The New Provisions on Illegality in the UNIDROIT Principles 2010

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1. – INTRODUCTION

As in all legal systems, also under the UNIDROIT Principles of International Commercial Contracts (hereinafter: the “UNIDROIT Principles”) it has always been understood that in order for a contract to be binding not only must the parties have concluded it without error and constraints but also its content and performance must not violate principles and rules of public policy or conflict with good morals. However, while avoidance of contracts for mistake, fraud, threat and gross disparity was specifically dealt with right from the first edition of the UNIDROIT Principles,¹ the invalidity of contracts arising from illegality or immorality was expressly excluded from the scope of the UNIDROIT Principles in both the 1994 and the 2004 editions ² and referred to the applicable domestic law on account of “the inherent complexity of questions of […] public policy and the extremely diverse manner in which they are treated in domestic law.” ³

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1 See Arts. 3.4 to 3.20 UNIDROIT Principles (1994 and 2004 editions).
3 See the Comments to Art. 3.1.
Indeed, with respect to this type of invalidity of contracts domestic laws vary considerably, at least at first sight, not only in content but even in terminology and conceptual structure.

While most common law jurisdictions know the general categories of “illegality” and “illegal contracts” and further distinguish between “statutory illegality”, i.e., contracts the formation of which is expressly or impliedly prohibited by statute, and “common law illegality”, i.e., contracts which are illegal at common law because they are contrary to public policy, in the United States one speaks in general terms of “contracts unenforceable on grounds of public policy”, of which “illegal contracts” represent just a particular type characterised by the fact that they involve the imposition of some penalty on at least one of the parties. As concerns civil law jurisdictions, for instance German, Austrian and Swiss law distinguish between “illegal” ("gesetzeswidrige" or "verbotswidrige") and “immoral” ("sittenwidrige") contracts, i.e., contracts violating statutory prohibitions and contracts contrary to good morals; by contrast, French and Italian law make the invalidity of the contracts dependent on their being based on a “cause illicit” or “causa illecita”, i.e., a cause, respectively, “prohibé par la loi ou […] contraire aux bonnes moeurs ou à l’ordre public” or “contraria a norme imperative, all’ordine pubblico o al buon costume”; a similar approach is also taken by the new Civil Code of Québec, while the new Dutch, Portuguese and Brazilian civil codes have abandoned any reference to cause

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6 See FARNSWORTH, supra note 5, 315.


8 See Art. 1133 (in conjunction with Arts. 6 and 1131) of the French Code civil.

9 See Art. 1343 (in conjunction with Arts. 1418, 1344, 1345 and 1346) of the Italian Codice civile.

10 See Arts. 1411 and 1413 of the Civil Code of Québec.
with respect to illegal or immoral contracts and basically follow the German approach.\footnote{See Arts. 3:40(1) and (2) of the Dutch Civil Code; Art. 280 of the Portuguese Civil Code; Art. 166 (2), (3), (6) and (7) of the Brazilian Civil Code.}

The reasons why, despite the extreme complexity of the subject, it was eventually decided to address illegality in the 2010 edition of the UNIDROIT Principles (hereinafter: the “UNIDROIT Principles 2010”) are twofold. First of all, in an inquiry conducted by UNIDROIT with a view to identifying additional topics for inclusion in the new edition, illegality emerged as one of the most widely supported topics.\footnote{Cf. UNIDROIT 2005 – C.D. (84) 19 rev. 2, para. 18.} Moreover, in the meantime even the Principles of European Contract Law (hereinafter: “PECL”) which, like the UNIDROIT Principles, had initially excluded illegality from their scope, in their Part III published in 2003 included a new chapter on illegality which provides a fairly comprehensive set of rules inspired by the most recent developments in this field at domestic level.\footnote{See Chapter 15 “Illegality”, Arts. 15:101-15:105. – Basically the same provisions are now contained also in Section 3 of Book II (“Infringement of fundamental principles or mandatory rules”) of the Draft Common Frame of Reference (hereinafter: “the DCFR”), prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law and published in 2009.}

In the following, after a brief account of the preparatory work leading to the adoption of the new provisions on illegality contained in the UNIDROIT Principles 2010 (II), an attempt will be made to analyse their content and assess their impact on international contract and dispute resolution practice (III), followed by some concluding remarks (IV).

II. – PREPARATORY WORK

It was in 2005 that the UNIDROIT Governing Council, when deciding to set up a Working Group for the preparation of a new edition of the UNIDROIT Principles, recommended illegality as one of the topics for consideration.\footnote{Cf. UNIDROIT 2005 – C.D. (84) 22, 19. – The other topics were unwinding of failed contracts, plurality of debtors and of creditors, conditions and termination of long term contracts for cause.}

At its first session in 2006, the Working Group was seized of a document prepared by the Secretariat containing a brief presentation of each of the new
With respect to illegality the document raised, among others, the following questions:

