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The Rules on Standard Terms in the UNIDROIT Principles: Misplaced and Misleading

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INTRODUCTION

Joachim Bonell is an important role model for academic lawyers. I admire his enthusiasm and commitment to ensuring that his research makes a difference to business and practising lawyers. He has been extraordinarily influential in this respect. The explanation for his success is persistence, a strong sense of humour, emotion and a passion for tough debate. In his role as missionary for the UNIDROIT Principles he has engaged in discussions with everybody; important and unimportant, young and old, from any jurisdiction. He is not a cunning diplomat, quite the contrary. His charm, focus on the legal questions and his openness to the views of others carry him further than any servile flattery would.

To honour Joachim Bonell, I will try to use his own method of presenting provocative ideas in a straightforward and passionate manner. I will dare to suggest a substantial revision of the UNIDROIT Principles, confident that he knows my strong support for the Principles in their current version and that my suggestion is intended only to make the Principles even better.

Standard terms pose hard questions to the law. The fundamental problem is the lack of "real" subjective intention with respect to the content of the contract. The problem has been solved all over the world by acknowledging standard terms despite the lack of subjective intention. The UNIDROIT Principles do likewise, with special provisions in Articles 2.1.19-22.

In this paper, I will draw attention to some shortcomings in the UNIDROIT structure. I will end with a proposal for an improvement in the next revision of the UNIDROIT Principles.

I THE TRADITIONAL MIXING UP OF FORMATION AND CONTENT – SOME GENERAL COMMENTS

Traditionally, contract law legislation did not deal with the content of contracts, only with their formation. It was argued that theoretically, there was no need for a special method to determine the content and interpretation of a contract since the content is established by the formation. The idea was that the contract's content is created at the same moment the contract is formed. The theory is logically sound: if the contract is formed by corresponding offer and acceptance, the content corresponds to the content of the offer and acceptance.

Illustration: A offers to provide technical consultancy to B for 100€ per hour. B accepts to buy the technical consultancy from A for 100€ per hour. The content of the contract is established as technical consultancy for 100€ per hour. Simple and unproblematic!

The theory, however, does not work well in practice.

Illustration: In the illustration above, what level of quality shall A provide? What if B has no use for the outcome? What are the consequences if A is negligent? How many hours

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is A obliged to provide and B obliged to buy? When must either party perform? These questions about the content of the contract receive no answer by analysing the formation through offer and acceptance.

The UNIDROIT Principles make a distinction between formation, on the one hand (Chapter 2) and interpretation and content, on the other hand (Chapters 4-6). The distinction is very useful. One of the most important innovations offered by the UNIDROIT Principles is the provisions on how to establish the content of the contract.[1] Formerly, it was customary to apply fictitious or analogous reasoning based on the offer-and-acceptance model in order to establish the content of the parties' obligations, which had adverse effects.

The great advantage of separating the question of content from the question of formation is that the reasoning becomes attuned to business realities and less "legalistic". Some may argue that the structure in the UNIDROIT Principles leads to less foreseeability and less certainty as compared to the old fictitious methods based on the offer-and-acceptance model. In my opinion, the UNIDROIT structure produces both foreseeability and certainty. The parties do not achieve more certainty by fictitious reasoning than by an overall assessment taking into account the factors provided in Articles 4.1–3 and 4.8.

II STANDARD TERMS IN THE UNIDROIT PRINCIPLES

The problems with standard terms are best solved by making a clear distinction between the following two questions:

1. Are the parties *bound* by a contract, despite references to standard terms?
2. When the parties have formed a contract, how do standard terms influence the *content* of the parties' obligations? Or in other words, are the standard terms included in the contract?

It is appropriate and necessary to have a rule establishing to what extent the parties can be bound by a contract when there is a reference to standard terms. It is natural for such a rule to be located in Chapter 2 on formation. UNIDROIT Principles Article 2.1.19 makes a reference to general rules on formation and thereby indirectly clarifies that the parties can be bound in exceptional circumstances even though only one party has referred to standard terms or the parties do not refer to the same standard terms. I am in favour of this rule, both with respect to its content and its location.

