AN INTRODUCTION TO INTERNATIONAL CONTRACT LAW
Foreword

The decision to write this book was taken in consideration of an unmet need of non-law students enrolled in undergraduate and postgraduate courses addressing international contracts.

In non-law faculties today there are more and more taught-in-English classes that deal with issues in connection with international contracts, and students may face serious difficulties in preparing for exams, mainly because of a lack of suitable handbooks in English taking into account their non-legal background.

We have tried to attend to this unmet need by providing those students with a useful tool summarising basic principles applicable to international contracts. In doing so, we have thought it appropriate to try to strike the right balance between general notions (a theoretical approach), on the one hand, and contract templates and sample contractual clauses (business-case approach), on the other, in order to give them a view of how international contract law may affect international business practice.

Throughout the process, we have relied on principles and notions resulting from international instruments (such as the Principles on Choice of Law in International Commercial Contracts recently promulgated by the Hague Conference on Private International Law) and on contract templates drafted in private practice or made available to the public by international chambers of commerce or trade centres, which we acknowledge as our sources.

Although this book is the result of a shared effort and the outcome of a joint project, chapters 1, 2, 5, 7, 8, 9 and 10 were authored by Vincenzo Salvatore, whilst chapters 3, 4, 6 and 11 were written by Renzo Cavalieri.

Each author remains individually responsible for any errors and inaccuracies contained in his respective chapters.

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Chapter 1

What is an international contract?

1.1. Contract: the legal instrument by which private parties enter and govern a business relationship between them

A contract is a voluntary, deliberate, legally binding and enforceable agreement creating mutual obligations between two or more parties. The term party is very broad, for its notion embraces any natural or legal person, including individuals, companies, foundations, unincorporated bodies, partnerships and publicly owned entities.

Contracts are usually written but, unless the applicable law requires them to be in writing, contracts may be verbal or implied.

Each contracting party undertakes the obligation to do something for the other or others in exchange for a benefit. However, whilst all parties may expect a fair benefit from the contract (since otherwise the courts may set it aside as inequitable), it does not follow that they are entitled to benefit to an equal extent.

A contractual relationship is evidenced by an offer, the acceptance of the offer, and valid (legal and valuable) consideration (i.e., each party must agree to give up something of value in order to obtain a benefit). Consideration frequently implies that one party pays a sum of money to the other party, typically in exchange for goods or provision of services.

In order for a contract to be valid, the parties to it must be competent, i.e. they must have the legal capacity to enter the contract. This means that they must be of legal age, of sound mind and not under the influence of drugs or alcohol.

All parties must enter into the agreement freely. A contract may prove unenforceable if certain mistakes are committed by one or more parties in its making. Likewise, a contract may be declared void if one party has committed fraud against or exerted undue influence over another.

If one party fails to fulfil his or her obligations, that party will be liable at law for breach of the contract. In this case the other party may seek compen-
sation for the economic loss suffered as a consequence by suing either for damages or for performance of the obligations assumed under the contract.

1.2. International contract

A contract is international when it has certain links with more than one State.

Internationality concerns all cases involving a choice between the laws of at least two distinct States. Hence the notion of conflict of laws (otherwise referred to in terms of private international law, especially in Civil law countries), used to identify the set of rules and criteria, amongst the two or more theoretically applicable “conflicting” national laws, the application of which is the most suitable for governing the parties’ relations.

The above will obviously be the case when parties from different countries have entered into a contract, but it is also the case when a contract contains, irrespective of the parties’ citizenship or nationality, one or more foreign elements, putting it in contact with one or more legal systems.

For instance, such may be the case when parties are based in different countries, or when a contract is to be executed abroad.

Conversely, a contract cannot be classified as international, and is therefore to be deemed purely domestic, when all of its significant elements are connected with one State only. In this regard, it must also be noted that when one or more significant elements of a contract are connected with different territorial units within the same national State (e.g. Quebec and Labrador in Canada, or Massachusetts and California in the United States, or Queensland and Victoria in Australia), such fact does not constitute internationality of the contract.

Additionally, the mere circumstance of the parties’ having chosen a foreign State’s law to govern their contractual relationship is not per se an element sufficient to classify a contract as international.

The ascertainment of internationality is thus an exercise that always implies careful case-by-case analysis.

1.3. International trade contract

An international trade contract is a contract for a commercial transaction, or a contract made by a trader for the purpose of his business.

International trade contracts are those in which each party intends to act in the exercise of its trade or profession.

The question whether a party is acting in the exercise of its trade or profes-
sion depends on the circumstances of the contract, not on the mere status of the parties.

The same person may act as a trader or professional in relation to certain transactions and as a consumer in relation to others.

The definition comprises both the commercial activities of merchants, manufacturers or craftsmen (trade transactions) and the commercial activities of professionals, such as lawyers or architects (professional services).

Insurance contracts and contracts transferring or licensing intellectual property rights between professionals also fall within the compass of trade contracts, as do agency or franchise contracts.

For example, a contract between a German entrepreneur and a Pakistani commercial agent constitutes an international trade contract. Such may also be the case when a joint venture agreement is made between a French fashion garment manufacturer and a Thai supplier of textiles.

1.4. Private international law and international civil procedural law

When parties enter into an international contract, it is crucial for them to know which law will be applicable to their relationship, as provisions governing contractual obligations can vary substantially between different countries, and differences in local laws may have a substantial impact on the outcome of a dispute.