- should the Principles distinguish between “immoral” and “illegal” contracts, i.e., between contracts contrary to basic ethical and socio-political principles and values, and contracts which violate specific statutory prohibitions?
- assuming such a distinction were to be made, how should “immoral” contracts be defined (e.g., “contracts contrary to internationally recognised fundamental rights and values”)?
- which mandatory provisions should be taken into consideration in order to determine whether or not a given contract is “illegal”? Would it be sufficient to refer generically to the “mandatory rules […] applicable in accordance with the relevant rules of private international law” referred to in Article 1.4 or should a special conflict-of-laws rule be adopted, e.g., along the lines of Article 7(1) of the 1980 Rome Convention on the Law Applicable to Contractual Obligations (now replaced by Article 9 of EC Regulation No. 593/2008 (Rome I)), or Article 11(2) of the 1994 Inter-American Convention on the Law Applicable to Contracts?
- should “immoral” contracts be at any rate null and void or should their effects depend on a number of factors to be assessed in each single case, and if so, what should these factors be?
- should the effects of “illegal” contracts depend on the mandatory provisions they violate and, absent an express provision in this respect, on a number of factors to be assessed in each single case, and if so, what should these factors be?

Not surprisingly, what proved to be the most controversial was the question as to whether a distinction should be made between two types of illegality according to the seriousness of the unlawful behaviour, and whether in this context reference should be made not only to contracts infringing mandatory rules of domestic law(s) applicable in accordance with Article 1.4 but also to contracts violating supra-national principles and rules widely accepted at international level.

Initially, the Working Group – inspired among others by PECL (and the Draft Common Frame of Reference – DCFR) which distinguish between “contracts contrary to fundamental principles”, i.e., “principles recognised as fundamental in the laws of the Member States of the European Union”, and “contracts infringing mandatory rules” \(^{17}\) – was clearly in favour of a two-tier approach,\(^{18}\) and consequently the first two versions of the Draft Chapter on Illegality \(^{19}\) distinguished between “contracts contrary to fundamental principles”, i.e., “principles widely accepted as fundamental in legal systems throughout the world”, and “contracts infringing mandatory rules”, i.e., “mandatory rules applicable under Article 1.4 of the Principles”.\(^{20}\) As to the effects of a contract contrary to fundamental principles, the drafts provided that where both parties knew or ought to have known of the violation, neither party had the right to exercise any contractual remedy, while where only one party was aware of the violation the other might have been granted the contractual remedies as reasonable in the circumstances.\(^{21}\) By contrast, with respect to a contract infringing mandatory rules, the drafts provided that the effects depended first of all on what the infringed mandatory rule expressly prescribed, whereas in the absence of an express indication the effects depended on what was reasonable in the circumstances.\(^{22}\)

However, at the Working Group’s fourth session in 2009, a rather unexpectedly large number of members expressed strong reservations concerning the two-tier approach. The main objection was that the very notion of “principles widely accepted as fundamental in legal systems throughout the world” was too vague and would inevitably give rise to divergent interpretations in the different parts of the world, thereby undermining one of the main objectives of the UNIDROIT Principles which was

\(^{17}\) Cf. Arts. 15:101 and 15:102 PECL; Arts. ll.-7:301 and ll.-7:302 DCFR.


\(^{20}\) Cf. Arts. 1 and 3, respectively, of the first and the second draft.

\(^{21}\) Cf. Art. 2 of the first and the second draft.

\(^{22}\) Cf. Art. 4 of the first and the second draft.
to promote legal certainty in international contract practice. It was suggested that the Principles should address only one kind of illegality, i.e., the infringement of mandatory rules of national, international or supranational origin applicable under Article 1.4. At the same time, however, it was suggested that the Comments to Article 1.4 be amended to make it clear that the reference to “mandatory rules” in the black letter rule was intended as a reference not only to specific statutory prohibitions but also to general principles of public policy of the respective national legal systems. Notwithstanding the strong support which other members and most of the observers continued to express for the two-tier approach, the Working Group eventually decided to adopt the more restrictive approach 23 and asked the Rapporteur to limit the scope of the draft chapter to “contracts infringing mandatory rules” and to amend the Comments to Article 1.4 in the sense indicated above.24

Much less controversial proved to be the question as to whether, even where as a consequence of the infringement of a mandatory rule the parties are denied any remedies under the contract, they may still claim restitution of what they have rendered in performing the contract. Indeed, contrary to the traditional view that, as a rule, the parties should be left where they stand, i.e., they should not even be entitled to recover the benefits conferred, there was from the very beginning a substantial majority within the Working Group in favour of adopting, in line with the modern trend, a more flexible approach.25 As a result both the second and third drafts provided that restitution may be granted where in the circumstances this would be reasonable, and that the criteria for determining whether the granting of restitution is reasonable are the same as those for determining whether to grant remedies under the contract.26

The Draft Chapter on Illegality eventually adopted by the Working Group at its fifth session in 2010 was composed of two articles, i.e., Article 1 on “Contracts infringing mandatory rules” and Article 2 on “Restitution”. It was

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23 For the lengthy discussion leading up to this decision, see UNIDROIT 2009 – Study L – Misc. 29, paras. 283-360, 374, 410-500.


26 Cf. Art. 5 of the second draft and Art. 2 of the third draft; Art. 5 of the first draft provided that restitution is excluded unless this would lead to unreasonable results.
decided that the two articles should form a section by themselves entitled “Illegality” and become Section 3 of Chapter 3 on Validity.27

III. – CONTENT

1. “Contracts infringing mandatory rules”

Both the title and paragraph 1 of Article 3.3.1 of the UNIDROIT Principles 2010 make it clear that the scope of the Section on Illegality is restricted to contracts infringing mandatory rules applicable under Article 1.4, i.e., mandatory rules, whether of national, international or supranational origin, of the domestic law(s) applicable in accordance with the relevant rules of private international law.