The UNIDROIT Principles appropriately make no mention in Article 2.19 of whether the standard terms form part of the contract. The comment to Article 2.19, however, is quite contradictory. On the one hand, the comment states that whether the standard terms are incorporated is dependent "*upon the circumstances of the case*", which I see as a silent reference to the later chapters on interpretation and content.[2] On the other hand, the comment states that implied "incorporation may be admitted only if there exists a practice established between the parties or usage to that effect (see Article 1.9)", which is a more limited

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[1] S. VOGENAUER, in Stefan Vogenauer (ed.), *Commentary on the UNIDROIT Principles of International Commercial Contracts*, 2nd ed., Oxford University Press, 2015, p. 570 f.

[2] The same contradiction is found in the legal literature on the Principles. T. NAUDÉ, in S. Vogenauer, *Commentary on the UNIDROIT Principles of International Commercial Contracts*, *op. cit.*, p. 382, states that the UNIDROIT Principles "reflect the general principle that a party is only bound to a standard term". Note that this comment does not refer to bound by the *contract*, but bound by the *term.*

assessment than what is stated in Chapter 4. A reference in the comment to applying *inter alia* Articles 4.3(b) and 4.3(f) concerning the relevance of practices between the parties and usages would have been more appropriate.[3]

The drafters of the UNIDROIT Principles decided to place all the rules on standard terms in Chapter 2 on formation of contract. UNIDROIT Principles Articles 2.1.20 – 2.1.22 concern the extent to which a standard term is "effective" (2.1.20(1)), whether a standard term "prevails" over a non-standard term (2.1.21) and on what "basis a contract is concluded" when the parties have referred to different standard terms. It is clear that the issues of *effectiveness, prevailing* and *basis of contract* do not refer to whether the parties have formed a binding contract. Instead they relate to what the parties have agreed in a situation where they are already bound by contract. Thus, we see that the UNIDROIT Principles deal with questions regarding *what* the parties are obliged to perform in the chapter on formation, which ought to be restricted to the question of *whether* the parties are bound by contract.

I am critical of the UNIDROIT Principles' rules on standard terms to the extent that they do not make a distinction between formation and content. I hold that it is misleading to include rules on content in the chapter on formation. In my view, it is preferable to make a clear distinction between whether the parties are bound by contract, on the one hand, and what the parties to a binding contract are bound to perform, on the other hand.

Illustration: A has started to build an office for B, who has paid an instalment to A. There is disagreement about A's liability for delay. A argues that its standard terms are applicable and B argues that its own standard terms are applicable. The parties agree that they are bound by contract. The dispute concerns what their rights and obligations are in the event of A's delayed performance.

The dispute in the example above is not fundamentally different from the situation where the parties have negotiated the terms of the contract and none of the parties has referred to standard terms. Consequently, it does not make sense for the UNIDROIT Principles to provide different rules on how to solve the problem and it certainly does not make sense to find these different rules in different chapters.

There are examples from case law regarding standard terms where rules on formation and content have been confused.

Example (UNILEX case No. 1235 from 10 February 2005 in an arbitral award from the Netherlands Arbitration Institute): The case concerned a contract for the sale of goods. The buyer argued that it had not approved the arbitration clause contained in the seller's general conditions. The Arbitral Tribunal first applied a method similar to the offer-and-acceptance model and concluded that the fact that buyer could not have been unaware of the seller's intention to apply its general conditions amounted to an implied acceptance of them. As to the question whether the buyer had to be in a position to know the content of the seller's general conditions before or at the time of the conclusion of the contracts, the Tribunal stated that the UNIDROIT Principles "only answer the question whether explicit acceptance of a certain clause is necessary and not whether the accepting party had a reasonable possibility to know the contents of the general conditions and whether good faith entails that the user of the general conditions takes the initiative to offer such a possibility to the accepting party."

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[3] S. VOGENAUER, in S. Vogenauer (ed.), *Commentary on the UNIDROIT Principles of International Commercial Contracts*, *op. cit*., p. 581 ff., has a special chapter on the interpretation of standard terms under UNIDROIT Principles Chapter 4.

