

THE USE OF THE UNIDROIT PRINCIPLES IN INTERNATIONAL CONSTRUCTION CONTRACTS

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1. Unidroit Principles

The Unidroit Principles of International Commercial Contracts (UP) are a set of a-national principles that apply to the formation, validity, interpretation, performance and termination of commercial contracts. They are intended to be a modern statement of a “*lex mercatoria*” for international contracts in which the rules are not derived from any particular national law, but nevertheless embody contractual principles which are or can be recognised by the laws of any country, whether those laws are based on the common law or the civil law.

The International Institute for the Unification of Private Law (Unidroit) is an independent intergovernmental organisation with its seat in Rome. Its purpose is to study needs and methods for modernising, harmonising and co-ordinating private and in particular commercial law as between states and groups of states. It was set up in 1926 as an auxiliary organ of the League of Nations. It was re-established in 1940 on the basis of a multilateral agreement, the Unidroit Statute. Membership of Unidroit is restricted to states acceding to the Unidroit Statute. Unidroit’s 63 Member States are drawn from the five continents and represent a variety of different legal, economic and political systems as well as different cultural backgrounds.¹

Unidroit first published the UP in 1994. The second edition of the UP was issued in 2004, followed by the latest 2010 edition. A helpful Table of Correspondence is available to cross-reference the Articles in the three editions and identify new or changed clauses or comments.² The UP are available to download from the Unidroit website in the five official languages (English, French, German, Italian and Spanish) as well as Russian, Japanese and Portuguese.³ In addition to the text of the Principles, a version with comments is also available in English and French, in which the reasons for and application of each sub-clause is explained. Many provisions are illustrated by examples of applicable contractual situations. There is a considerable literature available on the UP, and their application

¹ <http://www.unidroit.org/dynasite.cfm?dsmid=103284> (accessed 2 September 2010).

² <http://www.unidroit.org/english/principles/contracts/principles2010/tableofcorrespondence.pdf> (accessed 5 September 2012).

³ <http://www.unidroit.org/english/principles/contracts/principles2010/translations/blackletter2010-main.htm> (accessed 7 September 2012).

to contractual issues and national legal systems.⁴ Citations of court and arbitration cases in which the UP have been considered are also available by jurisdiction, and by subject. They have also usefully been tabulated by subclause, so that it is easy to find the treatment a particular subclause has been given in different jurisdictions.⁵

The UP have received limited attention by common law courts to date. Of the total of 133 court citations listed on the Unilex website, only 33 are for common law countries. The greatest number of common law judicial citations is in Australia (13), followed by the United Kingdom (8). These citations comprise cases in which the UP have been referred to, either noting whether or not the relevant national law is consistent, or as additional support for legal conclusions based on other principles.

The UP have been referred to in a significant number of publicly reported international arbitrations, in which the question of the choice of law has frequently been a live issue. As at 1 September 2012, the Unilex website listed a total of 161 international arbitration awards which have referred to the UP, and noted that the real number is undoubtedly considerably more because arbitration awards are generally confidential to the parties and therefore many awards are not publicly accessible. In a similar presentation to the case law citations, the details of the publicly available arbitration awards that have referred to the UP (without any identification of the parties), are accessible by keywords, in abstract, and in a number of cases, the full text of the judgment/award is available.⁶

The number and variety of the arbitration awards which have referred to the UP provide a range of situations in which arbitrators have found the UP relevant to the law applying to the contract in dispute. One of the significant applications in arbitration has been to apply the UP as the governing law of the contract where the parties have not made an express choice, or to supplement or reinforce national law. This is discussed in more detail below.

The UP have evolved from a considerable amount of work by a number of skilled and experienced lawyers from many countries and from all the major legal systems. It is suggested that they represent a set of overarching principles that are appropriate to regulate an international contract in a manner that is:

- fair to all parties;
- straightforward to apply;
- predictable in outcome;
- independent of a particular national legal system;
- generally consistent with the contract law and principles in any country (with some exceptions).

⁴ <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13623&x=1> (accessed 2 September 2010).

⁵ <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=14311> (accessed 5 September 2012).

⁶ <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13620&x=1> (accessed 7 September 2012).

Although the UP have been formulated with input from common lawyers as well as civil lawyers, there is probably a closer correspondence with civil law than the common law; as discussed further below, there are some important differences between the UP and the common law in England and other common law jurisdictions.

As a set of principles, the UP may be complementary to and supportive of the specific contract which applies to a given situation, in a similar way that the common law, civil law or statute law typically applies to regulate the entry into, and execution and termination of the contract in the given legal system. However, because the UP are transnational, they do not and cannot have the legal force of a national legal system which is based on government power. Any force that the UP have, can only be derived from the parties' contractual arrangements. Furthermore, any such power the parties themselves have invested in the role of the UP will be illusory, unless that power is supported by a relevant legal system which supports the parties' freedom of contract.

The United Nations Commission on International Trade Law (UNCITRAL) endorsed the 2004 edition of the UP in the following terms:

“ . . . Congratulating Unidroit on having made a further contribution to the facilitation of international trade by preparing general rules for international commercial contracts,

Commends the use of the Unidroit Principles 2004, as appropriate, for their intended purposes.”⁷

2. Contents of the UP

The Preamble to the UP sets out the following Purpose of the Principles:

“These Principles set forth general rules for international commercial contracts.

They shall be applied when the parties have agreed that their contract be governed by them.

They may be applied when the parties have agreed that their contract be governed by general principles of law, the *lex mercatoria* or the like.

They may be applied when the parties have not chosen any law to govern their contract.

They may be used to interpret or supplement international uniform law instruments.

