FEATURE ARTICLE

The use of the UNIDROIT Principles by arbitrators in international construction projects

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This article analyses how the UNIDROIT Principles can be used by arbitrators dealing with cases arising from international construction projects. The UNIDROIT Principles could be of great help to arbitral tribunals in a wide range of common situations, especially when the applicable law is part of a civil law system.

Construction disputes are frequently technically complex and require fact-intensive investigations, which necessitate efficient management of the claim process. A further complication is that construction projects invariably involve multiple parties from different jurisdictions with different cultural approaches and different legal traditions.[1]

Construction contracts are often voluminous and consist of many documents of various origins, authorship and development. The standard documents forming a construction contract are usually the articles of agreement, conditions of the contract, specifications and drawings. It is not uncommon to find inconsistent or ambiguous clauses in construction contracts. That is why construction disputes frequently involve the interpretation of inconsistent clauses. For example, one common problem is where a technical specification, prepared by a consultant engineer early in the life of a project, contains substantive clauses that contradict the conditions of a contract prepared much later, based on a standard form or by a lawyer who never saw the original technical specification. Another common problem is where the specification envisages procedures for design development that are inconsistent with the conditions of the contract.

Consequently, when a dispute arises the arbitral tribunal will often be required to define how to interpret conflicting contractual clauses, also with respect to the applicable law. Thus, it might be useful for the arbitral tribunal to consider the UNIDROIT[2] Principles of International Commercial Contracts (the 'UNIDROIT Principles') to help fill any gaps in determining the parties' intentions and the applicable construction law, as a modern manifestation of *lex mercatoria*.

This article will consider the UNIDROIT Principles and their use by arbitrators for resolving disputes, and will outline:

- basic characteristics of the UNIDROIT Principles and their use;
- the role of UNIDROIT Principles in international dispute resolution, including:
  - how arbitral tribunals use the UNIDROIT Principles;
  - the UNIDROIT Principles most commonly used by arbitral tribunals; and
- the extent to which UNIDROIT Principles cover construction matters.

Some basic characteristics of the UNIDROIT Principles

The UNIDROIT Principles[3] are a set of non-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 whose 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 common or civil law legal systems. However, there is probably a closer correspondence with civil law than with common law, as there are some important differences between the UNIDROIT Contract Principles and common law principles that may be found in England and other common law jurisdictions. [4]

The UNIDROIT Principles may help parties when negotiating and drafting international contracts in general and international construction contracts in particular

The UNIDROIT Principles may help parties when negotiating and drafting international contracts in general and international construction contracts in particular. They may assist parties in overcoming linguistic barriers, serve as a checklist of issues parties may wish to address in their contract, and serve as model clauses parties may wish to incorporate in their contract, with or without adaptation. In addition, there are a number of reasons why parties may choose the UNIDROIT Principles to govern their contract. When neither party is strong enough to impose its own domestic law or they cannot agree on the choice of the domestic law of a third country, the UNIDROIT Principles provide a comprehensive set of rules governing the most important areas of contract law. As the UNIDROIT Principles are written in clear and non-technical terminology, they are easier to be understood by the parties than most domestic laws. The fact of having been drafted with the participation of legal experts from the same countries or region as the parties, may make these principles to be easily compatible with their different legal systems. [5]

The role of UNIDROIT Contract Principles in international dispute resolution

The UNIDROIT Principles today play a major role in international dispute resolution, mainly because parties refer to them in their statements of claim or defence in support of their arguments and to demonstrate their conformity with internationally accepted standards. Courts and arbitral tribunals also refer in their decisions to the UNIDROIT Principles for similar reasons.

Among the 266 court and arbitral tribunal cases reported in the UNILEX data base,[6] 107 were decisions by domestic courts and 159 were arbitral awards. The UNIDROIT Principles were applied in these collected decisions according to the following criteria:

- as the law governing the merits of the dispute because expressly chosen by the parties or defined ex officio by the arbitral tribunal (55 arbitral awards, six court decisions);
- in order to confirm that the solution provided by the applicable domestic law is in conformity with international standards (25 court decisions, 33 arbitral awards);
- as a means of interpreting and supplementing domestic law (49 court decisions, 27 arbitral awards); and
- as a means of interpreting and supplementing international uniform law instruments (11 court decisions, 24 arbitral awards).[7]

Admittedly, 20 years after the publication of the first edition of the UNIDROIT Principles, the number of decisions may not seem very impressive. However, it is a fact that most decisions referring in one way or another to the UNIDROIT Principles are arbitral awards, most of which remain unpublished. In addition, the number of cases in which the UNIDROIT Principles have been used is increasing steadily.[8] In conclusion, what emerges from the statistical data is remarkable, mainly because of the considerable numbers of arbitral tribunals and domestic courts, which have used the UNIDROIT Principles around the world.