This is an example of the misleading structure in the UNIDROIT Principles, since they indeed state in Article 4.3(c) that conduct subsequent to the conclusion of the contract is of relevance to interpret the contract.[4]

Example (UNILEX case No. 1586 from 13 March 2009 by Argentina Court of Appeal of Buenos Aires): According to the Court of Appeal, the fact that the standard terms were prepared by one party was irrelevant and standard terms are to be interpreted basically in the same manner as individually negotiated terms. In support of its decision based on the applicable Argentinian law, the Court referred to UNIDROIT Principles Articles 2.20, 2.21 and 2.22 (now Articles 2.1.20, 2.1.21 and 2.1.22). The outcome is convincing, even though the UNIDROIT Principles articles referred to in the decision do not actually state that standard terms are to be interpreted in the same manner as individually negotiated terms.[5]

Not only the UNIDROIT Principles confuse problems with standard terms. We see the same confusion practically everywhere.[6] The legal literature, too, often deals with the matter of whether standard terms form part of the contract in chapters regarding formation. Most commentators to the CISG seem to deal with the question of inclusion of standard terms in connection with the provisions on formation of contracts.[7]

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4 For a similar reasoning, see UNILEX case No. 959, from 16 October 2002 by the Netherlands court Hof 's-Hertogenbosch. See another type of confusion between formation and content in relation to battle of forms, the UNILEX case No. 911 from 13 July 2001 by the Supreme Court of the Netherlands (C99/315HR). See also T. NAUDÉ, in S. Vogenauer, *Commentary on the UNIDROIT Principles of International Commercial Contracts*, *op. cit.*, p. 386, stating that it follows from Art. 2.1.19(1) "that standard terms are incorporated if they form part of an offer that was accepted." The next sentence makes a reference to UNIDROIT Principles Art. 4.2 (not to the whole of Chapter 4) without explaining the relationship to the offer-and-acceptance model.

5 For a similar extensive reading of UNIDROIT Principles Article 2.19 (now 2.1.19), see the UNILEX case No. 662 from April 1998 by arbitration (in the ICC Court of Arbitration).

6 *Inter alia* in CISG Art. 19(2) and Opinion No. 13 of the CISG Advisory Council; Principles of European Contract Law 2:104 and 2:209, The Draft Common Frame of Reference II.-4:208(2) and II.-4:209(1).

7 U.G. SCHROETER, in *Schlechtriem/Schwenzer Commentary* Art 14 paras 32-33; U. MAGNUS, Kommentar Art 14 para 41; F. FERRARI, in Kröll/Mistelis/Perales Viscasillas *CISG* Art 14 para 38; Austria 31 August 2005 Supreme Court (Tantalum powder case) http://cisgw3.law.pace.edu/cases/050831a3.html; Austria 31 August 2005 Supreme Court (Tantalum case) http://cisgw3.law.pace.edu/cases/050831a3.html; Austria 17 December 2003 Supreme Court (Tantalum powder case) http://cisgw3.law.pace.edu/cases/031217a3.html]; Germany 31 October 2001 Supreme Court (Machinery case) http://cisgw3.law.pace.edu/cases/011031g1.html]; Germany 26 June 2006 Appellate Court Frankfurt (Printed goods case) http://cisgw3.law.pace.edu/cases/060626g1.html; Italy 21 November 2007 *Tribunale* [District Court] *Rovereto* (*Takap B.V. v. Europlay S.r.l.*) http://cisgw3.law.pace.edu/cases/071121i3.html; Netherlands 29 May 2007 *Gerechtshof* [Appellate Court] *'s-Hertogenbosch* (Machine case) http://cisgw3.law.pace.edu/cases/070529n1.html; Switzerland 11 December 2003 District Court Zug (Plastic granulate case) http://cisgw3.law.pace.edu/cases/031211s1.html; United States Travelers Property Casualty Company of America et al v Saint-Gobain Technical Fabrics Canada Ltd, US Dist Ct (D Minn), 31 January 2007 http://cisgw3.law.pace.edu/cases/070131u1.html.