This is definitely a step backward compared to earlier drafts that had also covered “contracts contrary to principles widely accepted as fundamental in legal systems throughout the world,” but upon closer examination the difference between the two approaches is less significant than might appear at first sight. First of all, because fundamental principles sanctioned at universal or regional level by international conventions or other instruments are increasingly enacted by States by means of special legislation, thereby automatically falling into the category of “mandatory rules applicable under Article 1.4”.28 Second, as pointed out in the revised Comments to Article 1.4, the notion of “mandatory rules” is to be understood in a broad sense so as to cover not only specific statutory provisions but also unwritten general principles of public policy of the applicable domestic law(s), including those of international or supranational origin;29 not only this, but as was recalled in the course of the discussion within the Working Group, there are countries where also specific provisions laid down in international conventions are directly applicable even in the absence of ratification of those conventions simply because they are automatically incorporated in the respective domestic laws.30 Finally, unlike domestic courts that are traditionally and still predom-

28 See, for instance, the numerous ratifications of recent international conventions on corruption such as the 2003 United Nations Convention Against Corruption, the 1999 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Inter-American Convention Against Corruption. Similar developments are taking place also in other field such as money laundering, child labour, drug trafficking, anti-terrorism, etc.
29 See Comment 2 to Art. 1.4 (as added to the UNIDROIT Principles 2010).
30 Cf. UNIDROIT 2009 – Study L – Misc. 29, para. 481.
inantly bound to apply only mandatory principles and rules that are part of domestic laws, in the context of international commercial arbitration arbitral tribunals, lacking a predetermined \textit{lex fori} including the relevant conflict-of-laws rules, enjoy greater discretion as to the mandatory rules to be applied. Indeed, in addition to the mandatory rules of the domestic law governing the contract, and to those of other countries provided they claim application irrespective of what the law governing the contract is, arbitral tribunals may also refer to the so-called “transnational public policy” or “\textit{ordre public transnational}”, i.e., supranational principles and rules widely accepted as fundamental worldwide,\textsuperscript{31} and this not only in a positive but also in a negative function,\textsuperscript{32} i.e., either to corroborate corresponding principles and rules of the applicable domestic law,\textsuperscript{33} or to justify the non-application of the latter if manifestly incompatible with the former.\textsuperscript{34}

In light of the foregoing, also the differences with respect to the “two-tier” approach taken by both PECL and the DCFR appear less significant. Indeed, while it is true that the two European instruments distinguish between contracts infringing “fundamental principles” and contracts infringing “mandatory rules”, by specifying that the only relevant “fundamental principles” are those “recognised as fundamental in the laws of the member States of the European Union”, they seem to exclude principles that are not part of either EU law or of the domestic laws of all EU member States or at least of those States whose law(s) is(are) applicable in the case at hand. Yet, if this is so, the only difference on this point between the UNIDROIT Principles, on the one hand, and PECL and the DCFR, on the other hand, is that the former refer to mandatory principles and rules of domestic laws worldwide, while the latter refer to mandatory principles and rules within the EU.

\textsuperscript{31} See Comment 4 to Art. 1.4 (as added to the UNIDROIT Principles 2010). – On the notion of “transnational public policy” or “\textit{ordre public transnational}” and its relevance in the context of international commercial arbitration, see P. \textsc{Lalive}, “\textit{Ordre public transnational (ou réellement international) et arbitrage international}”, \textit{Revue de l’arbitrage} (1986), 329 et seq.; J.B. \textsc{Racine}, \textit{L’arbitrage commercial international et l’ordre public} (1999), 356 et seq.

\textsuperscript{32} On the two functions of transnational public policy see, in general, \textsc{Racine}, supra note 31, 319-431.

\textsuperscript{33} For examples of arbitral awards applying mandatory rules of the \textit{lex contractus}, such as rules prohibiting corruption, on account of their conformity with “principles widely accepted as fundamental worldwide”, see \textsc{Lalive}, supra note 31, 335 et seq.

\textsuperscript{34} For examples of arbitral awards upholding arbitral agreements between States and foreign companies notwithstanding the domestic legislation of those States prohibiting such agreements or requiring for their validity the approval of specific authorities which in the case at hand was missing, etc., see \textsc{Lalive}, supra note 31, 342 et seq.
2. Ways of infringement

There are various ways in which a contract may infringe a mandatory rule, the most important of which are illustrated in Comment 3 to Article 3.3.1. It is worth noting that the illustrations in question do not address the conflict-of-laws issue as to why the mandatory rule(s) referred to are applicable in the case at hand, but move from the assumption that the mandatory rule(s) does (do) in fact apply.