The answer to this question will also be important for a court or arbitral tribunal vested with the power to settle disputes that may arise between parties in relation to contract.

Private international law (or the rules governing the conflict of different national laws) may be defined as that branch of law which, in each State, deals with cases of private law involving a foreign element. Thus, the term “international” in cases of private international law can actually be considered a bit misleading, since it refers to the character of a case rather than to the international origin of the rules governing it.

Private international law rules are procedural and not substantive, meaning that they are used to identify the national law applicable to a given international case rather than to dictate the rules governing the relationship in question. Private international law may thus be properly defined as the procedural technique used to determine what national law is applicable to a private matter having cross-border implications.

On the other hand, international civil procedural law will address the following questions:
1) what court has jurisdiction in such a matter? and
2) under what conditions may a court’s decision be recognised and enforced
in another country?

Both private international law and international civil procedural law rely on connecting factors to identify the applicable law or the court or arbitral tribunal with jurisdiction.

Connecting factors are elements that link a transaction or occurrence with a particular national law or jurisdiction.

Amongst the most significant connecting factors in international contracts are:

- the citizenship or nationality of the parties,
- the parties’ domicile or habitual residence (in cases involving individuals),
- the parties’ place of incorporation or establishment (in cases involving legal persons),
- the place where the contract was made,
- the place where the contract is to be executed,
- the place where the object of the contract is located,
- the currency of payment,
- the place of payment.

Different countries may hold different views on which connecting factors are to be deemed most appropriate for establishing legal links.

As an alternative to private international law, international contracts may be subject to national or international substantive rules: i.e. they may be established either at national level, with the consequence that a given national legal system will apply its own rules to a contract, irrespective of the contract’s international nature, or at international level, by virtue of an international agreement (e.g. The Vienna Convention on International Sale of Goods, infra, Chapter 7).

1.5. The closest connection

The most recent theories in private international law share the view that an international contract should preferably be governed by the legal system with which it has the closest connection.

This approach, also known as the proximity rule, considers it appropriate, in the absence of a choice of applicable law made by the contracting parties, to subject a contract to the law of the country with which it has the most immediate ties. The identification of the country with which a contract is most closely connected is left to the appreciation of the judge, who will have to consider all of its factual elements on the basis of an ad hoc analysis.
With regard to international matters, as we shall see in further detail in the following chapter, a contract is generally considered to be most closely connected with the country where the party bound to effect the performance involved has its habitual residence. However, this consideration will be disregarded if it appears that the contract is more closely connected with another country.

1.6. Characterisation, qualification or classification

One of the major difficulties that parties and judges have to face when considering the question of the national law governing an international contract lies in the fact that a given situation may be deemed to be of one nature under the law of the forum (so called *lex fori*, *i.e.* the law of the country where the judge sits) and of another nature under the law of the country with which the contract is connected (so called *lex causae*, *i.e.* the law of the country which will substantially govern the contractual relationship). For instance, the same situation may be regarded by one national law as presenting an issue of contract and by another national law as one of succession. A similar problem may arise when the *lex fori* and the *lex causae* differ on questions of capacity and form. The question then is: are these issues to be classified according to the *lex fori* or the *lex causae*?

Similar matters may surface with respect to the classification of connecting factors: *e.g.* is the notion of domicile to be understood according to the *lex fori* or the *lex causae*? One question liable to arise is the following: once a legal notion has been understood according to the *lex fori* (*i.e.* primary qualification), can it be reclassified according to the *lex causae* as identified consequent to application of the rules on conflict of laws (*i.e.* secondary qualification)?

All of the aforementioned possibilities pose a problem of classification (also referred to as qualification or characterisation).

The prevailing doctrine considers that, as a general rule, the primary qualification (both of facts and of connecting factors) should be effected according to the *lex fori* (with the sole exception of the criterion of citizenship, since a given State cannot decide when an individual is a citizen of another country), whilst the secondary classification should be effected according to the *lex causae*.

An important exception to qualification according to the *lex fori* applies when a judge must ascertain facts or connecting factors governed by conventions addressing international conflict of rules or by other supranational sources of private international law (*e.g.* rules rendered applicable in a member State by a European Union regulation). In such cases the judge will have to take into account the international origin of the legal or regulatory source in order to ascertain the relevant notion, and follow the rules of interpretation applicable to the international conventions (or European Union law) involved.
Chapter 2
Applicable Law

2.1. Parties’ autonomy in assuming contractual undertakings

When entering into an international contract, the parties want to know which amongst the possible applicable national laws will govern their obligations. On the other hand, when a dispute arises from or is otherwise related to a contract having links to more than one legal system, the courts must also be in a position to determine what country’s law governs that contract.

Furthermore, a proper consideration of the law governing an international contract is important for the parties themselves, in order to better plan the transactions foreseen and to mitigate risk in case of failure to fulfil their respective obligations.

In international contract law, a general principle of contractual freedom allows parties to choose the national law applicable to their contractual relations. The parties to a contract are indeed best placed to determine which set of legal provisions is most suitable for their transaction: their autonomy enhances predictability and legal certainty of remedies available in the event of future disputes, both important conditions for efficient cross-border trade and commerce.