III A BETTER SOLUTION FOR SURPRISING TERMS

UNIDROIT Principles Article 2.1.20 concerns the content of the contract (and not formation). It deals with surprising standard terms and states that a standard term "of such a character that the other party could not reasonably have expected it, is ineffective…". The surprising term does not form part of the contract and the parties are not bound by it unless the term was expressly accepted. In determining whether the term is surprising "regard shall be had to its content, language and presentation". This provision is different in language but similar in outcome to the general rules in UNIDROIT Principles Chapter 4 on how to establish the parties' obligations.

UNIDROIT Principles Article 4.1 states that a contract shall be interpreted according to the common intention of the parties and that "the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances". The comment to Article 4.1 deals specifically with standard terms and states: "Both the "subjective" test laid down in paragraph (1) and the "reasonableness" test in paragraph (2) may not always be appropriate in the context of standard terms. Indeed, given their special nature and purpose, standard terms should be interpreted primarily in accordance with the reasonable expectations of their average users irrespective of the actual understanding which either of the parties to the contract concerned, or reasonable persons of the same kind as the parties, might have had. For the definition of "standard terms", see Article 2.1.19(2)."

Article 4.2(2) states that "statements and other conduct shall be interpreted according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances".

Article 4.3(a) (b) and (f) refer to the preliminary negotiations, practices which the parties have established and to usages.

The rationale underlying UNIDROIT Principles Article 2.1.20, that surprising standard terms should be expressly agreed, is better dealt with in Chapter 4 on the interpretation of contracts. In my opinion it is not necessary to have a special provision regarding surprising standard terms since Articles 4.1 and 4.2 already establish a rather high threshold and the overall assessment to be made according to Articles 4.3 and 4.8 makes it possible to take into account that a term was surprising and unexpected. The following examples illustrate that the outcome would be the same whether Chapter 2 on standard terms or Chapter 4 on general interpretation apply.

Illustration: Seller and Buyer have concluded a sales contract. Buyer has referred to its standard terms, which contain a small print provision that Buyer is entitled to keep the goods and recover the price if the goods are defective. This is an unusual and surprising term. According to UNIDROIT Principles Article 2.1.10, the term is "ineffective", i.e., it does not form part of the contract. If we instead apply Articles 4.1, 4.3(a) and (f), we see that Seller most likely did not intend to be bound by the surprising term (4.1), taking into account that Buyer did not draw attention to it during the preliminary negotiations 4.3(a) and that it is unusual 4.3(f).

Illustration (from the UNIDROIT Principles comment to Article 2.1.20):

"A, a travel agency, offers package tours for business trips. The terms of the advertisement give the impression that A is acting as a tour operator who undertakes full responsibility for the various services comprising the package. B books a tour on the basis of

A's standard terms. Notwithstanding B's acceptance of the terms as a whole, A may not rely on a term stating that, with respect to the hotel accommodation, it is acting merely as an agent for the hotelkeeper, and therefore declines any liability." The outcome would be similar if we applied Chapter 4. Neither B nor a reasonable person could reasonably have expected that A was acting merely as an agent. Furthermore, the preliminary negotiations indicate contradictory conduct by A in the advertisement and the standard terms. In the overall assessment carried out according to Chapter 4, A may not rely on the surprising term.

Illustration (from the UNIDROIT Principles comment to Article 2.1.20): "A, an insurance company operating in country X, is an affiliate of B, a company incorporated in country Y. A's standard terms comprise some 50 terms printed in small type. One of the terms designates the law of country Y as the applicable law. Unless this term is presented in bold letters or in any other way apt to attract the attention of the adhering party, it will be without effect since customers in country X would not reasonably expect to find a choice-of-law clause designating a foreign law as the law governing their contracts in the standard terms of a company operating in their own country." The outcome would be similar if we applied Chapter 4. Neither the individual customer nor a reasonable person could reasonably have expected the choice-of-law clause. Furthermore, A could have pointed out the choice-of-law clause more clearly during the preliminary negotiations. In the overall assessment carried out according to Chapter 4, A may not rely on the choice-of-law clause.