Thus, a contract may first of all infringe a mandatory rule by its very terms. For instance, if a foreign company asks a local intermediary to pay, against a fee, a bribe to a high-ranking governmental official in order to induce that official to award the company a particular contract, the content of such agreement violates the applicable statutory provision(s) prohibiting bribery.35

Yet a contract may infringe mandatory rules also by its performance. This is the case for instance where the parties, having entered into a contract for the supply of equipment, perform the contract notwithstanding a supervening embargo on the import of such equipment.36

Other cases of infringement are those where a contract violates the applicable mandatory rule(s) by the way in which it has been formed, for instance where as a consequence of a bribe, a governmental official awards the contract to a foreign company,37 or where the purpose for which parties enter into a contract is illegal, for instance where both parties know or ought to have known that the material supplied under the contract would be forwarded to a terrorist group for the manufacture of bombs.38

3. Effects of infringement

Contrary to domestic laws that use general and abstracts concepts such as nullity, voidness, unenforceability, Nichtigkeit, nullité, nullità, etc. to define

35 See Illustration 1 of the Comments to Art. 3.3.1. For other examples of contracts violating mandatory rules by their very terms, see Illustration 2 (relating to bribery in the private sector) and Illustrations 3 and 4 (relating to collusive bidding agreements) of the Comments to Art. 3.3.1.

36 See Illustration 6 of the Comments to Art. 3.3.1. For another example of a contract violating mandatory rules by its performance, see Illustration 5 of the Comments to Art. 3.3.1 (relating to an agreement for the supply of goods to be manufactured by one of the parties and both parties know or ought to have known that the goods would be manufactured by child labourers).

37 See Illustration 7 of the Comments to Art. 3.3.1.

38 See Illustration 8 of the Comments to Art. 3.3.1.
the effects of the infringement of a mandatory rule, the UNIDROIT Principles take a more pragmatic approach and describe the effects of the infringement in terms of available remedies.

It is true that also at the domestic level, usually only contracts that violate fundamental principles of public policy or good morals are considered to be automatically null and void, whereas contracts infringing statutory prohibitions are considered to be null and void “unless the law does provide otherwise.” Yet since statutory prohibitions rarely expressly prescribe the effects of their violation on contracts infringing them, they have to be determined by way of interpretation, i.e., by deciding whether or not the purpose of the statutory prohibitions in question requires that the contracts infringing them be considered null and void, and consequently courts inevitably enjoy a certain degree of flexibility in this respect.

Yet the UNIDROIT Principles take a more radical approach. They deliberately refrain from defining the effects of the infringement of mandatory rules – be they unwritten principles of public policy or good morals or statutory prohibitions – in dogmatic terms and instead focus on the remedies that may be granted in each given case. In this way they take an approach somewhat similar to that adopted by PECL, but different from that of the DCFR, which is more conceptualist in this respect.

Certainly, also under the UNIDROIT Principles the effects of the infringement of a mandatory rule are those provided for by the applicable domestic law whenever the infringed rule expressly prescribes those effects. This is only too obvious given the soft-law nature of the Principles, and is explicitly stated

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39 See references supra, notes 4-5 and 7-11.
40 Thus, literally, e.g., § 134 German Civil Code; Art. 1418 Italian Civil Code.
42 Cf. Art. 15:101, stating that a contract contrary to fundamental principles is “of no effect”, and Art. 15:102, stating that a contract infringing mandatory rules [...] “may be declared to have full effect, to have some effect, to have no effect, or to be subject to modification.”
43 See, in particular, Art. II-7:301 stating that a contract that infringes a fundamental principle “is void to the extent that [...] nullity is required to give effect to that principle” (emphasis added), as well as the “Definitions” of the same DCFR stating that “’void’ in relation to a juridical act or legal relationship means that the act or relationship is automatically of no effect from the beginning.” (emphasis added)
in Article 3.3.1(1) with respect to the remedies under the contract,\textsuperscript{44} but applies also with respect to restitution.\textsuperscript{45} It is only where, as admittedly is more often than not the case, the infringed mandatory rule is silent on the issue that the UNIDROIT Principles step in to provide their own solution, distinguishing between contractual and restitutionary remedies, the former being dealt with in Article 3.3.1(2) and (3), the latter in Article 3.3.2.

### 3.1 Remedies under the contract

Paragraph 2 of Article 3.3.1 states that if the mandatory rule does not expressly provide for the effects of its infringement,\textsuperscript{46} the parties may exercise “such remedies under the contract as in the circumstances are reasonable.” The formula used is deliberately broad so as to permit a maximum of flexibility. As pointed out in Comment 5 to Article 3.3.1, notwithstanding the infringement of a mandatory rule, one or both of the parties may, depending on the circumstances of the case, be granted not only the ordinary remedies available under a valid contract (termination, right to performance, damages) but also other remedies such as the right to treat the contract as being of no effect, the adaptation of the contract or its termination on terms to be fixed.\textsuperscript{47} The last

\textsuperscript{44} “Where a contract infringes a mandatory rule, whether of national, international or supranational origin, applicable under Article 1.4 of these Principles, the effects of that infringement upon the contract are the effects, if any, expressly prescribed by that mandatory rule.” As an example of a mandatory rule expressly prescribing the effects of its infringement, Comment 4 to Art. 3.3.1 mentions Art. 101(2) of the Treaty on the European Union (former Art. 85(2) of the Treaty of Rome) stating that anti-competitive agreements between enterprises which may affect trade between member States of the European Union prohibited under Art. 101(1) “shall be automatically void.”