Of course, the more extensively the parties have dealt with the respective duties, rights and consequences of breaches when agreeing the content of their contract, the less important the law that they choose as applicable to their contract will be. In other words, as has been correctly noted, the governing law operates as a “gap filler”, since it will be applicable to settle legal issues that have not been completely addressed by the contract. This latter fact is also particularly relevant when the parties make a partial choice of law, for the remainder of the contract, i.e. that part not covered by such choice, will be governed by the law otherwise applicable in the absence of choice (see, infra, section 2.2).
2.2. The principle of freedom of choice

A choice of law, or any modification of choice of law, must either be made expressly (express or explicit choice of law) or appear clearly in the provisions of the contract or in the circumstances detailed therein (tacit or implied choice of law).

A typical express choice of law clause reads as follows:

This Agreement shall be governed, construed, interpreted and enforced in accordance with the [substantive] laws of [France]

An implied or tacit choice of law can be deduced where the provisions of the contract and the circumstances of the matter concerned, considered as a whole (e.g. language of the contract, currency of payment, seat of the arbitral tribunal designated) make it clear and jointly and consistently concur to demonstrate with reasonable certainty that the parties have intended to subject their contract to the law of a specific country.

It must be noted that parties’ freedom to designate the law(s) governing their contractual relations is quite broad, since they may choose either the law applicable to the entire contract (or to only part of it) or other laws applicable to other parts of the contract; the latter option is known as “dépeçage” and has the effect of the contract’s being governed by more than one national law.

Parties have no restrictions in choosing the applicable law (i.e. they can designate the law of any State irrespective of any link thereto, geographical or other) and may also modify the choice of applicable law(s) at any time after the contract has been concluded.

Nonetheless, the parties cannot decide which laws govern their capacity, since the ability of a natural person to act and enter into contracts autonomously is governed by the laws of the particular State of which he or she is a national.

The law chosen by the parties does not even preclude the application of other governing laws supporting the validity of their contract.

2.3. Lex mercatoria

Instead of choosing the law of a given country to govern their contractual relations, parties may also refer to existing sets of rules developed primarily by the international business community itself, based on custom, practice and general legal principles. Such is the case when parties agree that their contract is to be governed by the lex mercatoria (i.e. law of merchants) or by general principles of law. Since it may be difficult for the contracting parties to identify, select and agree as to what must be considered a general principle of law,
international organisations have devoted significant efforts to codifying general principles applicable to international commercial contracts.

The most successful recent example of codification is to be found in the **UNIDROIT principles of International Commercial Contracts**. Originally adopted in 1994 by the International Institute for the Unification of Private Law (UNIDROIT) and subsequently revised in 2004, 2010 and, most recently, in 2016 (the current version), they represent a single (and living) uniform law instrument reflecting concepts that are present in many, if not all, legal systems. They address and provide substantive rules with which to govern, *inter alia*, validity, interpretation, content, performance, non-performance, assignment and termination of contracts.

As clarified in the introduction to the first edition (1994), their aim is to establish a balanced set of rules for use throughout the world irrespective of the legal traditions and economic and political conditions of the countries in which they are to be applied.

As stated in their preamble, in addition to serving as a model for national and international legislators they are applicable when parties have agreed that their contract will be governed by them, and may be applied when the parties have agreed that their contract will be governed by general principles of law, the *lex mercatoria* or the like.

They may also be applied when the parties have not chosen any law to govern their contract, since they may be used to interpret or supplement international uniform legal instruments, or to interpret or supplement domestic law.

### 2.4. Drafting tips

When choosing the law governing their relations, contracting parties should be duly mindful of the **consequences of their choice**, free of national prejudice and aware that neither the choice of the law of their respective countries (“my law” or “your law”) nor the choice, as a sort of compromise, of that of a third “neutral” country (many international contracts are subject to English law or to the laws of the State of New York) may be the best possible solution.

The choice requires indeed an in-depth analysis and a thorough consideration as to the reliability and effectiveness of the national law contemplated, with the parties bearing in mind that the choice of legal system governing their contract may have unintended consequences on their business relations and may sometimes even undermine the validity of the contract itself.

Parties should also avoid making reference to a nation that has more than one legal system overall (*e.g.* the USA), but rather specify the specific territorial unit that they are designating (*e.g.* the law of Delaware).
Finally it must be noted that many choice-of-law clauses contain the expres-
sion “substantive law of” or “excluding its conflict of laws provisions”. These
aim at excluding the applicability of the rules on conflict of laws in the country
chosen by the parties in order to avoid so-called renvoi, i.e. the application of
the law of a third country designated pursuant to the private international law
provisions of that country.

2.5. Mandatory rules and public policy (“ordre public”)

The autonomy of parties in choosing the law governing their contractual re-
lations does face certain limits, which either restrict their freedom (preventive
or active limits) or prevent the law chosen from being applicable to the matter
concerned (subsequent or passive limits).

In the former case there will be overriding mandatory rules that a given
country considers so crucial for the safeguarding of its public interests that they
will be applicable in any situation falling within their scope, irrespective of the
law chosen by the parties and otherwise applicable to the contract. These are
mainly rules of public law (e.g. import and export restrictions, tax provisions,
antitrust law) that are applicable directly to the contractual relations and cannot
be replaced by foreign law, regardless of any agreement to the contrary by the
contracting parties.

In the latter case, the notion of public policy (ordre public) will embrace the
fundamental values of the lex fori which must not be jeopardised by the appli-
cation of foreign law. Here, the judge will assess the possible impact of applica-
tion of a foreign law on the political order of his country and ascertain whether
such application will undermine the national interest. For instance, it might be
considered contrary to public policy to allow the application of a governing law
that does not ensure compensation for an agent upon termination of a given
contract in the absence of any fault committed by such agent.