Illustration (from the UNIDROIT Principles comment to Article 2.1.20): "A, a commodity dealer operating in Hamburg, uses in its contracts with its customers' standard terms containing, among others, a provision stating "*Hamburg – Freundschaftliche Arbitrage*". In local business circles this clause is normally understood as meaning that possible disputes are to be submitted to a special arbitration governed by particular rules of procedure of local origin. In contracts with foreign customers this clause may be held to be ineffective, notwithstanding the acceptance of the standard terms as a whole, since a foreign customer cannot reasonably be expected to understand its exact implications, and this irrespective of whether or not the clause has been translated into the foreign customer's own language." The outcome would be similar if we applied Chapter 4. Neither the individual foreign customer nor a reasonable foreign person could reasonably have expected the local implications of the dispute resolution clause. Furthermore, the foreign customer could refer to international usages (Article 4.3(f)) and point out that A could have more clearly expressed the implications of the dispute resolution clause during the preliminary negotiations. In the overall assessment carried out according to Chapter 4, A may not rely on its understanding of the dispute resolution clause.

IV A BETTER SOLUTION FOR THE CONFLICT BETWEEN STANDARD TERMS AND INDIVIDUALLY NEGOTIATED TERMS

UNIDROIT Principles Article 2.1.21 concerns conflicts between standard terms and non-standard terms. It states that a non-standard term prevails over standard terms. The same outcome can be achieved by applying the overall assessment provided in Article 4.3.

Illustration: Buyer and Advisor have concluded a contract for technical advice. Advisor has referred to standard terms with a term that his liability for damages is limited to 1 M€. The short assignment letter provided by Buyer contains terms on payment credit, hourly fee and that Advisor's liability for damages shall be limited to 3 times of the payment.

The parties negotiate the three terms in the assignment letter and agree *inter alia* to limit Advisor's liability to twice the amount of the payment. Taking into account the common intention of the parties (4.1) and that the parties expressly negotiated the liability during the preliminary negotiations (4.3(a)), the outcome will most likely be that the limitation term in Buyer's assignment letter prevails over Advisor's standard term.

The rule in UNIDROIT Principles Article 2.1.21 belongs to the old black-and-white contract law era.[8] In most cases, it is probably in harmony with the parties' common intention to apply the non-standard term, but not always. It is better to have a less rigid rule in the form of a presumption.

Illustration: In a Norwegian arbitration (ND 1961 s. 127) the tribunal set aside a specially (poorly) drafted term in favour of a standard term in a frequently used charterparty.

V A BETTER SOLUTION FOR BATTLE OF FORMS

UNIDROIT Principles Article 2.1.22 concerns battle of forms, i.e., when the parties have referred to different standard terms. The Article expresses the knock-out doctrine: the terms common in substance become part of the contract. This provision is in harmony with UNIDROIT Principles Article 4.1 about the common intention of the parties, and thus superfluous. The outcome is the same irrespective of whether Article 2.1.22 or Article 4.1 is applied.

Illustration: Buyer orders a machine from Seller indicating the type of machine, the price and terms of payment, and the date and place of delivery. Buyer uses an order form with its "General Conditions for Purchase" printed on the reverse side. Seller accepts by sending an acknowledgement of the order, on the reverse side of which appear its "General Conditions for Sale". Both Buyer's and Seller's standard terms contain a provision that the liquidated damages for delay is 1% of the purchase price per week. The parties are in agreement that they have concluded a contract. The terms on the liquidated damages per week are common in substance and express the parties' common intention. Therefore, they form part of the contract.

Neither UNIDROIT Principles Article 2.1.22 nor the comments clarify what to do with standard terms that are not similar in substance. What happens with the remaining gaps? To users of UNIDROIT Principles, it is not self-evident that after discovering that Chapter 2 does not provide an answer, they should apply Chapter 4 and sometimes also other provisions.[9]

Illustration: In the case above, Seller's standard terms contain a provision that the maximum damages for delay is 10% of the purchase price and Buyer's standard terms provide that the maximum damages for delay is 15% of the purchase price. The parties are in agreement that they have concluded a contract. The terms on the maximum damages are not common in substance. It is accordingly necessary to resort to Article 4.8 and determine

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[8] See the same rule in CISG Advisory Council Opinion No. 13:8: "8. Where there is a conflict between negotiated terms and standard terms in the contract, the negotiated terms override the standard terms."