\textsuperscript{45} See infra text and note 70.

\textsuperscript{46} As an example of a mandatory rule expressly prescribing the effects of its infringement, Comment 4 to Art. 3.3.1 mentions Art. 101(2) of the Treaty on the European Union (former Art. 85(2) of the Treaty of Rome) which states that anti-competitive agreements between enterprises which may affect trade between member States of the European Union prohibited under Art. 101(1) “shall be automatically void.”

\textsuperscript{47} For a similar approach at domestic level, see Art. 7(1) of the New Zealand Illegal Contracts Act 1970 (“[…] the Court may grant to [… ] any party to an illegal contract […] such relief by way of […] compensation, variation of the contract, validation of the contract in whole or part or for any particular purpose, or otherwise howsoever as the Court in its discretion thinks just”); § 178(1) of the U.S. Restatement, Second, Contracts (“A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms”). But see also the recommendations contained in Consultation
two remedies may be particularly appropriate where as a consequence of the infringement only part of the contract becomes ineffective.\footnote{Cf. Comment 5 to Art. 3.3.1.}

For the determination of what is reasonable in the circumstances, \textit{i.e.}, whether to grant one or both of the parties a contractual remedy, if any, and if so which remedy, paragraph 3 of Article 3.3.1 provides a list of criteria to be taken into account\footnote{For a similar list see, at domestic level, Art. 7(3) of the New Zealand Illegal Contracts Act 1970; §§ 178 (2) and (3) of the U.S. Restatement, Second, Contracts; Consultation Paper 154 of the English Law Commission, \textit{supra} note 47, para. 7.43; at international level, Art. 15:102(3) PECL and Art. II-7:302(3) DCFR (both instruments however provide such a list only with respect to “contracts infringing mandatory rules” and not with respect to “contracts contrary to fundamental principles” which in all cases are considered as having no effect).} and for each of these criteria offers one or more illustrations most of which are based on actual cases taken from international contract and arbitration practice.

The most important factors to be taken into consideration are:

\begin{itemize}
\item the purpose of the mandatory rule infringed and whether its attainment would be affected by granting the parties or even only one of them a remedy under the contract (\textit{cf.} Article 3.3.1(3)(a)). For instance, if, despite the payment by the local intermediary of a bribe to the government official, the contract is not awarded to the foreign company, the purpose of the applicable statutory prohibition(s) of bribery would clearly be defeated if the intermediary were entitled to request the agreed fee from the foreign company, or the foreign company to recover from the intermediary the bribe the latter has paid to the government official;\footnote{See Illustration 9 of the Comments to Art. 3.3.1; for further examples see Illustration 10 (foreign aircraft manufacturer A uses local intermediary B to negotiate purchase of aircraft by local government notwithstanding prohibition of employment of intermediaries to this effect: purpose of statutory prohibition being to discourage corruption defeated if A and B granted any remedy under the agency agreement); Illustration 11 of the Comments to Art. 3.3.1 (importation of equipment in country X notwithstanding U.N. embargo: purpose of embargo frustrated if parties granted any remedy under the contract).}
\item the category of persons to be protected by the rule infringed, \textit{i.e.}, whether it aims at protecting the interests of the public in general or those of a specific category of persons (\textit{cf.} Article 3.3.1(3)(b)). Thus, licensing requirements are often imposed by law on those carrying
\end{itemize}
out certain activities for the protection of their customers or clients. It follows that if a contract is entered into by, e.g., an engineer who does not have the necessary license it might be reasonable to grant the engineer’s client the right to damages for a delay in the completion of construction caused by defective design by the engineer;51

- any sanction that may be imposed under the rule infringed (cf. Article 3.3.1(3)(c)). For instance, if a statutory regulation imposing limits on the loads ships may carry provides for the payment of a fine in case of violation, whoever violates that regulation by overloading the ship may nevertheless be entitled to the agreed freight since the purpose of the statutory regulation, i.e., the safety of ship and crew, is achieved by imposing a fine on the carrier;52

- the seriousness of the infringement (cf. Article 3.3.1(3)(d)). Thus, if a party violates a mandatory rule of a purely technical nature the infringement of which has no impact on the other party (e.g., a statutory regulation requiring incoming cattle to be properly tagged and with accompanying documents containing additional information), it may nevertheless be granted the right to payment of the price.53

- the knowledge by one or both of the parties of the infringement (cf. Article 3.3.1(3)(e)). For instance, in the case where a construction contract has been awarded to a foreign company after paying a “commission” requested by the local Minister but, with the construction half completed, a newly elected Government invoking the payment of the “commission” cancels the contract and refuses to pay for the work already performed, the foreign company is not entitled to any remedy under the construction contract;54

- whether the performance of the contract necessitates the infringement, i.e., the contract itself provides for, or even only implicitly involves, the violation of a statutory regulation (cf. Article 3.3.1(3)(f)). For instance, if a contract for the construction of a chemical fertilizer production plant does not provide for the installation of the safety