2.6. Absence of choice by the parties

When parties omit to choose an applicable national law, or insofar as their
choice is void or ineffective, the solution of the question of law applicable will
be either of the following:

1. Applicability of international or national rules on conflict of laws: these rules are established at international level (by conventions) or at national
level (by private international law provisions). Should the matter at hand be
contemplated by a private international law convention to which the State con-
cerned is party, the provisions of such convention will prevail, as *lex specialis*, over such State’s own rules on conflict of laws by virtue of the principle *pacta sunt servanda*. Amongst the major conventions establishing international rules on conflict of laws designed to distinguish the law applicable to contractual relations one may mention the Hague Convention of 15 June 1955 on the law applicable to the international sale of goods, the Hague Convention of 14 March 1978 on the law applicable to agency and representation and, with regard to fiduciary contracts, the Hague Convention of 1 July 1985 on the law applicable to trusts and on their recognition.

2. Applicability of **substantive law** of the *forum* because such application is required either by international conventions or by domestic law. The latter is the case, for instance, when the 1980 Vienna Convention on international sale of goods is applicable (see, *infra*, Chapter 7).

### 2.7. Harmonisation of private international law at international and European Union levels

A key role in the harmonisation of private international law at international level has thus far been played by the Hague Conference on Private International Law (HCCH), an international organisation comprising 83 members (82 countries plus the European Union).

Amongst the nearly 40 treaties on specific matters (*e.g.* conventions on the law applicable to agency, on the international sale of goods, on the service of judicial and other official documents) drafted under its auspices and subsequently implemented, a relatively recent effort of the HCCH culminated in the adoption in 2015 of the *Principles on Choice of Law in International Commercial Contracts*.

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These are intended for use “as a model for national, regional, supranational and international instruments” with which “to interpret and supplement domestic private international law rules, as well as regional, supranational and inter-
character of the Rome Convention, since its rules on conflict may even lead to an application of the law of a non-EU State.

As for other similar recent private international law instruments, the paramount principle of the Rome Convention is contracting parties’ freedom of choice. In the absence of choice, the contract should be governed by the law of the country with which it is most closely linked. In order to determine that country, consideration shall be given, *inter alia*, to the question whether the contract concerned has a close relationship with another contract or contracts.

The Rome Convention additionally contains special rules to protect weaker contracting parties such as consumers and workers, the basic principle being that the law chosen by parties to a contract must not deprive consumers or employees of the protection of the mandatory provisions of the law which would normally be applicable to them in the absence of a choice of governing law.


The conversion of the Rome Convention into an EU Regulation has made it a primary source of private international law, meaning that it *prevails over the EU member States’ respective rules on conflict of laws*, and its provisions are subject to the exclusive interpretation of the Court of Justice of the European Union. Like all EU Regulations – and unlike an international convention, which has to be ratified and adopted by each individual State party – these provisions (and the subsequent amendments thereto) have immediate and direct applicability and the same force of law throughout the European Union; moreover, they require no measures for transposition into the member States’ domestic law.

### 2.8. Relationship between different sources of private international law

We have seen that the law governing an international contract may be determined primarily by the parties or, failing the parties’ choice of applicable law or should such choice be void or ineffective, according either to international or domestic rules on the conflict of laws or to the substantive rules of the country of jurisdiction.

Moreover, we have seen that a general principle prescribes that priority is to be afforded to the parties’ autonomy and to their freedom of choice, and that, failing such choice, either the rules governing conflict of laws or the substantive law established by international agreements to which the States concerned
are parties shall apply. Should the latter not be the case due to the existence either of certain overriding mandatory rules or of a public policy exception, then domestic substantive law or rules governing the conflict of laws shall apply.

Nonetheless, a State whose legal system may be concerned in a dispute about a given transaction may be party to one or more treaties on private international law or on uniformity of international law, in which case the drafters of an international contract ought to decide which such treaty shall take precedence over the others.

For the sake of certainty and predictability of applicable law, international treaties generally contain provisions specifying the relationship between their texts and other sources of private or substantive international law. This matter is addressed by the so-called **disconnection clause** (*clause de déconnexion*), which establishes the relationship between the source of law concerned and other legal instruments (*e.g.* article 25 of the Rome I Regulation states that the regulation shall not prejudice the application of international conventions to which one or more member States are parties at the time when the regulation was adopted and which lay down rules governing the conflict of laws with respect to contractual obligations. However, in cases between parties in different Member States this regulation will take precedence over any conventions established exclusively between two or more Member States, to such extent as the conventions in question concern matters governed by the regulation).
Chapter 3
Negotiation of international contracts

3.1. Contract formation

As explained in Chapter 1, contracts are legally binding and enforceable agreement creating mutual obligations between two or more parties. They are used in a wide range of transactions, from everyday purchases to the most complex business operations. A huge variety of contractual types has been developed in the business practice, and even within each contractual type there could be very different levels of complexity.

The concept of graduated complexity of a contractual type can be illustrated as a “stairway” leading from the most basic agreements up to those regulating highly sophisticated business transactions.

The first step of such a stairway may be represented by a common contract of sale: a simple exchange whereby ownership of an item is transferred immediately from one party to the other as a result of the payment of a price. In daily life, the terms of such a contract (e.g. price, quantity, quality of goods) are usually pre-determined and the parties can immediately and simultaneously proceed with their respective performances. The level of complexity of a contract of sale will increase if some of its elements deviate from the standard, for instance if payment of the price is deferred; it will also increase when the contract regulates a transaction between parties that are not physically present at its making, and particularly when the parties (or goods) involved are situated in different countries.

