. It demonstrates the relative primacy of demandeurs as the key motive force in transnational commercial law agreement design. Agreement design is thus a function of relative demandeur power. If demandeurs are highly integrated and do not depend on states for enforcement, they are more likely to opt for non-convention vehicles that contain deep commitments. This is exemplified by the UCP 600. To the extent that demandeurs depend on state enforcement, deep commitments in convention-form are likely to result if demandeurs are integrated and possess the ability to obtain ratification. This is exemplified by the Cape Town Convention. If demandeurs are integrated, but unable to obtain ratification, they are

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<sup>260</sup> The last of these is clearly rebutted by the perceptions of nonstate actors: *See generally*, ICC response to the Communication on a European Civil Code: "The use of soft law is often very successful. ICC has produced many soft law instruments that have been so widely used in practice that they have become as important as black-letter legislation (INCOTERMS for transportation clauses and UCP for banking transactions are good examples). As for general contract law, this type of instrument is probably not very useful. The reason is that contract law already is regulated on a national level. Soft law is usually most successful when it fills out gaps in national legislation or when it is elaborated as guidelines."

likely to opt for non-convention vehicles containing deep commitments. This is exemplified by the agreements adopted by IATA. If demandeurs are not integrated, and lack the ability to obtain ratification, they are likely to opt for non-convention law containing weak commitments, as exemplified by the UNIDROIT Principles. The demandeur-centric approach presents a starting point for further empirical examination.