51 See Illustration 12 of the Comments to Art. 3.3.1.
52 See Illustration 13 of the Comments to Art. 3.3.1.
53 See Illustration 14 of the Comments to Art. 3.3.1.
54 See Illustration 17 of the Comments to Art. 3.3.1.
devices required by the applicable environmental protection laws, and the parties deliberately agree on a price insufficient to cover the costs of installation of the devices in question, neither party should be granted any remedy under the contract; 55

- the parties’ reasonable expectations, i.e., one of the parties creates a reasonable expectation as to the enforceability of the contract or its individual terms and later invokes a statutory prohibition of its own law in order to nullify that expectation (cf. Article 3.3.1(3)(g)). For instance, if a contract between a foreign company and a local governmental agency contains an arbitration agreement, in case of a dispute the governmental agency cannot invoke a local mandatory rule according to which for disputes relating to contracts of the type in question domestic courts have exclusive jurisdiction which may not be contractually excluded by an arbitration agreement. 56

The list is far from exhaustive, 57 and the Comments indicate two additional criteria, 58 namely:

- the extent to which the contract infringes the mandatory rule, for instance where it infringes the rule only in part. Thus, if only some of the goods ordered by the foreign company from the local manufacturer are manufactured by child labourers, it may be reasonable to adapt the supply agreement accordingly and grant the parties ordinary remedies under the adapted terms; 59 and

- a party’s timely withdrawal from the improper transaction, for instance, if the foreign company, after having paid the local intermediary the agreed fee but before the intermediary pays the bribe to the high-ranking government official, decides no longer to pursue its illegal purpose and withdraws from the contract with the intermediary. 60

The inclusion of the latter criterion among the criteria to be taken into account to determine whether contractual remedies are available in the

55 See Illustration 18 of the Comments to Art. 3.3.1.
56 See Illustration 19 of the Comments to Art. 3.3.1.
57 Cf. Comment 6 to Art. 3.3.1.
58 Cf. Comment 6 lit.(h) to Art. 3.3.1.
59 See Illustration 20 of the Comments to Art. 3.3.1.
60 See Illustration 21 of the Comments to Art. 3.3.1.
circumstances may come as somewhat of a surprise.\textsuperscript{61} Indeed, at domestic level, the so-called “time for repentance” or \textit{locus poenitentiae} is generally invoked only to obtain restitutionary but not contractual remedies,\textsuperscript{62} and it may not be by chance that in the example given in the Comments reference is made not to any contractual remedy but only to the right of the foreign company to recover the fee paid to the local intermediary.\textsuperscript{63}

In practice, quite often more than one of the criteria listed in Article 3.3.1(3) will be relevant: if, as may be the case, they lead to opposite results,\textsuperscript{64} they will have to be weighed in relation to one another.\textsuperscript{65}

On the whole, however, it is fair to say – and the illustrations in the Comments to Article 3.3.1 amply show it – that as under most domestic laws, also under the UNIDROIT Principles, in case of a violation of fundamental principles of public policy, as a rule no contractual remedies will be granted to either of the parties, and that even in cases of infringement of statutory prohibitions, the granting of such remedies is rather exceptional.

\textbf{3.2 Restitution}

It is with respect to the question as to whether, even where as a consequence of the infringement of a mandatory rule parties are denied any remedies under the contract, they may at least claim restitution of what they have rendered in performing the contract, that the UNIDROIT Principles 2010 are most innovative.

At domestic level, the traditional and still prevailing rule, dating back to Roman law,\textsuperscript{66} is that benefits rendered in performance of an illegal contract can generally not be reclaimed.

\textsuperscript{61} In fact, its inclusion was proposed at the very last moment with very little discussion if any: \textit{cf. Minutes of the meeting of the Drafting Committee} (Hamburg 25-28 January 2010) (UNIDROIT 2010 – Study L – WP 29), Item 3, para. 21.

\textsuperscript{62} Thus, e.g., under English law, McKendrick, \textit{supra} note 4, 283; under U.S. law, see § 199(a) of the U.S. Restatement, Second, Contracts; critically \textit{vis-à-vis} the criterion in question, Kötz / Flessner, \textit{supra} note 7, 169 (with further references).

\textsuperscript{63} See Illustration 21 of the Comments to Art. 3.3.1.

\textsuperscript{64} See § 178(2) and (3) of the U.S. Restatement, Second, Contacts, distinguishing between criteria that may favour enforcement of the contract and criteria that may be against enforcement.

\textsuperscript{65} For examples, see Illustrations 15 (case of weighing seriousness of infringement against fact that infringed rule provides sanctions for infringement) and 16 (case of weighing purpose of infringed rule against parties' knowledge of infringement) of the Comments to Art. 3.3.1.

\textsuperscript{66} See the brocard \textit{in pari delicto potior est conditio possidentis} (“Where both parties are equally in fault, there is no recovery”).
Certainly, there are differences in approach. Thus, while in common law jurisdictions as a rule no restitution is granted and only a few exceptions in specific circumstances are admitted (e.g., where the party seeking restitution is excusably unaware of the illegal nature of the contract or is otherwise not in pari delicto; where that party withdraws from the contract before its improper purpose is achieved; where denial of restitution would cause that party a disproportionate forfeiture),\(^{67}\) in most civil law jurisdictions restitution is excluded only where also the party seeking restitution acted “consciously”\(^ {68}\) or “intentionally”\(^ {69}\) in violation of the mandatory rule in question, or even only where both parties were actuated by an “immoral” and not merely “illegal” purpose.\(^ {70}\)

However, notwithstanding these conceptual differences, in practice the solutions adopted are basically the same and characterised by a considerable degree of rigidity.\(^ {71}\) Indeed, in both common law and civil law jurisdictions, whenever the parties knew or ought to have known of the infringement of a mandatory rule and the rule infringed is not merely a technical rule or regulation aiming at the protection of the category of persons to which the party seeking restitution belongs, restitution will generally not be granted and the parties are left where they stand even though this will result in a benefit to one of them.

