

# **IBA Working Group on UNIDROIT Principles**

Compiled Summaries of Selected Cases

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# Chapter 1: General provisions

## I. Article 1.2: No form required

### 1. *Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2013*

**Case:**<sup>482</sup> Company A from country X and company B from country Y entered into a joint venture agreement (JVA) to provide technical assistance to the government of country Z in the framework of a project in country Z. According to the JVA, any net margin of the joint venture company was to be divided equally between company A, which was the manager of the joint venture company, and company B. The JVA provided that the parties could refer their disputes to arbitration (*‘pourront faire appel à la Cour d’Arbitrage’*) and that the International Federation of Consulting Engineers (FIDIC) rules prevailed in such cases.

After the completion of the project, company B sent an invoice to company A for 50 per cent of the joint venture company’s net margin. Company A refused to pay, alleging that company B’s employees did not provide any assistance to its employees during the project. After first referring the case to the courts in country X, company B initiated arbitration proceedings against company A, which contested the jurisdiction and alleged that the arbitration clause was too vague to constitute a valid agreement to arbitrate and that company B has waived its right to arbitration by first commencing state court proceedings.

In their submissions on jurisdiction, the parties did not specify the rules of law determining the substantive validity of the arbitration agreement. For this reason, the arbitral tribunal seated in Switzerland considered that, within the boundaries of Swiss law, it had certain discretion when deciding which rules of law it will apply to this issue. After considering the different sets of rules of law that came into play in determining the applicable law, the arbitral tribunal held that the lack of an agreement of the parties can be interpreted as implied negative choice and that the contract’s connection with the different countries is not predominant enough to justify the application of one national law to the exclusion of others. Based on the foregoing, the arbitral tribunal decided to apply the UNIDROIT Principles and Swiss law to the question of the substantive validity of the arbitration agreement. In determining whether the parties consented to submit their dispute to the arbitral institution, the arbitral tribunal applied Article 4.1 as well as Article 4.3(c) of the UNIDROIT Principles. In the context of interpretation of the subsequent conduct of the parties, the arbitral tribunal considered that company B’s statements evidenced the fact that, in its view, the arbitration clause was defective and inoperable. The arbitral tribunal held that claiming the opposite would go against the principle of *venire contra factum proprium*, which is applicable under UNIDROIT Principles Article 1.7 and Article 1.8 as well as Swiss law.

The arbitral tribunal further found that both parties revoked the arbitration agreement and accepted the jurisdiction of the state courts. It stated that ‘such mutual waiver can be concluded without observing any requirement of form and must be interpreted according to the generally applicable

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<sup>482</sup> ICC, Case No 19127, Final Award, 2013.

principles for the interpretation of private statements of intent', thereby referring to and applying article 1.2 of the UNIDROIT Principles.<sup>483</sup>

Based on the foregoing, the arbitral tribunal decided that it has no jurisdiction to decide on company B's claims.

## II. Article 1.3: Binding character of contract

### 1. *Paraguay / National Court / Nunziante / Unilex 2143 / 2017*

**Case:**<sup>484</sup> Seller A terminated a contract for the sale of land to B, alleging that B had not paid the full amount for the land. B argued that the terms of the contract allowed for the payment to be made in two instalments and that the property was to be transferred before both payments were made. The matter reached the court, where it was decided that A had a duty to cooperate with B in order to ensure proper performance of the contract.

In the court's view, A was primarily responsible for a contractual breach and therefore not able to terminate the contract. While quoting Article 1.3 of the UNIDROIT Principles, which relates to the binding character of a contract, the court also affirmed that the contract had to be performed correctly by both parties, who had a duty to cooperate with each other.

### 2. *Russia / Arbitration / Petrachkov, Bekker / Unilex 1325 / 2007*

**Case:**<sup>485</sup> A claimant, an Estonian company, filed a lawsuit against a defendant, a Kazakh company, for collection of advance payment paid by the claimant for the goods, which were partially delivered by the defendant, and incurred interest. The arbitral tribunal ruled in favour of the claimant. The contract for the sales of goods provided that Russian law was the law governing the contract.

The court's reasoning is explained below.

In determining the applicable law, the arbitral tribunal found that the contract for the sale concluded between the claimant and the defendant, whose commercial enterprises are in different states, contains a provision that: 'applicable law shall be the substantive and procedural law of the Russian Federation'.