Ascending the stairs, we may find a contract of supply, that is, an agreement between a seller (supplier) and a buyer (purchaser) for the provision of certain goods over a certain period of time. This is more complicated than a basic sale, as the contractual relationship between the parties does not cease with a single exchange of goods for money. Indeed, a contract of supply is characterised by the repetition of performances over a determinate period of time: goods are supplied on a regular basis, according to a scheme agreed by the parties. Contrary to the case of a simple contract of sale, the parties will be expected to

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1 Under the Italian Civil Code (art. 1321), a contract is defined as an “agreement between two or more parties intending to establish, regulate or extinguish an economic relationship”. In the context of international trade, a basic principle is the “Freedom of contract”, according to which “[i]he parties are free to enter into a contract and to determine its content.” (clause 1.1 of UNIDROIT Principles 2016).
agree on several more aspects of their dealings, for instance on the consequences of an unjustified delay in provision or in payment.

As a third step we may find, for example, a manufacturing & supply contract. In the same manner as under a supply contract, goods are provided in instalments within a determinate timeframe. The distinguishing feature of this type of contract lies in the fact that the purchaser has an active role in determining the nature and quality of the goods that he or she wishes to receive periodically against payment of the price. More precisely, the purchaser desiring a custom-made product needs to provide the manufacturer with precise production information on such product: it means that the contract will contain not only clauses typical of supply contracts, but also new clauses regulating, for instance, the extent and limits of transfer of intellectual property rights (industrial know-how, but also trademarks etc.) as needed in a given transaction.

The climb up this contractual stairway could continue to the most complicated structures for large cross-border corporate deals, but here our sole interest is to point out that the more complex the envisaged commercial operation is, the more time and resources the parties will need to spend in order to reach a viable agreement and execute their contract.

Given the great variety of contractual types, there is no formula that applies to every situation: the determining of a contract’s contents is wholly dependent on the type of transaction that the parties contemplate.

Obviously, the degree of complexity of the commercial operation undertaken by the parties will have an impact on the length and complexity of the process leading to the conclusion of the contract regulating that operation. Whilst simple transactions carried out in daily life are usually not negotiated, the making of complex contracts requires a preliminary stage of negotiation (pre-contractual phase) in order to reach the actual agreement stage, and the signing of a definitive written document is only the final step taken after an agreement on all aspects of the deal has been reached.

Depending on the particularities of the specific case, each contract has its own history and features. Nonetheless, it is possible to classify contracts in different types and according to various criteria. For the purposes of this text the following three deserve mention:

1) With respect to their formation, contracts can be formed either immediately or after a process of progressive negotiation. In the first case, when the contents of the contract are fully pre-determined, and in particular when the parties are physically present, the declaration containing the offer and the declaration of acceptance are formulated simultaneously, or in any event within a very short time-frame. The conclusion of the agreement is therefore simultane-

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2 The expression “conclusion of the contract” is here to be understood as the final stage of the contract’s making, attained when the parties have completed and given legal validity (e.g. by signing a written document) to their agreement. It will be noted that in common law systems this stage is also termed “contract execution”. This expression may be misleading, as in most civil law systems the term “execution” (esecuzione, execution, etc.) is used to denote the stage of performance, as defined in footnote 4.
ous with its formation, no preliminary stage of negotiation being undertaken by
the parties, and the contract is immediately legally binding.

On the other hand, a progressive contract requires various stages of negotia-
tion and, quite often, also the drafting of pre-contractual documents, prelimi-
nary contracts or other forms of understanding. As remarked above, such a long
process of formation is typical of complex contracts of any kind, and as such is
very common in international transactions.

Many types of contract can be formed either immediately or progressively,
depending on the specificities involved. For instance, as regards a contract of
sale, if I buy a book in a bookshop, the conditions of such a transaction (price,
quality, delivery etc.) are pre-determined and the contract is formed immediate-
ly upon my payment of the price at the cash desk, but if I buy industrial equip-
ment, before signing a contract I shall probably need to negotiate a significant
number of aspects and conditions of the deal with the seller.

2) Contracts can be classified also in view of the modalities of their conclusion. In concluding a contract, the parties give legal force to the agreements
reached between them and undertake certain obligations. Once concluded, the
contract becomes enforceable and the parties can be legally compelled to com-
ply with it.

But how do parties actually bind themselves under law? Generally, contrac-
tual obligations are undertaken expressly, through an oral or written agreement:
in many jurisdictions, in some limited cases, agreements may also be concluded
with no form at all but merely as a result of certain conduct on the part of the
parties which bears a specific meaning (so-called implied contracts).

In express contracts the parties state the terms of their agreement, either
orally or in writing. On the one hand, the oral conclusion of a contract is an un-
complicated and time-saving procedure. On the other hand, without a written
text the parties may well be unable to regulate in detail the substance of their
contract and, eventually, also find it difficult to prove their respective under-
standings before a judge.

This is the reason why, in the practice of international business, but also
and in more general terms in the practice of all complex transactions, con-
tracts are almost always laid down in one or more written documents, often
with the assistance of lawyers. In almost all jurisdictions, the law requires
certain types of contracts to be made in writing: this is usually the case of
contracts involving the transfer of real property (as prescribed, for example,
by art. 1350 of the Italian Civil Code), or the establishment of a limited lia-
bility company.