Furthermore, the fact that the parties involved in the respective disputes were situated in so many countries may be seen as a confirmation that the UNIDROIT Principles are increasingly accepted worldwide. Finally, the substantive scope of application of the UNIDROIT Principles, though centring mainly on sales contracts, also covers a great variety of other important international commercial contracts, including international construction contracts.[9]

How arbitral tribunals use the UNIDROIT Principles

According to their Preamble, the UNIDROIT Principles shall be applied when the parties have agreed that their contract be governed by them or by general principles of law, *lex mercatoria* or the like. They may also 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.[10]

If an arbitral tribunal finds that the UNIDROIT Principles may not be relied upon as the applicable 'rules of law', they may nevertheless be used to supplement or interpret the *lex contractus*.

In practice, arbitral tribunals rely frequently on the UNIDROIT Principles, using them as described herein. Even if the relevant law and arbitration rules allow the application of 'rules of law', the arbitral tribunal might wish to use the UNIDROIT Principles merely as a means of supplementing or interpreting the applicable domestic law.

This is especially useful where the contract has connections with a number of domestic laws and the arbitral tribunal would like to account for such diversity.[11] In these instances, it usually does not matter to the arbitral tribunal whether the domestic law is applicable to the contract by virtue of an agreement between the parties or because the arbitrators have selected it as the applicable law, when there is no express choice by the parties. The parties may even agree during the proceedings that the UNIDROIT Principles be applied as a complement to the otherwise applicable domestic law.[12]

On the other hand, the arbitration rules of most institutions (as well as some national laws) permit the arbitral tribunal to take into account usages, even where the parties have selected a national law as applicable to their contract.[13]

UNIDROIT Principles as applicable trade usages

Arbitral tribunals sometimes consider that the UNIDROIT Principles can be taken into account as part of the applicable trade usages.[14] For example, in a contract for the sale of fuel oil between an English company and an Italian company, which expressly referred to Italian law as the governing law,

the arbitral tribunal relied on Article 834 of the Italian Code of Civil Procedure in order to refer to the UNIDROIT Principles. As 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 UNIDROIT Principles, which were understood as a set of parameters 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.[15]

Furthermore, some provisions of the law applicable to a contract might be unclear or inappropriate in an international context when they have been conceived mostly for their application in domestic situations. Interpreting these provisions in the light of transnational norms such as the UNIDROIT Principles can prove useful. Abundant case law shows that arbitrators refer to UNIDROIT Principles to validate a decision reached under the domestic law selected by the parties. Arbitral tribunals may do so either on their own initiative or when required by the applicable domestic law or arbitration rules to consider general principles.[16]

There are numerous examples of arbitral awards containing *obiter dicta* to the effect that a particular solution in domestic arbitration reflects transnational evidence, where the arbitral tribunals used the UNIDROIT Principles to support national provisions regarding rules of interpretation, the principles of good faith, nominalism, price determinability, quantification of losses, loss of profit, mitigation of damages and hardship. These examples will now be considered.

The UNIDROIT Principles most frequently relied upon by arbitral tribunals

In practice, the UNIDROIT Principles most commonly used by arbitral tribunals are: good faith and fair dealing (Article 1.7); main principles of contract interpretation (Articles 4.1 to 4.5); cooperation between the parties (Article 5.3); hardship (Article 6.2.1 to 6.2.3); withholding performance (Article 7.1.3); certainty of harm (Article 7.4.3); mitigation of harm (Article 7.4.8), and interest for failure to pay order (Article 7.4.9).[17]

Good faith

The most used principle by international arbitrators is that of good faith. However, the issue of whether there is a general duty of good faith in entering into and performing contracts differs in civil and common law jurisdictions. Whereas in the US the Uniform Commercial Code has enshrined the obligation of good faith in the performance of contracts, good faith is not part of English common law. In Australia, although the High Court has not considered the issue, there is a case law that indicates that there may be a general duty of good faith in the performance of some contracts.[18] On the other hand, in civil law countries the good faith principle is widely recognised and accepted, and is extremely broad. It extends to all phases of the life of a contractual relationship, from the start of the negotiations, through the course of the performance and to the consequences of non-performance. It continues to apply during the enforcement of the contract.[19]

The UNIDROIT Principles contain a large number of specific applications of the general obligation of good faith

The UNIDROIT Principles contain a large number of specific applications of the general obligation of good faith, such as the sanctions for inconsistent behaviour provided for in Article 1.8; the irrevocability of the offer in the cases of Article 2.1.4(2); the obligations of loyalty and confidentiality in the course of contractual negotiations imposed by Articles 2.1.15 and 2.1.16; the rule on written modification clauses in Article 2.1.18; the stipulation in Article 2.1.20 that 'surprising' standard terms are generally ineffective; the sanctions for fraud, threat, and gross disparity in Articles 3.8–3.10; the rules on supplying omitted terms and on implying obligations in the contract under Articles 4.8 and 5.1.2; the balancing of interests in the cases of partial and anticipated performance required by Articles 6.1.3(1); and the rules on interference by the other party, withholding performance, and mitigation of harm in Articles 7.1.2, 7.1.3 and 7.4.8.