Since the substantive law of the Russian Federation as a contracting state is applicable in this case, the provisions of the Vienna Convention, which is part of the legal system of the Russian Federation, should be applied in the dispute between the parties.

In the Vienna Convention (clause 2 of Article 81), it is established that: 'A party who has performed the contract either wholly or in part may claim restitution from the other party of whatever the first party has supplied or paid under the contract.' It is clear from this provision that the buyer who paid the price, but did not receive the goods in return, may require the seller to pay back the amounts paid.

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483 Albert Jan van den Berg, *Yearbook Commercial Arbitration Volume XLII* (Kluwer 2017) 275 et seq.

484 Tribunal de Apelación en lo Civil y Comercial de Asunción, 2017.

485 The International Commercial Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation (ICAC), Case No 23/2006, Award, 2007.

Arbitral tribunal interprets the provision of Article 81 of the Vienna Convention as not only fixing the obligations of the defaulting party, in this case the seller, but also as reflecting the general legal principles: ‘If the party obligated to pay money does not perform it, the other party may demand payment’, as well as the compulsory execution of the agreed contract (according to Articles 7.2.1–7.2.2 and 1.3 of the UNIDROIT Principles).

The fact that the above provisions of the Vienna Convention and the UNIDROIT Principles are universally recognised is confirmed by the existence of the same principles in the Civil Code of the Russian Federation. For example, according to Article 309 of the Civil Code of the Russian Federation, obligations shall be properly fulfilled; Article 487 of the Civil Code of the Russian Federation contains a general rule that a buyer who made an advance payment for goods, which were not delivered or were delivered in part, is entitled to demand the transfer of goods or the return of the amount of advance payments for the goods.

On the basis of the foregoing, the ICAC considered that the fact of the defendant’s indebtedness is proved, and the claims of the claimant shall be satisfied in accordance with Article 81 of the Vienna Convention.

### 3. *Switzerland / Arbitration / Nunziante / Unilex 863 / 2002*

**Case:**<sup>486</sup> This case came about pursuant to a dispute that arose based on a contract entered into between A and B, a company from Country Y and two individuals from Country X, respectively. One of the terms in the contract required B to provide A with certain information pertaining to production and sale/marketing of its products.

A terminated the contract and instituted arbitration proceedings. The arbitration clause mentioned the European Convention on Commercial Arbitration of 1961 and provided for Country Z to be the seat of arbitration. The contract did not have a clear provision containing a chose of law. B argued for the application of neutral law, that is, law of Country Z, but recognised that the contract contained a reference to ‘general principles of law applicable to international commercial contracts.’ Therefore, B accepted the application of the UNIDROIT Principles. Since A also agreed on their application, the arbitral tribunal applied the principles as the law governing the substance of the disputes chosen by the parties themselves. Further, it was also noted that no law of countries X, Y and Z prohibited the application of such principles. The tribunal also observed that the contract at hand involved the marketing of new products in a dozen or so countries, and that applying domestic law would not be as reasonable as applying the UNIDROIT Principles. As the contract involved contracts of services, sale of goods and contract for works the UNIDROIT principles were found to be suitable.

In conclusion, the tribunal found that the termination by A of the contract was unjustified. It went on to mention Article 1.3 to iterate that an unjustified termination went against the sanctity of the contract. The reference made at the end of Article 1.3 is to Article 3.13, Article 5.8 (Article 5.1.8 of the 2004 edition), Article 6.1.16, Article 6.2.3, Article 7.1.7, Article 7.3.1 and Article 7.3.3.

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486 Arbitration Court of the Lausanne Chamber of Commerce and Industry, Award, 2002.

#### 4. *France / Arbitration / Nunziante / Unilex 644 / 1996*

**Case:**<sup>487</sup> Certain pre-bid agreements in the telecoms systems sector were entered into between A (a supplier) and B (a manufacturer), located in country X and Y, respectively. These agreements stipulated that a good-faith negotiation for the supply of cables would take place if A succeeded in winning a bid to be the prime contractor in a telecoms expansion project. However, though A won the bid, A and B could not negotiate a final deal for the supply of cables and thus A terminated the preliminary agreements. A dispute arose and the matter was to be heard by an arbitral tribunal.