3) Contracts can also be classified, with respect to the time required for their

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3 See footnote 2.
performance\textsuperscript{4}, either as simultaneous or long-term. The main example of the first kind is, again, the simple contract of sale, whereby a party (the seller) transfers the ownership of the good and the counterparty (the buyer) simultaneously effects payment of the price.

On the other hand, as we have seen above, the parties may wish to create a long-term agreement\textsuperscript{5}, the duration of which can be limited or unlimited, there remaining, as an effect, some future act to be performed or some obligation to be discharged long after the conclusion of the agreement, in accordance with its terms. As observed, this may be for example the case with supply contracts, but also with many other types of contract like, for instance, those for employment, licence of intellectual property rights, lease, partnership, etc.

\section*{3.2. Negotiation}

Negotiation is the first step in the process of formation of the majority of international contracts, and the content and length thereof usually vary according to the complexity and economic value of the contract involved. Almost all major business transactions are characterised by lengthy and complex negotiations: in such cases, the definition of contractual terms is progressive, and the partial understandings progressively reached in this stage do not yet legally bind the parties.

The whole of the preparatory activity carried out by the parties before reaching the final agreement is called the pre-contractual phase.

In cross-border transactions, which typically place into contractual relations subjects speaking different languages and belonging to different business environments, the process of reaching an agreement that will meet the expectations of both parties often turns out to be more complicated than in domestic dealings.

If the negotiation succeeds, the parties thereby reach the balancing point of their respective interests in the planned transaction and a mutual understanding of the rights and obligations to be set forth for each of them.

But what do parties need to agree upon? An enormous number of topics could be brought to the negotiating table, depending on the specific type of contract under discussion.

\textsuperscript{4}By the term “performance” we mean the discharge of obligations as required of the parties to a contract.

\textsuperscript{5}The \textit{UNIDROIT Principles of International Commercial Contracts 2016} define a “long term contract” as a contract to be executed over a period of time that normally involves, to a varying degree, complexity of transaction and continuing relations between the parties.
Just to give an example, in a contract of commercial distribution of certain goods, the parties will probably, first of all, discuss the basic economic conditions of the agreement, such as the quality, quantity and price of the goods, to deal only at a later time with less critical issues like the place of delivery or the modalities of payment. Only when all the elements of the deal have been agreed by the parties can the final contract be drawn up and signed.

**Bargaining power**

In business negotiations, the respective strength of parties is often uneven: in other words, one of them enjoys more **bargaining power**.

An advantageous negotiating position may be the consequence of various factors, such as dimension, technological level or financial strength. Other key elements are the readiness or capacity of a given party to invest money in negotiations (e.g. by retaining lawyers or external advisors) or the availability of appropriately skilled human resources to be employed in the negotiations. The time factor is important as well: it will be clear that a party eager to conclude a contract is more likely to accept less favourable conditions just to speed up the negotiation process.

*Also, the existence of an institutional or relational network behind a given party may be a crucial factor. For example, when seeking to make a contract in China with a Chinese company, it is easy to feel the impact on negotiations brought about by the strong connections existing in that country between its main political, financial and business players.*

### 3.3. Good faith

Even though the construction of the contract has not yet been concluded and, therefore, no legal obligations yet bind the parties, they have the duty, in the pre-contractual phase as well, to follow certain fundamental rules of conduct.

The minimum standard of behaviour is generally embodied in the duty to **negotiate in good faith**. The familiarity of the term “good faith” – even beyond its strict legal meaning – does not, unfortunately, help us provide a precise definition of the legal concept.

When applied to the negotiation stage, **the principle of good faith** – a key element of ancient Roman law widely absorbed by the continental European legal tradition – translates into obligations of many forms that differ from legal system to legal system. For example, the Italian Civil Code, requires each party to conduct itself in accordance with the principle of good faith, and prescribes specific duties of disclosure, clarity and confidentiality. When a party fails to observe a reasonable standard of fairness, for instance by providing a negligent or a fraudulent misrepresentation of the contractual elements, it is in breach of the duty to act in good faith.

The variety of ways in which good faith in bargaining is perceived, interpreted and applied in the different legal systems is effectively illustrated in the following considerations by a common law judge:
In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as “playing fair”, “coming clean” or “putting one’s cards face upwards on the table.” (...). English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness. (Lord Justice Bingham)

Since it is clear that the concept of “good faith” may be subject to different interpretations depending on the applicable legal system, what, in practice, should parties do in order to conduct their negotiations in good faith?

Firstly, parties to negotiation are to enter into the process only if they sincerely aim at entering into contractual relations. Negotiation should not be conducted with the mere purpose of acquiring significant information about the counterparty, or of diverting its attention from possible alternative business opportunities.

Obviously the negotiation stage implies, for each party, expenditure of time and economic resources. A party that pretends to be negotiating an agreement but has, in fact, no real intention to conclude it, or that at a final stage of a long process suddenly abandons it without providing any reasonable justification, may cause significant harm to a counterparty that has been counting on the imminent conclusion of a contract. This is one of the moments at which the principle of good faith comes into play: the harmed party has the possibility of obtaining judgment against the counterparty for compensation for loss of profits or loss of opportunity due to the fruitless effort to reach the intended agreement.