Hardship

Another of the most widely invoked principles is that of hardship, in the context of long-term contracts such as international construction contracts, where it is difficult, if not impossible, for the parties to make a provision for every event, which may have an impact on their contractual obligations.

According to the UNIDROIT Principles, the general rule is that the contract is binding and that it must be performed in accordance with its terms. Thus, the application of the hardship principle is very much the exceptional case. Article 6.2.2 of the UNIDROIT Principles states that there is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has greatly diminished. However, in addition, the arbitral tribunal must have regard to all of the following provisions: (1) the events occurred or were known to the disadvantaged party after the conclusion of the contract; (2) the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract; (3) the events were beyond the control of the disadvantaged party; and (4) the risk of the events was not assumed by the disadvantaged party.

There is an interesting award, which illustrates the issue of hardship. A US oil company entered into a contract with the government of a state formerly belonging to the Soviet Union, according to which the US company was to construct a power station. In return, the US company was granted a long-term contract to supply electricity to customers in that state at prices fixed in such a way that a return from the investment could be expected. Subsequently, the energy supply system in the state in question was fundamentally changed by law, making it impossible for the power station set up by the US company to supply energy at profitable prices. The contract contained a choice of law clause in favour of the domestic law of the state in question; however, the arbitral tribunal found that this domestic law had not yet been fully developed following the changeover to a market economy and contained a number of lacunae and ambiguities having a bearing on the dispute. Consequently, the arbitral tribunal found that the domestic law of that state should be supplemented by taking into consideration the UNIDROIT Principle on hardship and force majeure.[20]

The extent to which UNIDROIT Principles cover construction law

International construction contracts contain a number of unique features that distinguish them from other types of commercial contracts. Those unique features may be covered by the terms of the construction contract. However, as previously mentioned, in the context of long-term contracts, such as international construction contracts, where it is difficult, if not impossible, for the parties to make a provision for every event which may have an impact on their contractual obligations, disputes often arise over a number of typical construction law issues.

Conflicts frequently arise over who is liable for ground conditions; whether work can be suspended and why; extension of the time for completion; whether work can be added or omitted; how changes are valued, etc. These typical construction law issues are often covered in some detail in the general and particular conditions of a specific construction contract, especially if the construction contract follows a well-known international construction contract model, such as the FIDIC Conditions of Contract for Construction.

The UNIDROIT Principles provide very good tools to help the arbitral tribunal to fill any gaps of construction contracts and also construction laws

However, this raises the question as to whether the UNIDROIT Principles adequately address the specific requirements of construction contracts to the extent necessary for them to be the governing law of the contract.

Filling gaps in construction contracts and construction laws

In this regard, I believe the UNIDROIT Principles provide very good tools to help the arbitral tribunal to fill any gaps of construction contracts and also construction laws.

For example, Article 4.1 of the UNIDROIT Principles states as follows:

'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 in the same circumstances'.

Thus, 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.[21]

Furthermore, there are some general principles in the UNIDROIT Principles that could fill the gap if a construction contract does not make provision for a construction law issue that arises. For example, Article 1.9, which states:

'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'.

In the performance of a construction contract it is quite common to establish practices such as addition or deletion of work or extension of time for completion, which were not specifically detailed in the contract. In this case, widely accepted practices of international construction law may be applied to fill gaps in the contract, providing the parties with the appropriate evidence on what the construction law practices are.

Another useful tool for the arbitral tribunal that may assist in filling a gap is that if the parties have not made provision for an issue, then a term can be implied pursuant to Article 4.8 of the UNIDROIT Principles, which states:

'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 UNIDROIT Principles that may be of assistance in filling gaps in the parties' specific construction contract include the following: Articles 5.1.1. (express and implied obligations); 5.1.2 (implied obligations); 5.1.3 (cooperation between the parties); 5.1.4 (duty to achieve a specific result); 5.1.7 (price determination) ; 6.1.1. (time of performance), 6.1.11 (costs of performance); 6.2.1 to 6.2.3 (hardship); 7.1.7 (force majeure); 7.2.2. (performance of non-monetary obligations); 7.3.1 (termination for fundamental non-performance)[22] and, 7.4.13 (agreed payment for non-performance).

These principles offer very good guidance to assist an arbitral tribunal, experienced in construction law and provided with appropriate evidence, to fill the gaps consistent with the parties' intentions and international construction law practice.