They may be used to interpret or supplement domestic law.

They may serve as a model for national and international legislators.”⁸

The 2010 edition of the UP consists of 211 Articles (120 Articles in the 1994 edition and 185 Articles in the 2004 edition) in the following sections:

1. General Provisions
2. Formation and Authority of Agents

⁷ *Report of the United Nations Commission on International Trade Law on the Work of its Fortieth Session*, Vienna, 25 June–12 July 2007, 54.

⁸ <http://www.unidroit.org/english/principles/contracts/principles2010/integralversionprinciples2010-e.pdf> (accessed 7 September 2012).

- Section 1: Formation
- Section 2: Authority of agents (not in 1994 edition)
- 3. Validity
 - Section 1: General provisions
 - Section 2: Grounds for avoidance
 - Section 3: Illegality (not in 1994 or 2004 editions)
- 4. Interpretation
- 5. Content, Third Party Rights and Conditions
 - Section 1: Content
 - Section 2: Third party rights (not in 1994 edition)
 - Section 3: Conditions (not in 1994 or 2004 editions)
- 6. Performance
 - Section 1: Performance in general
 - Section 2: Hardship
- 7. Non-performance
 - Section 1: Non-performance in general
 - Section 2: Right to performance
 - Section 3: Termination
 - Section 4: Damages
- 8. Set-off (not in 1994 edition)
- 9. Assignment of Rights, Transfer of Obligations, Assignment of Contracts (not in 1994 edition)
 - Section 1: Assignment of rights
 - Section 2: Transfer of obligations
 - Section 3: Assignment of contracts
- 10. Limitation Periods (not in 1994 edition)
- 11. Plurality of Obligors and Obligees (not in 1994 or 2004 editions)
 - Section 1: Plurality of obligors
 - Section 2: Plurality of obligees

It can be seen from this list of contents that the UP contain detailed provisions on all the main elements of entry into, performance and termination of contracts. The additional Articles added in the 2004 and 2010 editions indicate a continuing development of the scope to keep up with the requirements of modern international contracts.

3. The application of the UP to international construction contracts

In contracts where the parties have expressly referred to the UP, then, in accordance with the principle of freedom of contract, they will generally apply to the extent and in the manner that the parties have provided for in their contract. This statement is subject to the two important exceptions discussed below, that the parties' freedom of contract is subject to any applicable statute law, and must not conflict with public policy. Thus, as one possibility, the parties may explicitly nominate the UP as the system of law to govern their contract, to the exclusion of any national law that would otherwise apply based on the application of the well-established principles of conflict of laws. Any dispute arising under such a contract could, in principle, be resolved by the award of a properly constituted arbitral tribunal sitting anywhere in the world. If, as Unidroit suggests, the UP are

sufficiently developed as a *lex mercatoria*, an arbitral tribunal would not need to refer to any national law to determine the meaning of the contract, and the “*lex contractus*” would be the UP.

Interface with national law does, however, occur where:

- a dispute is litigated in court;
- support of the courts is required in the conduct of an arbitration;
- an arbitration award is appealed; and
- where an arbitration award needs to be enforced.

These applications of the relevant national law may involve issues relating to the entry into, execution or termination of the contract the subject of the dispute. In any such case, the court in the relevant jurisdiction may be required to enquire into the legal basis of the contract, the arbitration and/or the arbitration award, and the extent to which the UP are compatible with the local law.

It is suggested that the principle of party autonomy and freedom of contract generally accepted across all jurisdictions means that a court would uphold all the terms of the contract the parties have agreed on, except those terms which are:

- in breach of a relevant statute; or
- against public policy.

Thus, if contracting parties explicitly nominated the UP as the law governing their contract, a court would generally be expected to uphold the parties’ bargain, unless the choice of the UP as the governing law or specific aspects of the UP were in breach of a relevant statute or public policy. For example, although the European Regulations on the law applicable to contractual relations (Rome I),⁹ allow the incorporation of a non-state body of law into a contract, a European court would limit the parties’ choice of governing law to a national system of law, and in the absence of the parties’ choice would apply the conflict of laws rules in Rome I to determine the applicable law.¹⁰ The extent of application of the chosen UP in these circumstances would depend on the relevant national law.

As another example, Article 869 of the Colombian Commercial Code states that contracts that are performed in Colombia will be governed by Colombian law; it would be expected that even if the UP were chosen by the parties, a Colombian court would limit their application to issues not addressed by Colombian law, and then only to the extent that the UP were not inconsistent with Colombian law.

⁹ Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the Law applicable to Contractual Obligations.

¹⁰ Guido Carducci, “The Impact of the EU ‘Rome I’ Regulation on International Litigation and Arbitration, A-National Law, Mandatory and Overriding Rules” (2011) 22(2) *ICC International Court of Arbitration Bulletin* 31, 36.

Public policy varies from jurisdiction to jurisdiction, and is sometimes widely construed by courts so as to significantly limit the operation of contractual terms agreed by the parties.

The relevance of the UP in cases where the parties have not expressly agreed to use them as the law of their contract raises different issues. As some of the cases below show, in appropriate circumstances, the UP has been used by an arbitral tribunal to fill the gap resulting from the parties' failure to nominate the system of law within which their contract operates.