Another rule of conduct dictated by the principle of good faith is the requirement for each party to provide the other with all essential information about the object of the deal envisaged, thus allowing reciprocal ascertainment of an actual interest in the making of a contract. Such duty is breached when one party intentionally misleads the other about the object of the contract by failing to disclose relevant information which, if known by the latter, would lead it to a different decision. For example, in the case of an insurance contract, the insured party who intentionally does not provide the insurer with all the information required to determine the risk, is in breach of the duty of good faith. In addition to this, each party should use language that is clear and intelligible in consideration of the counterparty’s cultural level and specific competence, refraining from causing confusion for the latter or taking advantage of his or her lack of knowledge. Parties to negotiation must also keep information obtained therein confidential.

To sum up, the principle of good faith in negotiation constitutes a general condition of fairness, the content of which cannot be predetermined in a precise
manner. As stated above, the extent of parties’ liability before reaching a final agreement varies substantially from country to country. Thus, at international level, the consequences of conduct contrary to standards of good faith will depend on the applicable legal framework, which may be either that already chosen by the parties at the negotiation stage or that determined in accordance with the rules governing potential disputes. In cases of doubt as to the law applicable, the judge or the arbitrator may find useful to consider, at least as a means for integration and interpretation of the parties’ behaviour, the UNIDROIT Principles, which constitute an attempt to provide a uniform solution based on the civil law tradition.

The main UNIDROIT provisions on good faith in negotiation read as follows:

*Article 1.7 Good Faith and Fair Dealing*
(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.

*Article 2.1.15 Negotiation in bad Faith*
(1) A party is free to negotiate and is not liable for failure to reach an agreement.
(2) However, a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party.
(3) It is bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party.

The UNIDROIT Principles also prescribe a duty of confidentiality, defined as follows:

*Article 2.1.16 Duty of Confidentiality*
Where information is given as confidential by one party in the course of negotiations, the other party is under a duty not to disclose that information or to use it improperly for its own purposes, whether or not a contract is subsequently concluded. Where appropriate, the remedy for breach of that duty may include compensation based on the benefit received by the other party.

### 3.4. Pre-contractual documents: the letter of intent

Prospective contracting parties, especially in the case of lengthy and complex negotiation, may wish to outline the progress of the negotiation stage by drafting and exchanging notes on the state of the negotiation process itself. Such notes may be formalised as letters, memoranda or “terms of agreement” duly signed by the parties.

The instrument most commonly used to this purpose is the **letter of intent** (LOI). Letters of intent differ in their structure, which may indeed be that of a business letter whereby the sender presents a text to the recipient for examination, confirmation and signature; otherwise, LOI structure may closely resem-
ble that of a contract, relating the convergence of the parties’ intentions and bidding them to set their respective signatures to the text.

LOIs may differ in substance but they usually list the points of a transaction on which a common intent has been reached by the negotiating parties. Given that the contract is not yet formed at this stage, the letter of intent is generally **not a legally binding document**, but it nonetheless has a strong moral value for the parties and engages their business reputation. Indeed, its purpose is to ensure that both or all parties have the same understanding of the most important terms of the transaction proposed and to state their intent to proceed with negotiations for the future contract, rather than to bind them to specific terms and conditions.

However, it should be noted that many such pre-contractual documents also contain provisions that are actually binding, such as terms governing the negotiation itself: these may concern, for example, timing for the conclusion of the contract, confidentiality of information exchanged or exclusivity in the negotiation for agreements of similar content.

In any case, the parties must mind the form and wording of the LOI, since it may even be interpreted as binding in its entirety if it too closely resembles a contract (**i.e.** if all the essential elements of the agreement have been established and written in a form that appears definitive). Indeed, even using the legal term (**nomen juris**) “letter of intent” will not completely exclude the possibility of legal consequences arising from the content, as the actual wording may render the agreement enforceable even if such outcome has not been desired by the parties.

In order to prevent misunderstandings and avoid an undesired raising of expectations of those involved, if the parties do not wish to be bound by the LOI’s content, it is preferable that the text expressly states such fact and, conversely, specify which of the terms, if any, are to be considered binding.

(See the example of Letter of Intent below)

### Preliminary agreements

In some cases, parties to negotiation may decide to draft a document whereby they formally undertake to conclude a final contract subject to certain conditions. This **preliminary agreement** is substantially different from a letter of intent or a memorandum of understanding in that it actually entails the obligation (and not merely the intent) of one, both or all parties to conclude a final contract within a certain period, usually subject to conditions. In other words, it is a legal promise to conclude a final agreement. Such agreements are suitable for situations wherein the parties have not yet converge on all details but nevertheless wish to commit themselves to concluding a main contract in the near future.

If one party breaches a preliminary agreement to conclude a contract, the other may request the court to order it to pay compensation not only for damages and expenses arising from the negotiations, but also to effect specific performance of the obligations contained in the envisaged contract. Also, the parties use to stipulate in the preliminary agreement a contractual penalty to be paid by the party in breach.
LETTER OF INTENT

This Letter of Intent is signed on June 23, 2017 in Nanjing (PRC) by and between:
[COMPANY’s name], incorporated under the laws of China, with registered office in Beijing, Badaling Development Zone, Yanqing District, represented by _____________, (hereinafter referred to as “Party A”)

and

[COMPANY’s name], a limited company incorporated under the laws of Italy, with registered office in Florence, Viale Europa 12, represented by _____________, (hereinafter referred to as “Party B”)

WHEREAS, Party A is a limited company duly incorporated under the laws of the PRC which conducts its business, inter alia, in the field of industrial production of furnishing objects, stationery, gadgets, decoration and gift ideas;
WHEREAS, Party B is a limited company incorporated under the laws of Italy which conducts its business, inter alia, in the field of production and distribution of home accessories and decorative items in the Italian market;
WHEREAS, Party A and B already entered into a mutually fruitful contractual relationship for the supply of three lots of decorated Easter eggs;
WHEREAS, based upon our discussions over the past month, the Parties are entering into this Letter of Intent for an agreement (hereinafter referred to as “the Agreement”) under which Party A will supply its manufactured “singing Christmas trees” (hereinafter referred to as: “the Product”) to Party B.