The agreements did not provide for a clear choice of law clause and parties A and B requested that the tribunal apply the law of different countries. Party B also asked the tribunal to apply the general principles of law as under the UNIDROIT Principles. Although the tribunal saw the merit of applying the general principles over applying municipal laws of any one country, in the case at hand it decided that the law of a neutral country, J, would be applicable. However, the tribunal also referred to the UNIDROIT Principles, which evidenced the general principles of international commercial contracts.

In particular, Article 1.3 of the UNIDROIT Principles was referred to. They confirmed, in the tribunal's view, a source for establishing general rules for international commercial contracts. The tribunal used those rules to support its conclusion, under the law of the state of New York, on the issue of the enforceability of the parties' agreement to negotiate in good faith. Thus, it was finally held that A and B were to restart their discussions on the supply of cables in accordance with the pre-bid agreements and aim to reach a consensus.

#### 5. *Italy / Arbitration / Nunziante / Unilex 622 / 1996*

**Case:**<sup>488</sup> A dispute arose when A (principal) terminated a commercial agency contract entered into with B (agent) for breach of the contract by B. B claimed that the termination was unlawful and instituted arbitration proceedings. At the start of the arbitral proceedings, the parties agreed that the UNIDROIT Principles would be referred to, along with the general principles of equity, since the contract did not have a clear choice of law clause.

The tribunal in its decision cited many articles of the UNIDROIT Principles and even the accompanying comments. To unambiguously iterate the binding character of the parties' original agreement, Article 1.3 specifically was quoted.

#### 6. *Switzerland / Arbitration / Voser, Ninković / Unilex 630 / 1996*

**Case:**<sup>489</sup> Company A from country X entered into a contract with company B from country Y by means of an order confirmation for the sale of a plant for manufacturing a certain product for the market of country Y. Due to financial difficulties caused by a sudden fall in the price of the product on the market of country Y, company B made an advance payment in the amount of only three per cent of the contractual price and did not open the letter of credit within the agreed time limit, which was a condition for the delivery of the equipment by company A. Nonetheless,

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487 International Court of Arbitration of the International Chamber of Commerce (ICC), Case No 8540, Award, Paris, 1996.

488 Camera Arbitrale Nazionale ed Internazionale di Milano, Award, 1996.

489 ICC, Case No 8486, Final Award, 1996.

company A offered to deliver half of the equipment and following company B's acceptance of the offer, issued an invoice in the amount of 50 per cent of the contractual price. However, company B was not ready to pay the amount as invoiced and offered to pay approximately 60 per cent of the invoiced amount. Company A did not accept this and reserved its rights under the original contract concerning the full delivery. Company A initiated arbitration proceedings against company B and claimed damages. In addition to the compensation for the part of the equipment which it could not sell to other buyers because they have been made according to the special requirements of company B, company A requested payment of interest and legal fees. Company B argued that it was discharged from payment because of the sudden fall in the price of the relevant product on the market of country Y, which amounted to hardship, and counterclaimed for repayment of its advance payment to company A.

The general conditions to the contract provided for the application of Dutch law and the arbitral institution fixed Zurich (Switzerland) as the seat of the arbitration.

The arbitral tribunal granted the claim for damages of company A, denied in part its claim for interest and denied the counterclaim of company B. In particular, the arbitral tribunal found that the circumstances raised by company B fell within the economic risk to be borne by company B and did not constitute unforeseen circumstances in the sense of the hardship provision; thus, the requirement for discharge from payment was not met. In reaching its decision, the arbitral tribunal held that the relevant mandatory provisions of Dutch law must be applied with utmost restraint. It stated that 'Dutch common opinion of law' is 'replaced by the common opinion in international contract law when the provision is applied in an international context', both of which are 'influenced in a decisive manner by the principle of contractual good faith (*pacta sunt servanda*) expressed in Article 1.3 of the UNIDROIT Principles for International Commercial Contracts.'<sup>490</sup> According to the arbitral tribunal, 'this common opinion of law must also be taken into account for the application of national law to international relationships'.<sup>491</sup>

The arbitral tribunal held that 'the termination of a contract for unforeseen circumstances (hardship, *clausula rebus sic stantibus*) should be allowed only in truly exceptional cases' and that, in international commerce, 'one must rather assume in principle that the parties take the risks of performing under and carrying out the contract upon themselves, unless a different allocation of risk is expressly provided for in the contract'.<sup>492</sup> In that context, while not directly applying the provision, the arbitral tribunal referred to article 6.2.1 of the UNIDROIT Principles, which expressly provides that the mere fact that the performance of the contract entails a higher economic burden for one of the parties does not suffice to assume that there is hardship.