As discussed below, there are a significant number of reported cases of courts and arbitral tribunals that have referred to the UP in a variety of ways. Agro has recently tabulated the statistics on these cases.¹¹ That paper enumerates the reported cases of courts and arbitral tribunals referring to the UP in the following categories:

- (1) applied as the law governing the substance of the dispute: (i) expressly chosen by the parties, and (ii) applied *ex-officio* by the arbitral tribunal (55 arbitral awards, 6 court decisions);
- (2) to confirm that the solution provided by the applicable domestic law is in conformity with international standards (25 court decisions, 33 arbitral awards);
- (3) as a means of interpreting and supplementing domestic law (49 court decisions, 27 arbitral awards); and
- (4) as a means of interpreting and supplementing international uniform law instruments (11 court decisions, 24 arbitral awards).

Agro notes that although the majority of applications of the UP in these cases are sales contracts, they also cover a great variety of other important international commercial contracts, especially service contracts, distribution contracts and licensing contracts.¹² Although there are few reported construction law cases, there is no apparent reason why the issues highlighted by the cases would not be applicable to construction law contracts in appropriate circumstances.

4. Case law referring to the UP

The UP have been referred to in a number of reported judgments in common law countries, in litigation based on the common law in those countries. By virtue of their nature as a set of principles that have not been formally adopted in statute, the UP cannot themselves be a source of law for a judge, except to the extent expressly adopted by the parties in their contract. However, they can be of value in establishing international

¹¹ Eleonora Finazzi Agro, "The Impact of the UNIDROIT Principles in International Dispute Resolution in Figures" (2011) 3 *Uniform Law Review* 719.

¹² *Ibid.*, 721.

contractual norms that assist judges in developing the common law towards greater international consistency.

The relatively few reported court common law cases that have referred to the UP are valuable both for identifying areas where the common law is (or is becoming) consistent with the *lex mercatoria* of the UP, and for highlighting where the common law diverges from the UP.

4.1 *Good faith*

The issue of whether there is a general duty of good faith in the entry into and execution of contracts differs from jurisdiction to jurisdiction in the common law world. Whereas in the USA the Uniform Commercial Code has enshrined in legislation the obligation of good faith in the performance of contracts,¹³ good faith is not part of the common law of England. In Australia, although the High Court has not considered the issue, there is case law that indicates that there may be a general duty of good faith in the performance of some contracts in Australia. Article 1.7 [*Good faith and fair dealing*] of the UP has been used as support for this proposition by several judges.¹⁴ In *United Group Rail Services v. Rail Corporation of New South Wales*,¹⁵ Allsop J found that a commitment to negotiate in good faith was enforceable, and recognised that good faith was part of the law of performance of contracts in numerous sophisticated commercial jurisdictions, and expressly referred to Article 1.7 of the UP. And in *Macquarie International Health Clinic Pty Ltd v. Sydney South West Area Health Service*,¹⁶ Allsop J found support in UP Article 1.7 as a factor confirming an increasing recognition at international level of the principle of good faith and fair dealing.

4.2 *UP as support for the common law*

Common law judges have also used other Articles of the UP as additional support for findings as to what the common law is. For example, in *GEC Marconi Systems Pty Ltd v. BHP Information Technology Pty Ltd*,¹⁷ Finn J referred to Article [2.1.18]¹⁸ [*Modification in a particular form*] in relation to the parties' right to make an oral variation, and Article 6.1.4 [*Order of performance*] in relation to the time at which instalment payments become due and payable under an "entire contract" clause.

¹³ Uniform Commercial Code, §1-304, Obligation of Good Faith: "Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement."

¹⁴ *Hughes Aircraft Systems International v. Airservices Australia* (1997) 146 ALR 1; *Aiton v. Transfield* (2000) 16 BCL 70.

¹⁵ [2009] NSWCA 177.

¹⁶ [2010] NSWCA 268.

¹⁷ [2003] FCA 50.

¹⁸ Article numbers in square brackets are quoted as those in the 2010 edition, although the Article number originally quoted from the 1994 edition was different.

In *Koompahtoo Local Aboriginal Land Council v. Sanpine Pty Ltd*,¹⁹ the Australian High Court noted that a distinction between breach of essential terms and “intermediate” terms is not part of Australian law, and referred to UP Articles 7.3.1 [*Right to terminate the contract*] and 7.3.3 [*Anticipatory non-performance*], implicitly recognising that the UP and Australian law coincide on this issue.

In *Hannaford (trading as Torrens Valley Orchards) v. Australian Farmlink Pty Ltd*,²⁰ Finn J recognised that a prior course of dealing between parties and practices and usages can provide for both the drawing of inferences as to the actual terms on which the parties have contracted and also for the imputation of implied terms in their contract, and referred to UP Articles 1.9 [*Usages and practices*] and 5.1.2 [*Implied obligations*] in support.

The High Court of Delhi in *Sandvik Asia Pvt Ltd v. Vardhman Promoters Pvt Ltd*^{20a} had to construe the terms of a contract for the sale of real estate. In reaching its conclusion the court referred not only to a number of Indian and English decisions and legal writings, but also to the UP, citing Article 4.4 [*Reference to contract or statement as a whole*] and quoting Article 4.5 [*All terms to be given effect*].

4.3 UP Articles incompatible with common law

In Chapter 4, the UP contains eight Articles on the interpretation of the terms of contracts. Article 4.4 [*Reference to contract or statements as a whole*], Article 4.5 [*All terms to be given effect*], Article 4.6 [*Contra proferentem rule*] and Article 4.7 [*Linguistic discrepancies*] are probably consistent with most common law rules of contract construction. However, Articles 4.1 [*Intention of the parties*], Article 4.2 [*Interpretation of statements and other conduct*], Article 4.3 [*Relevant circumstances*] and Article 4.8 [*Supplying an omitted term*] allow for a greater amount of factual material to assist in interpreting the meaning of a contract, particularly in allowing for evidence of pre-contractual negotiations, earlier drafts of the contract, and each party’s subjective intent than is generally applicable to many common law rules. In *Chartbrook Ltd v. Persimmon Homes Ltd*,²¹ Lord Hoffmann confirmed the traditional exclusionary rule of the inadmissibility of evidence of pre-contractual negotiations. Referring to UP Article 4.3 he noted that this reflects the French philosophy of contractual interpretation, which is altogether different from that of English law:

“One cannot in my opinion simply transpose rules based on one philosophy of contractual interpretation to another, or assume that the practical effect of admitting such evidence under the English system of civil procedure will be the same as that under a Continental system.”