By contrast, the UNIDROIT Principles, in line with a modern trend that is emerging at domestic\(^ {72}\) as well as at international level,\(^ {73}\) adopt a more flexible approach.\(^ {74}\)

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67 See, e.g., for English law, McKENDRICK, supra note 4, 284-286; for U.S. law, FARNSWORTH, supra note 5, 348-351; §§ 197-199 of the U.S. Restatement, Second, Contracts.

68 Thus, e.g., § 817, first and second sentence, of the German BGB; § 1174 of the Austrian ABGB.

69 Thus, e.g., Art. 66 of the Swiss Code of Obligations.

70 Thus, expressly, Art. 2035 of the Italian Civil Code; similarly, French legal writings and case law (for references see KÖTZ / FLESSNER, supra note 7, 168 fn. 70). However, in this context both in Italy and in France the concept of “immoral” is generally understood very broadly so as to exclude basically only infringement of mandatory rules of a technical nature: cf. P. TRIMARCHI, Istituzioni di diritto privato, 15th ed. (2003), 203.

71 For an excellent comparative analysis, see KÖTZ / FLESSNER, supra note 7, 164-170.

72 See, in particular, Art. 6:211(1) of the Dutch Civil Code, according to which restitution is excluded whenever granting it would in the circumstances be contrary to “reasonableness and equity”. But see also Art. 7(1) of the New Zealand Illegal Contracts Act 1970, stating that the court may grant to a party to an illegal contract restitution “howsoever as [it] in its discretion thinks just,” and the recommendations contained in Consultation Paper 154 of 1999 of the English Law Commission, supra note 47, Part VII, para. 7.2 et seq., in particular paras. 7.17-7.22.
Certainly, as is the case with the remedies under the contract, also with respect to the question as to whether or not to grant restitution the UNIDROIT Principles refer to the applicable domestic law whenever the infringed mandatory rule expressly provides a solution. It is only where, as is almost always the case, the infringed rule is silent on the issue that the UNIDROIT Principles provide their own solution by stating in paragraph 1 of Article 3.3.2 that “[w]here there has been performance under a contract infringing a mandatory rule [...] restitution may be granted where this would be reasonable in the circumstances.”

As is the case with respect to contractual remedies, also for the determination of what is reasonable in the circumstances, i.e., whether to grant one or both of the parties restitution of what they have rendered in performing the contract, paragraph 2 of Article 3.3.2 provides a list of criteria to be taken into account. The criteria are the same as those indicated in Article 3.3.1(3) but they have to be applied “with the appropriate adaptations.” Indeed, as pointed out in the Comments, given the different nature of contractual and restitutionary remedies, the same criteria may well lead to different results under the same facts. In other words, in one and the same case it may be reasonable to deny any remedy under the contract but to grant restitution, also in view of the fact that the impact of a particular criterion may differ depending on the type of remedy at stake.


74 Decidedly in favour of the flexible approach KOTZ / FLESSNER, supra note 7, 166, quoting G. TREITEL, The Law of Contract, 9th ed. (1995), 448 who points out that “[i]t would be better if the law did not adopt a ‘general rule’ but asked in relation to each type of illegality whether it was recovery or non-recovery that was the more likely to promote the purpose of the invalidating rule.”

75 See Comment 1 to Art. 3.3.2. – As an example of mandatory rules expressly providing for restitutionary remedies in case of infringement, Comment 4 to Art. 3.3.1 mentions the UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects providing that “[a] Contracting State may request [...] the return of a cultural object illegally exported from the territory of the requesting State” (Art. 5) and that “[t]he possessor of a cultural object who acquired the object [...] illegally exported shall be entitled [...] to payment by the requesting State of fair and reasonable compensation, provided that [i]t neither knew nor ought reasonably to have known at the time of acquisition that the object had been illegally exported.” (Art. 6)

76 Cf. Comment 2 to Art. 3.3.2.
The examples given in the Comments are particularly significant in this respect. They all refer to fact situations already illustrated in the Comments to Article 3.3.1. However, whereas in that context these examples serve to demonstrate that under the circumstances none of the parties should be granted any remedy under the contract, in the context of Article 3.3.2 two of them serve to demonstrate that at least restitution would be appropriate and one to demonstrate that on the contrary not even restitution should be granted.

The latter example relates to an international carriage of dangerous goods on a vehicle which does not comply with the required safety requirements, and is intended to illustrate that even where the goods have arrived safely at destination not only should the carrier not have the right to payment of the agreed freight but it should not even be entitled to recover the value of its service. The reason for this solution may be seen, on the one hand, in the necessity of preventing carriage of dangerous goods by vehicles lacking the required safety requirements in order to avoid the risk of serious injury to the public and/or damage to the environment and, on the other hand, in the fact that even if in the case at hand the parties are left where they stand, the benefits received by one of them are generally rather limited in amount.