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490 Albert Jan van den Berg, *Yearbook Commercial Arbitration Volume XXIVa* (Kluwer 1999) 24, 166 et seq.

491 *Ibid* at 167.

492 *Ibid*.

### III. Article 1.7: Good faith and fair dealing

#### 1. *Ireland / Court of Appeal / De Paor / Not Unilex / 2017*

**Case:**<sup>493</sup> The case involved an appeal against a High Court decision prohibiting the respondents' sale of shares otherwise than in accordance with certain terms of the relevant shareholders' agreement. The appeal was allowed and the appellants were unsuccessful in their argument that there existed a general principle of good faith (which, they contended, required the shares to be disposed of in accordance with specific provisions of the shareholders' agreement) in Irish contract law.

In contrasting the common law's approach of not recognising a standalone duty of good faith in contractual relations, Judge Hogan referred to the duty of good faith and fair dealing set out in the continental civil law codes and Article 1(7) of the UNIDROIT Principles (2010). Judge Hogan made an observation which is insightful in terms of understanding the difficulty of common law jurisdictions like Ireland in embracing the necessarily broad concepts and duties in the principles: 'The fact that the Irish courts have not yet recognised such a general principle [of good faith] may over time be seen as simply reflecting the common law's preference for incremental, step by step change through the case-law, coupled with a distaste for reliance on overarching general principles which are not deeply rooted in the continuous, historical fabric of the case-law, rather than an objection per se to the substance of such a principle.'

#### 2. *Italy / National Court / Nunziante / Not Unilex / 2017*

**Case:**<sup>494</sup> Claimant A, following an allotment approved by the municipality and by the region, undertook to build in its area two buildings, called X and XI. During the construction, claimant A had serious economic problems and, therefore, renounced the construction of the second building.

Notwithstanding said declaration, the municipality, believing that the instalments for the supplementary contributions imposed with the building permits were not paid, formally requested the company to pay the amount of €241,891.92 for urbanisation and construction costs, as well as the forfeiture of the guarantee policies.

The court, in examining the issue, on one side acknowledged that it is not enough to renounce the construction of a building to obtain the reduction of the urbanisation costs; on the other, that the cost of construction should have been proportional to the actual construction of the building.

In light of these considerations, the court established that the formation of credit by the Municipality assumed, as a condition of enforceability, the actual construction activity and entailed the payment of a contribution proportional to the overall construction cost, referring to the entire work actually performed.

In addition to this, the court acknowledged that the municipality should nevertheless have considered the company's renunciation to construct the building by virtue of two principles of law:

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<sup>493</sup> *Flynn v Brescia* (2017) IECA 74, (2017) 1 ILRM 369.

<sup>494</sup> Judgment of the Administrative Regional Court of Molise – Campobasso, 17 May 2017.

first, the obligation to renegotiate in good faith, which regulated the conventions of the allotment; and second, the privatistic instruments on a contractual or negotiation basis.

In such thought, the court recalls the general clause of good faith, which under Articles 12 and 41 of the Constitution stands as a hermeneutical rule and supplements the contract in its execution (so called good faith *in executivis*). The judge, moreover, states that: ‘Such hermeneutics on negotiations find solid anchors in international law and European law (UNIDROIT Principles)’.

### 3. *France / Arbitration / Sierra / Not Unilex / 2016*

**Case:**<sup>495</sup> Company A, of country X and company B, of country Y, entered into a joint venture agreement (JVA), by which both parties created companies C and D for the production and commercialisation of certain products in country X. The parties agreed that the JVA would be subject to the UNIDROIT Principles, supplemented if necessary by the laws of Country X. One of the obligations provided under the JVA, was that the parties would be able to allow the rotation of the chairman of company C.

In the first years of operation of the JVA, company B did not require the rotation of the chairman, entrusting company A to continue holding such position. However, after company A restricted company B with access to certain information pertaining to the JVA, company B required company A to appoint a new chairman.