¹⁹ [2007] HCA 61.

²⁰ [2008] FCA 1591.

^{20a} 2006 (2) CTLJ 305 Del.

²¹ [2009] UKHL 38.

However, this issue is not without controversy, as several judges have argued in favour of a flexible application of the exclusionary rule whenever a cautious use of the pre-contract material would enable the court to arrive at a meaning of the contract that accorded with the ascertainable intention of the parties. In *Proforce Recruit Ltd v. The Rugby Group Ltd*,²² Arden LJ suggested that consideration should be given to the possibility of admitting evidence of pre-contractual negotiations in interpretation questions on a wider basis than the law presently permits. In her view “it may be appropriate to consider a number of international instruments applying to contracts”, such as the UNIDROIT Principles which “give primacy to the common intention of the parties and on questions of interpretation requires regard to be had to all the circumstances, including the pre-contractual negotiations of the parties (Article 4.3)”.

5. Arbitration cases referring to the UP

One of the reasons for the popularity of arbitration as a method of dispute resolution is the extent to which the parties have autonomy to set their own rules, not only in relation to the arbitration procedures, but also in relation to the law governing the substance of their dispute. In *Musawi v. RE International (UK) Ltd*,²³ the High Court of England affirmed that section 46 (1) (b) of the UK 1996 Arbitration Act “allows parties the freedom to apply a set of rules or principles which do not in themselves constitute a legal system” and that “such a choice may include a non-national set of legal principles (such as the 1994 UNIDROIT Principles of International Commercial Contracts) or, more broadly, general principles of commercial law or the *lex mercatoria*”.

If the parties have not made a choice of governing law in their contract, it will fall to the arbitral tribunal to determine it. Such a tribunal typically has considerable latitude in determining the applicable law under the applicable procedural arbitration rules. For example, Article 21.1 of the ICC Arbitration Rules (2011) provides:

“The parties shall be free to agree upon the rules of law to be applied by the arbitral tribunal to the merits of the dispute. In the absence of any such agreement, the arbitral tribunal shall apply the rules of law which it determines to be appropriate.”

Article 33.1 UNCITRAL Arbitration Rules (1998) provides:

“The arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.”

Thus, under these (and other institutional) rules, the arbitral tribunal determines the rules of law it determines to be appropriate in the

²² [2006] EWCA Civ 69.

²³ [2007] EWHC 2981 (Ch).

circumstances, taking into account relevant trade usages. It is generally accepted that an arbitration has no *lex fori*, and accordingly provisions such as Rome I that would require a court to apply a national system of law, do not apply to an arbitral tribunal.²⁴ An arbitral tribunal is therefore generally free to select the UP as the governing law of the contract if appropriate.

The cases discussed below illustrate the ways in which arbitral tribunals have applied the UP, including applying the UP as the governing law of the contract.

5.1 UP applied as the law governing the substance of the dispute

In addition to cases in which the parties themselves have expressly adopted the UP as the governing law of the contract, or supplementary to their choice of law, there are a number of reported arbitration cases in which the arbitral tribunal has applied the UP as the law governing the substance of the dispute, or supplementary to the law chosen by the parties. These cases are valuable for identifying the factors that may be relevant in determining the application of the UP in cases where the parties have not explicitly made their own choice of law.

In a dispute between a US national and the Government of the Ukraine, an International Centre for the Settlement of Disputes (ICSID) arbitral tribunal recorded a settlement agreement in the form of an award. The US plaintiff subsequently commenced arbitral proceedings alleging breach of the terms of settlement. The settlement agreement provided that the applicable law was to be determined by the arbitral tribunal who shall apply “(a) the law determined by the conflict of laws rules which it considers applicable and (b) such rules of international law as the Tribunal considers applicable”. The arbitral tribunal found that such a choice of law clause amounted to an implied negative choice of any municipal legal system by the parties and concluded that the most appropriate approach was to submit the settlement agreement to the rules of international law, and within these, to have particular regard to the UP. In support of its decision the arbitral tribunal noted that when negotiating the agreement, the parties had evidently given thought to the issue of applicable law, but were apparently unable to reach an agreement to apply either Ukrainian or US law. Instead they incorporated extensive parts of the UP into the agreement, and included a clause authorising the tribunal either to select a municipal legal system or to apply the rules of law the tribunal considered appropriate. In determining the merits of the dispute, the arbitral tribunal referred to UP Articles 4.1 [*Intention of the parties*], 4.3 [*Relevant circumstances*], 2.1.17 [*Merger clauses*], 1.8 [*Inconsistent behaviour*] and 5.1.4 [*Duty to achieve a specific result. Duty of best efforts*].²⁵

²⁴ Guido Carducci, *op. cit.* n. 10, 31, 36.

²⁵ <http://www.unilex.info/case.cfm?pid=2&do=case&id=1533&step=Abstract> (accessed 7 September 2012).