NOW, THEREFORE, in consideration of the foregoing the Parties wish hereby to summarise in this non-binding Letter of Intent the outcome of their friendly discussions on the matter as follows.

1. The Parties agree to negotiate in good faith, starting from the date of execution of this Letter of Intent, the Agreement for the supply of the Product.

2. Description of the Product (…).

3. The price to be paid for each unit of the Product shall be determined in the Agreement, reasonably within the range of Euro 1,2 - 1,5 (CIF Genoa).

4. The Parties will endeavour their best efforts to execute such Agreement within 60 days from the date of execution of this Letter of Intent.
5. Given the nature of the Product, the Parties acknowledge that Party A shall deliver the Product in the agreed date, with no delay. Punctuality of delivery shall be considered as an essential term of the Agreement and a penalty for delays shall be provided for.

6. The Parties agree to discuss the possible future establishment of a joint enterprise for the production and distribution of the Product and of similar decorative items, two years after the successful implementation of the final Agreement.

7. By the signature of this Letter of Intent and for a period of at least 90 (ninety) days there from, the Parties undertake to abstain from negotiating contracts covering the same subject of this Letter of Intent with any third party.

8. Each Party agrees to treat the content of this Letter of Intent and any information received from another Party as strictly confidential, unless such information is of public domain, and to use such information only for the purposes of this Letter of Intent.

For Party A __________ (The Legal Representative, _______ )

For Party B __________ (The Legal Representative, _______ )
Chapter 4

Drafting of international contracts

4.1. Introduction

As remarked in the previous chapter, parties to an international contract generally opt for establishing in writing the agreement reached throughout negotiation. In some cases it is the law applicable to the contract itself that requires the agreement to be made in writing, or in line with certain formalities (e.g. as mentioned, Italian law requires contracts for the conveyance of real property to be made in written form).

The drafting stage is a delicate one: in drawing up a contract, the parties state in black and white the substance and terms of their respective obligations. Crystallised in a formal written document, the agreement serves as the legal base governing relations between them: it becomes “the law of the parties”.

Acting as “legislators” for themselves, the parties should be able to find in the contractual text a clear definition both of the rights to which they are entitled and of the obligations that they have agreed to assume: the confines of such rights and obligations must be as precise as possible in order to avoid misinterpretation or need of further discussions. Also, it should be taken into consideration that if any misunderstandings or disputes arise between the parties, a third subject (an arbitrator or court) will be called upon to resolve the issue; thus, such decision will come from someone who has not taken part in the contract’s negotiation and has no other means with which to interpret the will of the parties than a reading of the terms and conditions as stated on paper. For this reason it is essential that the contract be drafted in such a manner as to leave no room for divergent interpretations, or ambiguities.

However, the main reason why the proper drafting of a written contract may prove crucial consists not only in the text’s major role in guiding the parties and possible interpreters to a correct understanding of the agreement, but also in the utmost importance of using a form suitable to produce a contract that is rational, intelligible and in compliance with applicable law. This is mainly the task of lawyers.
4.2. The role of lawyers and law firms in cross border transactions

Even more than the negotiation phase, the drafting phase is usually carried out on a basis of strict cooperation between company managers and business lawyers.

The growth of international business and trade in the last decades has transformed not only financial, accounting or advisory services, but also the legal profession. Since multinational enterprises started to expand further abroad and as new countries and players have emerged in global markets, several law firms – entities that in the past used to be very conservative professional groupings, practicing only their own domestic law – have also improved their international capacity and started to expand internationally, becoming global providers of legal services.

In international practice, lawyers usually operate within large firms able to provide all the legal services that may be required by clients in relation to a given transnational deal (corporate, finance, administrative compliance, intellectual property, labour, litigation etc.). Large law firms operate as companies, in some cases with several thousand professionals and specialised employees, and dozens of offices in the world’s main financial centres. The role that they play, together with banks and financial advisors, in the structure and implementation of large international transactions is increasingly crucial.

Despite the still strong prevalence of national law in matters of international business, the need for an understanding of common business practices and legal technicalities and the use of English as a common language tend to make law firms’ practice quite uniform at the global level: today, the work of an international business law firm based in Shanghai is very similar to that of a firm based in Milan.

Business players daring to enter into contracts without the assistance of legal counsel are likely to take for granted seemingly uncontroversial matters which, in the event of dispute, may lead to a court ruling or arbitration award contrary to their intentions. That is why the drafting stage should, preferably, be conducted in consultation with knowledgeable professionals; lawyers may advise the parties on the legal implications of their written statements, point out possible ambiguities or gaps left in a draft, provide information on the legal framework applicable to the planned contractual relationship and, in general, carry out all consultative functions aimed at minimising the risks borne by their clients and protecting their legitimate interests.

4.3. Drafting style and standards

With only a few exceptions (such as those due to effects at national level for States party to the UN Convention on Contracts for the International Sale of