Company A did not attend the meeting where the new chairman was to be appointed arguing a deadlock prevented the chairman rotation. The JVA foresaw that if both parties failed to pass a resolution in two shareholders or board of directors meetings, of companies C or D, with no less than 15 days between each other, a ‘deadlock’ provision would be triggered and which would eventually lead to the JVA dissolution.

Furthermore, company A argued that company B’s behaviour was to be interpreted as a waiver of its right to require chairman rotation, given that the parties were bound by the usage and mutual understanding they had established between themselves pursuant to Article 1.9 of the UNIDROIT Principles.

The arbitral tribunal ruled that the fact that company B did not request the strict application of the JVA could not be interpreted as a waiver of its right.

Furthermore, the arbitral tribunal found that even though the deadlock could lead to the dissolution of the JVA, until the dissolution takes place, the parties were obliged to comply with the JVA in good faith. Consequently, the arbitral tribunal held that company A breached its obligation to renew the chairman position of companies C and D under the JVA and thus breached its good faith obligation, pursuant to Article 1.7 of the UNIDROIT Principles.

### 4. *The Netherlands / National Court / Meijer / Unilex 1924 / 2015*

**Case:**<sup>496</sup> The claimant, a company, and the respondent, the government of a country, entered into nine related contracts for the supply of anti-missile systems. Pursuant to the end of an internal

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<sup>495</sup> ICC, Case No 18795/CA/ASM (C-19077/CA).

<sup>496</sup> Supreme Court of the Netherlands, *BAE Systems PLC, UK v Ministry of Defence and Support for Armed Forces of the Islamic Republic of Iran*, 2015.

conflict within the country, the respondent terminated the contract. The claimant initiated arbitral proceedings claiming damage. The respondent on the other hand claimed restitution of the advance payments it had made.

The contracts did not contain a choice of law provision but did contain references to ‘natural justice’ and ‘laws of natural justice’ or ‘rules of natural justice’.

Arbitral proceedings were initiated by the claimant and several awards were rendered by the tribunal. In its first partial award the tribunal found that the UNIDROIT Principles were applicable. It stated that: ‘[...] the Contracts are governed by, and should be interpreted in accordance with, the UNIDROIT Principles with respect to all matters falling within the scope of such Principles and that for all other matters, by such other general legal rules and principles applicable to international contractual obligations enjoying wide international consensus which would be found relevant for deciding controverted issues falling under the present arbitration.’

In another partial award, the tribunal dealt with the issue of whether the claims of the respondent were time-barred. This is an issue that was not dealt with in the UNIDROIT Principles at the time. However, the tribunal found that it might be a general principal of law that a claim is time-barred if it is pursued with unreasonable delay. This duty stems from the duty of parties to act in accordance with good faith and fair dealing, also affirmed in Article 1.7 of the UNIDROIT Principles. However, the tribunal found that the passing of 11 years did not stop the respondent from pursuing its claim, and the claim was not made with unreasonable delay.

The claimant pursued a setting-aside action and made arguments for the annulment of all four partial final awards issued by the arbitral tribunal. The claimant argued that the UNIDROIT Principles, namely Articles 10.2.2 and 10.9, as they were written in 2004 and which contained a chapter on limitation periods, contradicted the tribunal’s conclusion that the respondent’s claims were not time-barred. The respondent, in opposition, asserted that such retroactive application of the UNIDROIT Principles was not to be permitted and that the 2004 edition of the principles had not yet achieved general consensus.

The claimant’s arguments did not succeed, and the District Court confirmed all four partial final awards, a decision upheld by both the Court of Appeal and then the Supreme Court. The Supreme Court ruled that the tribunal’s decision, being on the merits, could not be reviewed in setting aside proceedings before the courts. It also held that the fact that the tribunal’s decision regarding the application of the UNIDROIT Principles was at least partly procedural in nature did not affect the Court’s finding in this respect.

## 5. *Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2013*

**Case:**<sup>497</sup> Company A from country X and company B from country Y entered into a joint venture agreement (JVA) to provide technical assistance to the government of country Z in the framework of a project in country Z. According to the JVA, any net margin of the joint venture company was to be divided equally between company A, which was the manager of the joint venture company, and

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<sup>497</sup> ICC, Case No 19127, Final Award, 2013.

company B. The JVA provided that the parties could refer their disputes to arbitration (*pourront faire appel à la Cour d'Arbitrage*) and that the FIDIC rules prevailed in such cases.