A dispute arose in a contract between parties from two Middle Eastern countries relating to high-technology based services to be provided by the claimant with respect to certain instances of alleged non-performance. The contract did not contain a choice-of-law clause but provided for resolving disputes by ICC arbitration in London with the language of the arbitration to be English. The claimant argued, based on English case law, that there had been a tacit choice of English law as the law governing the contract. The respondent argued in favour of the applicability of the law of its own country. In a Partial Award, the arbitral tribunal decided that the law governing the contract was the UP, if and where necessary supplemented by the otherwise applicable law as determined in accordance with Article 17.1 of the 1998 ICC Arbitration Rules (Article 21 in the 2011 ICC Arbitration Rules). The tribunal gave the following reasons for the choice of the UP:

- (1) There had been a “negative choice” as regards the laws of the claimant’s and respondent’s countries, and there had been no shared expectations of the parties in this respect.
- (2) There was no clearly identifiable “objective” connecting factor or other conflict of laws rule.
- (3) The UP were shaped by the laws of the community of trading nations and constituted an international restatement (and pre-statement) of modern contract law in its most authoritative form.
- (4) In the meantime, they were well known, not least due to many hundreds of publications and more than 150 documented arbitral awards and court decisions.
- (5) The United Nations Commission on International Trade Law (UNCITRAL) had endorsed the UP.²⁶

A contract between a French company and a US company was silent as to the applicable law. The arbitral tribunal held that none of the connecting factors advocated by the parties to select the applicable law such as the parties’ domicile, the place of contracting or the place of performance of the contracts was compelling. And since the parties themselves accepted the general principles of law as a subordinate alternative, it concluded that it would be more appropriate not to apply any particular domestic law but rather follow the so-called direct method admitted under Article 17 (1) of the ICC Rules of Arbitration and base its decision on general principles of law or the *lex mercatoria*. The arbitral tribunal recalled that several ICC cases have considered that the UNIDROIT Principles are the best approach to apprehend the general principles of law and determined that it would likewise have recourse in the case at hand to the UNIDROIT Principles “as

²⁶ <http://www.unilex.info/case.cfm?pid=2&do=case&id=1440&step=Abstract> (accessed 2 September 2010).

a primary set of guidelines in determining international rules of law applicable to the parties' contract".²⁷

5.2 Reference to UP as evidence of international trade usages

The significance of international trade usages is that some arbitration rules include them as a factor to be taken into account by the arbitral tribunal in determining the law to be applied to the merits of the dispute, e.g.:

"The arbitral tribunal shall take account of the provisions of the contract, if any, between the parties and of any relevant trade usages."²⁸

"In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction."²⁹

A number of arbitral tribunals have referred to the UP as evidence of international trade usages, including the following examples.

In an arbitration in which the governing law of the contract was Lithuanian, the claimant also invoked the application of the UP and the Principles of European Contract Law as a source of trade usages. The arbitral tribunal decided that it would refer, when necessary, to "the relevant trade usages" according to Article 17 of the 1998 ICC Rules of Arbitration, and that such reference included but was not limited to the UP and the Principles of European Contract Law.³⁰

In an arbitration between two Italian companies who had chosen New York law as the law governing the validity of their agreement, the arbitral tribunal concluded that the silence with respect to all other matters was an indication of the parties' intention not to have these matters governed by a particular domestic law. The arbitral tribunal therefore decided to apply, in addition to the terms of the agreement, "the usages of international trade", having regard whenever necessary to "international public policy" and for this purpose to refer to the UNIDROIT Principles which it considered an "accurate representation, although incomplete, of the usages of international trade".³¹

In a contract for the sale of fuel oil between an English and an Italian company, the contract contained an express reference to Italian law as the law governing the contract. In view of the fact that Article 834 of the Italian Code of Civil Procedure requires the arbitral tribunal in an international arbitration to take into account the terms of the contract and the trade usages, the arbitral tribunal repeatedly referred to the UP, which it defined

²⁷ <http://www.unilex.info/case.cfm?pid=2&do=case&id=1409&step=Abstract> (accessed 2 September 2010).

²⁸ ICC Rules of Arbitration 2011, Art 21.2 [*Applicable Rules of Law*].

²⁹ UNCITRAL Arbitration Rules 1998, Art 33 [*Applicable law, amiable compositeur*].

³⁰ <http://www.unilex.info/case.cfm?pid=2&do=case&id=695&step=Abstract> (accessed 2 September 2010).

³¹ <http://www.unilex.info/case.cfm?pid=2&do=case&id=680&step=Abstract> (accessed 2 September 2010).

as a parameter of the principles and usages of international trade in order to prove that the solutions provided by Italian law were in conformity with international standards.³²

5.3 Reference to UP as corroboration for a conclusion arrived at by reference to national law, or consistent with national law

The following give some examples of reported arbitration cases in which the arbitrator(s) has (have) found specific provisions of the UP to be compatible with domestic law:

- Articles 1.1 [*Freedom of contract*], 1.3 [*Binding character of contract*], 1.7 [*Good faith*], and 2.1.15 [*Negotiations in bad faith*] and New York law³³;
- Article 1.7.1 [*Good faith*] and French Law³⁴;
- Articles 1.7 [*Good faith*], 1.8 [*Inconsistent behaviour*], 4.1 [*Intention of the parties*], 4.2 [*Interpretation of statements and other conduct*] and 4.3 [*Relevant circumstances*] and Greek law³⁵;
- Article [2.1.19] [*Contracting under standard terms*] and French law³⁶;
- Articles 3.5 [*Relevant mistake*], 4.1 [*Intention of the parties*] and 4.2 [*Interpretation of statements and other conduct*] and Swiss law³⁷;
- Article 6.2.1 [*Contract to be observed*] and Dutch law³⁸;
- Article 6.2.2 [*Definition of hardship*] and Article 6.2.3 [*Effects of hardship*] and French law³⁹;
- Article 7.4.1 [*Right to damages*] and Lebanese law⁴⁰;
- Article 7.4.8 [*Mitigation of harm*] and English law⁴¹;
- Article 7.4.9 [*Interest for failure to pay money*] and Italian law.⁴²

³² <http://www.unilex.info/case.cfm?pid=2&do=case&id=631&step=Abstract> (accessed 2 September 2010).