Conclusions

International construction contracts contain a number of unique features that distinguish them from other types of commercial contracts. However, when a dispute arises and the terms of the contract and the construction law are ambiguous, it could be useful for an arbitral tribunal to apply the UNIDROIT Principles to fill any gaps or inconsistencies among the articles of agreements, conditions of the contract, specifications and drawings, and in determining the parties' intention.

The UNIDROIT Principles of International Commercial Contracts are a reliable source of international commercial law in international arbitration mainly because they contain in essence a restatement of those '*principes directeurs*' that have enjoyed universal acceptance and are, moreover, at the heart of those most fundamental notions which have consistently been applied in arbitral practice. Thus, they are a useful tool for arbitrators to settle a dispute because they represent, at least as far as contract interpretation is concerned, a kind of summary of the generally accepted principles

on interpretation developed in the Western countries and deriving from the main civil law codes and case law in international trade.[23]

Arbitral tribunals frequently rely on UNIDROIT Principles mainly to supplement or interpret domestic law. However, they might also be applied by arbitrators when the parties authorise the tribunal to determine the applicable law; the parties have agreed to use international law, international trade usages, general principles of commercial law or *lex mercatoria*; the parties have chosen not to employ the laws of their own jurisdictions; there is no common connecting factor such as parties' domicile, the place of contracting or the place of the performance of the contracts to make one of the laws of their jurisdictions appropriate; there is no common intention as to the applicable law; and there is no applicable conflict of laws that would determine otherwise.

Arbitral tribunals frequently rely on UNIDROIT Principles mainly to supplement or interpret domestic law

Finally, in my opinion, the UNIDROIT Principles, an internationally accepted general statement of contract principles, provide a very useful tool for helping an arbitral tribunal fill gaps with respect to both international construction contracts and construction laws, applicable to a dispute in the various situations described above.

Notes

1 Jane Jenkins and Simon Stebbings, *International Construction Arbitration Law* (Kluwer Law 2006) 6.
2 The International Institute for the Unification of Private Law (UNIDROIT), created in 1926 as an auxiliary organ of the League of Nations, is an independent intergovernmental organisation with its headquarters in Rome. Its purpose is to study needs and methods for modernising, harmonising and coordinating private and in particular commercial law between states and groups of states.
3 There are three editions of the UNIDROIT Principles of International Commercial Contracts, published in 1994, 2004 and 2010.
4 Donald Charrett, 'The Use of the UNIDROIT Principles in International Construction Contracts' [2013] The International Construction Law Review 507–526.
5 Herbert Kronke, 'UNIDROIT Principles of International Commercial Contracts', Seminar sponsored by the Chamber of Commerce Santiago, 13 June 2007.
6 See: www.unilex.info.
7 Eleonora Finazzi Agro, 'The Impact of the UNIDROIT Principles in International Dispute Resolution in figures' [2011] Uniform Law Review 719–733.
8 According to the UNILEX database visited 7 August 2014, there are 387 cases from 1990 to 2014. However, UNILEX noted that the real number is undoubtedly considerably higher because arbitration awards are generally confidential to the parties and therefore many awards are not publicly accessible.
9 See n7 above, 721.
10 See: www.unidroit.org.
11 Stefan Vogenauer and Jan Kleinheisterkamp, *Commentary on the UNIDROIT Principles of International Commercial Contracts* (Oxford 2009) 96.
12 For example, in the Arbitral Award ICC Case No 7365, the choice of law clause was in favour of Iranian law. The parties agreed at the outset of the proceedings to apply general principles of international law to supplement or complement the Iranian law. In determining these general principles of international law, the tribunal declared itself to be guided by the UNIDROIT Principles.
13 Article 21 of the Arbitration Rules of the ICC (2012), in reference to the applicable rules of law, states: '1. 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. 2.The arbitral tribunal shall take account of the provisions of the contract, if any, between the parties and of any relevant trade usages.'
14 Arbitral award, October 2000, ICC Case No 10022, in which Lithuanian law was applicable to the merits; the tribunal ruled that the UNIDROIT Principles were applicable as part of the relevant trade usages mentioned in the ICC Rules.
15 See n 5 above, 514–515.
16 See n 11 above, 99.
17 Pierre Mayer, *The role of the UNIDROIT Principles in ICC Arbitration practice, special supplement- ICC, UNIDROIT Principles of International Commercial Contracts, Reflections on their use in international arbitration* (2002), 105–117.
18 See n 5 above, 513.
19 See n 11 above, 168–170.
20 Award of an ad hoc arbitration (date and place unknown), quoted by Herbert Kronke; see n 3 above, 21.
21 See n 5 above, 523.
22 For example, in construction contracts, this principle could help to decide disputes about whether or not defects meet the fundamental breach test.
23 See n 5 above, 525, who quoted an arbitral award published in: www.unilex.info/case.

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