After the completion of the project, company B sent an invoice to company A for 50 per cent of the joint venture company's net margin. Company A refused to pay, alleging that company B's employees did not provide any assistance to its employees during the project. After first referring the case to the courts in country X, company B initiated arbitration proceedings against company A, which contested the jurisdiction and alleged that the arbitration clause was too vague to constitute a valid agreement to arbitrate and that company B had waived its right to arbitration by first commencing state court proceedings.

In their submissions on jurisdiction, the parties did not specify the rules of law determining the substantive validity of the arbitration agreement. For this reason, the arbitral tribunal seated in Switzerland considered to have, within the boundaries of Swiss law, certain discretion when deciding which rules of law it will apply to this issue. After considering the different sets of rules of law that came into play in determining the applicable law, the arbitral tribunal held that the lack of an agreement of the parties can be interpreted as implied negative choice and that the contract's connection with the different countries is not predominant enough to justify the application of one national law to the exclusion of others. Based on the foregoing, the arbitral tribunal decided to apply the UNIDROIT Principles and Swiss law to the question of the substantive validity of the arbitration agreement. In determining whether the parties consented to submit their dispute to the arbitral institution, the arbitral tribunal applied Article 4.1 as well as Article 4.3(c) of the UNIDROIT Principles. In the context of interpretation of the subsequent conduct of the parties, the arbitral tribunal considered that company B's statements evidenced the fact that, in its view, the arbitration clause was defective and inoperable. The arbitral tribunal held that claiming the opposite would go against the principle of *venire contra factum proprium*, which is applicable under Article 1.7 and Article 1.8 of the UNIDROIT Principles as well as Swiss law.

The arbitral tribunal further found that both parties revoked the arbitration agreement and accepted the jurisdiction of the state courts. It stated that 'such mutual waiver can be concluded without observing any requirement of form and must be interpreted according to the generally applicable principles for the interpretation of private statements of intent', thereby referring to and applying Article 1.2 of the UNIDROIT Principles.<sup>498</sup>

Based on the foregoing, the arbitral tribunal decided that it had no jurisdiction to decide on company B's claims.

## 6. Italy / National Court / Martinetti / Not Unilex / 2013

Case:<sup>499</sup> Company A lodged an opposition to an order for payment issued on request of company B for payments and sanctions related to an off-take of gas from strategic storage sites that, according to company B, company A unduly withdrew without a subsequent restitution or payment. The opposition was notified also to company C and D because of their alleged responsibilities in relation to the closing of the gas pipeline.

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<sup>498</sup> Albert Jan van den Berg, *Yearbook Commercial Arbitration Volume XLII* (Kluwer 2017) 275 et seq.

<sup>499</sup> Tribunale of Milano, Case No 16351/2013 and Case No 16354/2013.

In this judgment the court deals with UNIDROIT Principles only by reporting a part of the claimant's legal argument concerning the duty to inform and the good faith. In particular, company A states that company D (the managing operator of the gas pipeline) had a specific duty to inform about the risk conditions of the pipeline. Company A considers that the non fulfilment of such duty is, inter alia, a breach of UNIDROIT Principles.

#### 7. *Singapore / National Court / Koh / Not Unilex / 2013*

**Case:**<sup>500</sup> Company A, the appellant, and company B, the respondent, entered into a lease agreement which contained a rent review mechanism (rent review mechanism), which provided that the rent for each new rental term after the first rental term was to be determined by agreement between the parties, or, failing agreement, by 'three international firms of licensed valuers' appointed either jointly by parties or the President of an institute of surveyors and valuers. In particular, the lease agreement provided that parties shall 'in good faith endeavour to agree on the prevailing market rental value' of the premises prior to the appointment of the designated valuers. Despite this, the respondent unilaterally approached all eight 'international firms of licensed valuers', and subsequently engaged seven firms to prepare valuation reports.

The court held that there was no reason why such an express agreement between two contracting parties that they had to negotiate in good faith should not be upheld. Reasonable commercial standards of fair dealing call for the disclosure of all material information which could have an impact on the negotiations and/or ultimate determination of the new rent. The fact that company B had valuations carried out would surely have qualified as material information. Given that the respondent commissioned reports from seven of the eight international valuation firms eligible for appointment, its failure to disclose the existence of these valuation reports constituted a breach of its 'good faith' obligation. For disclosure of time-sensitive information to have any real impact, disclosure had to be made as soon as practicable. The respondent was contractually obliged to make full disclosure of these valuations in a timely manner, as part of the parcel of obligations imposed on the parties to 'in good faith' negotiate the new rent.