³³ <http://www.unilex.info/case.cfm?pid=2&do=case&id=644&step=Abstract> (accessed 2 September 2010).

³⁴ <http://www.unilex.info/case.cfm?pid=2&do=case&id=973&step=Abstract> (accessed 2 September 2010).

³⁵ <http://www.unilex.info/case.cfm?pid=2&do=case&id=699&step=Abstract> (accessed 2 September 2010).

³⁶ <http://www.unilex.info/case.cfm?pid=2&do=case&id=662&step=Abstract> (accessed 2 September 2010).

³⁷ <http://www.unilex.info/case.cfm?pid=2&do=case&id=642&step=Abstract> (accessed 2 September 2010).

³⁸ <http://www.unilex.info/case.cfm?pid=2&do=case&id=630&step=Abstract> (accessed 2 September 2010).

³⁹ <http://www.unilex.info/case.cfm?pid=2&do=case&id=1062&step=Abstract> (accessed 2 September 2010).

⁴⁰ <http://www.unilex.info/case.cfm?pid=2&do=case&id=1365&step=Abstract> (accessed 2 September 2010).

⁴¹ <http://www.unilex.info/case.cfm?pid=2&do=case&id=691&step=Abstract> (accessed 2 September 2010).

⁴² <http://www.unilex.info/case.cfm?pid=2&do=case&id=1068&step=Abstract> (accessed 2 September 2010).

In an arbitration in which the parties had chosen Mexican law as the governing law of the contract, the arbitral tribunal noted that “the UNIDROIT Principles, which are the result of a thorough comparative study, may be used to interpret [the domestic law chosen by the parties] and solve unexpected difficulties in applying [that law] to an international contract”.⁴³

5.4 UP referred to as supplementary to national law

When a Swiss company initiated arbitration proceedings against a Polish company alleging violation of contractual rights, the question arose as to whether the claimant, when it transferred those rights to its subsidiary, had transferred them alone or had transferred the whole contract. The applicable Polish law did not provide any specific solution on this point, and the arbitral tribunal determined to “*subsidiarily [sic]* apply international law instruments” such as the UP. The arbitral tribunal found the solution by interpreting the terms of the contract, and referred to the canons of interpretation laid down in the Polish Civil Code as well as in UP, Articles 1.1 [*Freedom of contract*], 4.1 (1) [*Intention of the parties*] and 4.8 (2) [*Supplying an omitted term*], i.e., that a contract is to be interpreted and supplemented having regard to the common intention of the parties, the nature and purpose of the contract, good faith and fair dealing and reasonableness.⁴⁴

In a contract governed by Egyptian law for the supply of equipment for an industrial plant and the supervision of the construction of the plant, an Egyptian company claimed that due to the French company defendant’s faulty design and performance, the plant could not be run on schedule. The claimant initiated arbitration proceedings, claiming damages for loss of profits. In addressing the question of the quantification of the losses the arbitral tribunal referred not only to the relevant provisions in the Egyptian Civil Code but also to UP, Articles 7.4.1 [*Right to damages*], 7.4.2 [*Full compensation*] and 7.4.3 [*Certainty of harm*].⁴⁵

A German company concluded two contracts with an Indian company defendant, for the delivery and installation of industrial equipment. When the defendant declared its intention to return allegedly defective equipment, the claimant filed a request for arbitration. In interpreting the choice of law clause contained in the contract to determine that the applicable law was Swiss law, the arbitral tribunal expressly referred to UP, Articles 4.1 [*Intention of the parties*] and 4.2 [*Interpretation of statements and other conduct*].

⁴³ <http://www.unilex.info/case.cfm?pid=2&do=case&id=1423&step=Abstract> (accessed 2 September 2010).

⁴⁴ <http://www.unilex.info/case.cfm?pid=2&do=case&id=1070&step=Abstract> (accessed 2 September 2010).

⁴⁵ <http://www.unilex.info/case.cfm?pid=2&do=case&id=1061&step=Abstract> (accessed 2 September 2010).

In relation to the merits of the case, the arbitral tribunal pointed out that the issue of fraud and misrepresentation would not be determined differently even if Indian law were found to apply. It noted that the avoidance of a contract for wilful deception is “a common understanding of all civilised jurisprudence” and in this context referred to UP, Articles [2.1.15 (2)] [*Negotiations in bad faith*], 3.8 [*Fraud*] and 3.9 [*Threat*].⁴⁶

In an arbitration on alleged breach of a settlement agreement governed by Italian law, the arbitral tribunal referred, in addition to the relevant provisions of the Italian Civil Code, to provisions contained in the United Nations Convention on Contracts for the International Sale of Goods (CISG) and the UP, defining both as “normative texts that can be considered helpful in their interpretation of all contracts of an international nature”. In support of the provisions of the Italian Civil Code on the rules of interpretation, the Arbitral Tribunal referred to the corresponding rules contained in UP, Articles 1.7 [*Good faith and fair dealing*] and 4.1–4.8 [*Interpretation*]. And in finding that a modified acceptance amounts to a counter-offer which the original offeror may tacitly accept by not objecting to the varying terms contained in the acceptance, and by starting performance of its own obligations, the arbitral tribunal referred to UP, Article [2.1.11] [*Modified acceptance*] as consistent with the Italian Civil Code.⁴⁷