The situation is quite different in the other two examples concerning contracts for the construction of large industrial works entered into by a foreign company and a local Government as a result of the payment of a bribe by the former to the latter. In both cases, when the works have already been completed or almost completed, a new Government comes to power which, invoking the bribery paid to the previous Government, refuses to pay the outstanding contract price. While the seriousness of the parties’ improper conduct necessarily leads to the conclusion that neither party is entitled to any remedy under the contract, it seems reasonable to grant the foreign company an allowance in money for the work done corresponding to the value the (almost) completed construction has for the Government and in turn to grant the Government restitution of any payments it or its predecessor has made exceeding this amount.

The granting of restitutionary remedies in the presence of corruption may at first sight come as somewhat of a surprise, but at closer examination it appears under the circumstances justified for at least two reasons: first and above all, it would not be fair to let the Government have the (almost) completed works which may be worth an enormous amount of money for significantly less than the agreed price; second, Governments, far from being

77 See Illustration 3 in Comment 2 to Art. 3.3.2.
dissuaded from accepting bribes when awarding important contracts, may
even be encouraged to do so if they know that by invoking the bribery at a
later stage they are able to shift the entire loss resulting from the illegal
transaction to the foreign company.

If restitution is granted under Article 3.3.2(2) and (3), it is governed, “with
appropriate adaptations”, by the rules set out in Article 3.2.15 on restitution in
the context of avoidance (Article 3.3.2(3)). The only adaptations mentioned in
the Comments are rather obvious: thus, the reference in paragraph (1) of
Article 3.2.15 to avoidance is to be understood as a reference to the case
where the contract becomes ineffective as a result of the infringement of a
mandatory rule, and the reference to avoidance of part of the contract as a
reference to the case where only part of the contract becomes ineffective as a
result of the infringement of a mandatory rule. Yet the rules laid down in
Article 3.2.15 may need to be adapted also in substance. Indeed, whereas on
avoidance of the contract for mistake, fraud, threat or gross disparity each
party has a right to restitution subject to the rules laid down in Article 3.2.15,
in the case of a contract infringing mandatory rules according to Articles 3.3.1
and 3.3.2 restitution is a discretionary remedy that, depending on what is
reasonable in the circumstance, may or may not be granted to either both or
to only one of the parties. At least in the latter case, the rules laid down in
Article 3.2.15 may therefore have to be adapted accordingly.

IV. – CONCLUDING REMARKS

For a non-binding instrument such as the UNIDROIT Principles to deal with a
complex and politically sensitive topic such as illegality may be considered
overambitious. Yet this conclusion is not justified.

First of all, by restricting the scope of illegality to the infringement of
mandatory rules applicable in accordance with the relevant rules of private
international law, the UNIDROIT Principles take into account that according to
the traditional and still prevailing view it is primarily up to the applicable
domestic law(s) to set the limits to the validity of contracts, be they domestic or
international, and that only in the context of international arbitration the arbitral
tribunals may refer also to the so-called transnational public policy or ordre
public transnational. At the same time, however, by adopting a broad notion of
“mandatory rules”, the UNIDROIT Principles make it clear that restrictions on
freedom of contract may derive not only from statutory prohibitions but also
from unwritten general principles of public policy of the applicable domestic
law(s), including those of international or supranational origin.
Secondly, also with respect to the effects of the infringement of a mandatory rule, the UNIDROIT Principles refer above all to the applicable domestic law(s) provided that the infringed rule expressly prescribes those effects. It is only where the infringed rule is silent on the issue that the UNIDROIT Principles step in to provide their own solution, thereby offering judges and arbitrators internationally uniform guidelines for determining the effects of an infringement of the mandatory rule in question.

It is true that by stating that the parties may exercise such contractual remedies “as in the circumstances are reasonable” and that also restitution may be granted where “reasonable in the circumstances”, the UNIDROIT Principles adopt a flexible approach that at least at first sight contrasts with the rigidity or “lack of remedial flexibility” 78 of most domestic laws.

However, at least with respect to contractual remedies, in practice the results are not so different. In fact, as under most domestic laws, also under the UNIDROIT Principles, whenever a contract violates fundamental principles of public policy, no contractual remedies will be granted to either party and even in cases of infringement of statutory prohibitions the granting of such remedies is rather exceptional.

It is only with respect to restitution that the UNIDROIT Principles are really innovative. Indeed, contrary to the traditional and still prevailing view at domestic level that, whenever as a consequence of the infringement of a mandatory rule the parties are denied any remedies under the contract, they should not even be entitled to recover the benefits conferred, the UNIDROIT Principles, by making the solution also in this respect dependent on what is reasonable in the circumstances, provide a maximum of flexibility. In doing so, the UNIDROIT Principles follow a modern trend that is emerging at both domestic and international level and seems particularly suited to the special situations that may arise in the context of international commercial contracts, in particular in the case of works contracts and, more in general, long-term contracts, involving large investments.

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78 Thus McKENDRICK, supra note 4, 285.