[9] T. NAUDÉ, in S. Vogenauer, *Commentary on the UNIDROIT Principles of International Commercial Contracts*, *op. cit*., p. 410 ff., solves the gap-problem by the offer-and-acceptance method, general principles and good faith, instead of referring to the interpretation method in Chapter 4. This illustrates the need to make a structural connection between standard terms and interpretation.

the appropriate term taking into account, among other things, the parties' intentions, the nature and purpose of the contract, good faith and fair dealing and reasonableness. Furthermore, it is relevant that the default rule in UNIDROIT Principles Article 7.4.2 provides that Seller is liable to provide full compensation for all harm due to delay. If Buyer's actual harm exceeds 15% of the purchase price, it is likely that Buyer's term regarding liquidated damages will apply, as it is closer to the default rule.

VI A FUTURE REVISION OF THE UNIDROIT PRINCIPLES

I suggest that a future revision of the UNIDROIT Principles make a clear distinction between standard terms in relation to formation and content. It might look something like this:

Article 2.1.19 remains unchanged in Chapter 2 as it stands today:

> "**Article 2.1.19 (Contracting under standard terms)**
> (1) Where one party or both parties use standard terms in concluding a contract, the general rules on formation apply, subject to Articles 2.1.20 - 2.1.22.
> (2) Standard terms are provisions which are prepared in advance for general and repeated use by one party and which are actually used without negotiation with the other party."

Article 2.1.20 about surprising terms is either abolished altogether or relocated to Article 4.3:

> "**Article 4.3 (Relevant circumstances)**
> (g) No term contained in standard terms which is of such a character that the other party could not reasonably have expected it, is effective unless it has been expressly accepted by that party. In determining whether a term is of such a character regard shall be had to its content, language and presentation."

Article 2.1.21 about conflict between standard terms and non-standard terms is abolished, as it is too rigid. It is appropriate in most cases for the standard term to give way to other terms, but not always. It is better to solve this problem by applying the overall assessment described in Article 4.3. If a specific rule is preferred, an addition to Article 4.3 could be modified to a presumption rule and read:

> "**Article 4.3 (Relevant circumstances)**
> (h) In case of conflict between a standard term and a term which is not a standard term the latter is presumed to prevail."

Article 2.1.22 is relocated to Chapter 4 and split up into two parts, one regarding terms that are common in substance, and one regarding terms that are not common in substance.[10]

[10] I am aware that UNIDROIT Principles Article 4.8 has been criticised as superfluous (see S. VOGENAUER, in S. Vogenauer (ed.), *Commentary on the UNIDROIT Principles of International Commercial Contracts*, *op. cit*., p. 611 ff., with references). My suggestion here is intended to remain close to the present version of UNIDROIT Principles. My concern in this paper can be easily dealt with if Articles 4.3 and 4.8 are merged in a future revision.

"**Article 4.3 (Relevant circumstances)**
(i) Where both parties use standard terms, any standard terms which are common in substance become part of the contract. (Standard terms not common in substance shall be solved by applying Article 4.8.)"

"**Article 4.8 (Supplying an omitted term and conflicting standard terms)**
(1) Where the parties to a contract have not agreed with respect to a term which is important for a determination of their rights and duties, a term which is appropriate in the circumstances shall be supplied.
(2) In determining what is an appropriate term regard shall be had, among other factors, to
(a) the intention of the parties;
(b) the nature and purpose of the contract;
(c) good faith and fair dealing;
(d) reasonableness."

FINAL REMARK

My proposal does not entail any fundamental change with respect to the substance of the UNIDROIT Principles. The outcome in a practical case will likely be the same whether the changes are made or not. However, my proposal is quite far-reaching with respect to the structure of the UNIDROIT Principles. The importance and difficulty of reforming lawyers' minds away from the traditional ideas of connecting formation and content towards a separation of the two issues should not be underestimated. I have provided several illustrations of how the present structure in the UNIDROIT Principles is misleading. A revised, modern and coherent structure for the UNIDROIT Principles would contribute to this necessary and fundamental change.