5.5 Parties to an arbitration agreed to use general principles of international law, as complementary and supplementary to the choice of national law

The case concerned two 1977 contracts for the sale and the installation of military equipment, between a United States corporation and the Iranian Air Force. The contracts were duly performed until the advent of the Islamic Revolution in early 1979. The contracts’ choice of law clause designated the law of Iran, but the parties eventually agreed to the complementary and supplementary application of general principles of international law. In relation to the substantive applicable law to the dispute, the arbitral tribunal held that, to the extent necessary, it would be guided by the UP as manifesting the general principles of international law. Thus, in finding that each party was entitled to unilaterally request termination of the contracts or adaptation of their terms, the arbitral tribunal expressly referred to UP, Article 6.2.3 [*Effects of hardship*]. Furthermore, in order to justify the application by analogy of a “Termination for Convenience Clause” contained in the contracts, to the termination of the contract as a result of changed circumstances, the arbitral tribunal applied UP, Articles 5.1 [*Express and implied obligations*] and 5.2 [*Implied*

⁴⁶ <http://www.unilex.info/case.cfm?pid=2&do=case&id=692&step=Abstract> (accessed 2 September 2010).

⁴⁷ <http://www.unilex.info/case.cfm?pid=2&do=case&id=663&step=Abstract> (accessed 2 September 2010).

obligations], and the “widely accepted principles therein set forth regarding implied obligations”. In dealing with the consequences of the termination of the contracts, the Arbitral Tribunal quoted UP Article 7.3.6 [*Restitution*] in support of the right of either party to claim restitution of whatever it had supplied, provided that such party concurrently made restitution of whatever it had received.

However, in relation to the date from which interest was to be awarded, the arbitral tribunal declined to award interest from the time when the payment became due without any need for the aggrieved party to give notice of the default (as provided for in UP, Article 7.4.9 [*Interest for failure to pay money*]). It concluded that

“[e]ven if a generally accepted principle of international law existed in this respect, the Tribunal would only be authorized to apply it as a complementary and supplementary rule, not as a rule in clear contradiction to an unambiguous provision of the Iranian law chosen by the Parties”.⁴⁸

6. To what extent do the UP cover construction law?

Construction contracts contain a number of unique features that distinguish them from other types of contracts. Those unique features of “construction law” may be covered by the terms of the construction contract itself, or by the Civil Codes of some jurisdictions. For example, Chapter 16 [*Contracts for Construction Projects*] of the Peoples’ Republic of China Contract Law contains general construction law provisions, and the PRC Construction Law contains detailed legal requirements for the execution of construction projects.

This raises the question as to whether the UP, as a general statement of principles of contract law, adequately address the specific requirements of construction contracts to the extent necessary for them to be the governing law of the contract.

Without attempting to define the unique characteristics of construction contracts, or enumerate the specific issues that may arise in particular circumstances, the following represent some typical areas of “construction law”:

- Who is liable for ground conditions?
- Can work be suspended and why?
- Extension of the time for completion.
- Can work be added or omitted?
- How are changes valued?

These typical areas of construction law are frequently covered in some detail in the general and particular conditions of a specific construction contract. To the extent that a contract addresses these “construction law”

⁴⁸ <http://www.unilex.info/case.cfm?pid=2&do=case&id=653&step=Abstract> (accessed 2 September 2010).

areas, the role of the UP as the governing law would generally be confined to upholding the terms of the contract that the parties had agreed to. Pursuant to Article 1.1 [*Freedom of contract*]: “The parties are free to enter into a contract and to determine its content.” Further, pursuant to the principle of *pacta sunt servanda* in Article 1.3 [*Binding character of contract*]: “A contract validly entered into is binding upon the parties. It can only be modified or terminated in accordance with its terms or by agreement or as otherwise provided in these Principles.”

The primary role of the UP as the governing law of a comprehensive construction contract, such as the FIDIC Conditions of Contract for Construction (the “Red Book”), would be construction of the contract terms in accordance with Chapter 4 [*Interpretation*]. Specifically the UP provide in Article 4.1 [*Intention of the parties*]:

- “(1) A contract shall be interpreted according to the common intention of the parties.
- (2) If such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give it in the same circumstances.”

It is submitted that an experienced arbitral tribunal would generally have little difficulty in applying these principles of interpretation to a comprehensive construction contract, if provided with the appropriate evidence. However, if a construction contract does not make provision for a construction law issue that arises (e.g., one of the five issues identified above) the UP typically only provide general principles to apply to fill the gap.

One such general principle is in Article 1.9 [*Usages and practices*]:

- “(1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves.
- (2) The parties are bound by a usage that is widely known to and regularly observed in international trade by parties in the particular trade concerned except where the application of such a usage would be unreasonable.”

Article 1.9 (1) may enable the parties, by agreement during the execution of a project, to establish practices such as addition or deletion of work or extension of time for completion, that were not specifically detailed in the contract. Article 1.8 [*Inconsistent behaviour*] would support the consistent application of such practices: “A party cannot act inconsistently with an understanding it has caused the other party to have and upon which that other party has acted to its detriment.”

In the absence of the parties’ agreement to such practices, Article 1.9 (2) may apply widely accepted practices of international construction law to fill gaps in the contract. Although there would inevitably be evidential hurdles to overcome to convince an arbitral tribunal as to the relevant “widely known to and regularly observed” construction law practices, it could be argued that provisions common to widely used international construction law contracts such as the FIDIC Red Book satisfied this requirement.

Another general principle from the UP that may assist in gap filling is that if the parties have not made provision for an issue, then a term can be implied pursuant to Article 4.8 [*Supplying an omitted term*]:

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

Other provisions of the UP that may be of assistance in filling gaps in the parties’ specific construction contract include:

- Article 5.1.1 [*Express and implied obligations*];
- Article 5.1.2 [*Implied obligations*];
- Article 5.1.3 [*Cooperation between the parties*];
- Article 5.1.4 (1) [*Duty to achieve a specific result*];
- Article 6.1.1 [*Time of performance*];
- Article 6.1.11 [*Costs of performance*];
- Section 2 [*Hardship*];
- Article 7.1.7 [*Force majeure*];
- Article 7.2.2 [*Performance of non-monetary obligations*];
- Article 7.4.13 [*Agreed payment for non-performance*].

The text of these Articles and Sections does not provide a definitive answer to any of the “construction law” issues enumerated at the beginning of this section of the paper, in the absence of appropriate contractual provisions. At best, the UP provide some general principles that may assist an arbitral tribunal, experienced in construction law and provided with appropriate evidence, to fill gaps consistent with the parties’ intentions and international construction law practice. The evidential issues involved in invoking these general principles emphasise the importance of the parties addressing the foreseeable construction law issues specifically in their contract; the advantages of applying a widely used form of contract such as FIDIC should be self-evident in comprehensiveness, wide acceptance and understanding.

There is one “construction law” issue identified above that appears to be adequately covered by the UP: that of how changes are valued. Article 5.1.7 [*Price determination*] provides:

- “(1) Where a contract does not fix or make provision for determining the price, the parties are considered, in the absence of any indication to the contrary, to have made reference to the price generally charged at the time of the conclusion of the contract for such performance in comparable circumstances in the trade concerned, or if no such price is available, to a reasonable price . . . ”

Thus, if the contract does not provide a mechanism for valuing changes, this Article provides the benchmark to assess the evidence submitted in respect of a given item of additional work.

7. Summary

The following arbitrators' statements highlight the essence of the UP and the ways in which they may be used by parties to international construction contracts:

- The UP are a private codification of civil law, approved by an intergovernmental institution. Although neither treaty, nor compilation of usages, nor standard terms of contract, they are in fact a manifestation of transnational law, as confirmed in the Preamble stating that the Principles “shall be applied when the parties have agreed that their contract be governed by them” and that they “may be applied when the parties have agreed that their contract be governed by ‘general principles of law’, the ‘*lex mercatoria*’ or the like”.⁴⁹
- The rules should be applied in the case at hand not only because the relevant rules of contract interpretation of Italian law do not substantially differ from them but also because the UP “represent, at least as far as [contract interpretation] is concerned, a kind of summary of the generally commonly accepted principles on interpretation developed in the Western countries and deriving from the main civil law codes and case law in the international trade”.⁵⁰
- “The Unidroit Principles of International Commercial Contracts are a reliable source of international commercial law in international arbitration for they ‘contain in essence a restatement of those “*principes directeurs*” that have enjoyed universal acceptance and, moreover, are at the heart of those most fundamental notions which have consistently been applied in arbitral practice’.”⁵¹
- The UP consecrate rules “. . . broadly recognised throughout the world and the practice of international contracts”.⁵²

If parties to an international construction contract wish to incorporate the international and widely accepted principles of the UP as the governing law of their contract, they would be well advised to make an explicit choice in terms. If they do not make an explicit choice of law, the UP may

⁴⁹ <http://www.unilex.info/case.cfm?pid=2&do=case&id=1533&step=Abstract> (accessed 2 September 2010).

⁵⁰ <http://www.unilex.info/case.cfm?pid=2&do=case&id=1427&step=Abstract> (accessed 2 September 2010).

⁵¹ <http://www.unilex.info/case.cfm?pid=2&do=case&id=668&step=Abstract> (accessed 2 September 2010).

⁵² <http://www.unilex.info/case.cfm?pid=2&do=case&id=658&step=Abstract> (accessed 2 September 2010).

nevertheless be found by an arbitral tribunal to be governing law of the contract in situations where some of the following apply:

- the parties authorise the tribunal to determine the applicable law, as in Article 21.1 of the 2011 ICC Rules;
- the parties have agreed to use international law, international trade usages, general principles of commercial law or the *lex mercatoria*;
- the parties have made a “negative choice” of the laws of their own jurisdictions;
- there is no common connecting factor such as the parties’ domicile, the place of contracting or the place of performance of the contracts to make one of the laws of their own jurisdictions appropriate;
- there is no common intention as to the applicable law;
- there is no applicable conflict of laws rule that would determine otherwise.

An arbitral tribunal making such a decision would no doubt draw comfort from the international recognition of the UP by UNCITRAL, from the extensive literature on the UP, and from the considerable number of reported court and arbitration cases which have applied many of the provisions of the UP in a variety of circumstances and jurisdictions.

As a general “contract code” applicable to a wide range of commercial contracts, the UP do not have specific provisions to address most “construction law” issues *per se*, i.e., the issues that are unique to the nature of a construction contract. It is therefore important for the parties to agree, to the extent possible, on the relevant “construction law” to be applied within the ambit of the UP. Conventionally this is done by the terms of the construction contract itself. To the extent that there are gaps in the relevant “construction law” in the construction contract, the UP incorporate a number of general principles that would guide an arbitral tribunal in determining the parties’ intentions and the applicable construction law. However, these general principles do not necessarily provide a definitive answer, and are not an effective substitute to the parties’ prior agreement on the appropriate contract terms.