#### 8. *Spain / National Court / Doria / Unilex 1651 / 2011*

**Case:**<sup>501</sup> Two Spanish individuals, A and B, were debtors of the Spanish bank C by a loan granted by the latter to the individuals, which was secured with a mortgage over a property. Following outstanding payments of the loan, the bank started an enforcement procedure in February 1985 before the Spanish courts. As a result of this procedure, in December 1985 the bank and the debtors agreed to settle by means of the assignment of the property to the bank to cancel part of the debt.

Eighteen years later, in March 2003, the bank reactivated the same enforcement procedure and obtained the embargo of the salaries and other properties of the individuals. The latter appealed against the court decision based on statute of limitations. The decision was reversed in July 2003 and the embargos were released.

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500 *HSBC Institutional Trust Services (Singapore) Ltd v Toshin Development Singapore Pte Ltd* (2012) SGCA 48.

501 Spanish Supreme Court, First Chamber, Ruling 872/2011, 12 December 2011.

The individuals started a civil procedure against the bank claiming material damages (legal expenses and costs) and moral damages (psychical stress, affectation of professional reputation and family life) caused by the bank.

Following two court rulings (first instance and appeal) dismissing the claim, the Spanish Supreme Court finally upheld the claim in a ruling, declaring that the bank failed to act in good faith due to unfair delay in the exercise of the bank's rights. The decision of the Supreme Court was based on Article 7.1 of the Spanish Civil Code (Rights must be exercised in accordance with the requirements of good faith), with express mention to the concept of good faith in European law, among others, as provided for in Article 1.7 of the UNIDROIT Principles.

#### 9. *Australia / National Court / Koh / Unilex 1614 / 2010*

**Case:**<sup>502</sup> The government of country X entered into a 'heads of' agreement for the construction of a private hospital by company A on land that was owned by the government. The agreement required the parties 'to act with the utmost good faith in the performance of their respective duties, in the exercise of their respective powers, and in their respective dealings with one another'. It was expressly agreed that the private hospital would be located next to and be physically linked to a public hospital and also that there would be other agreements that the parties would enter into.

The government soon took on an asset strategic plan which was not disclosed to company A. By virtue of this plan, there was no proposal of any link between the public hospital and the private hospital. Thus, company A instituted a case against the government claiming that the non-disclosure of the asset strategic plan during the negotiations in relation to the subsequent agreements was an act in breach of the good faith obligations under the 'heads of' agreement.

The court decided the case in favour of company A and reasoned that the government should indeed have disclosed the required information to company A. The court noted that any information that would have made a substantial difference to company A's reasonable expectations under the agreement was required to be shared with company A pursuant to the good faith obligation under the 'heads of' agreement. The good faith obligation in the agreement was indeed enforceable and in coming to its decision, the court took into account Article 1.7 of the UNIDROIT Principles, thus confirming its increased recognition on a global scale.

#### 10. *Australia / National Court / Koh / Unilex 1517 / 2009*

**Case:**<sup>503</sup> Company A contracted with company B for the construction of rail infrastructure. A dispute arose between the parties regarding the content and operation of a dispute resolution clause in the contract. Under the dispute resolution clause, parties are required to undertake 'good faith negotiations'. The question for the court was whether such a requirement was valid.

In its consideration of the concept of good faith, the court made reference to Article 1.7 of the UNIDROIT Principles, stating that this concept is 'recognised as part of the law of performance of contracts in numerous sophisticated commercial jurisdictions.'

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502 *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* (2010) NSWCA 268.

503 *United Group Rail Services Ltd v Rail Corporation New South Wales* (2009) NSWCA 177.

## 11. *Australia / National Court / Koh / Unilex 845 / 2003*

**Case:**<sup>504</sup> The government of a country and two companies, company A and company B, entered into contracts for software development and systems integration. The contract between the government and company A was the head contract, while the contract between company A and company B was the subcontract.

The dispute arose when company B served a notice of termination on company A on the grounds of company A's alleged failures to comply with its contractual obligations. These included company A's alleged failure to deliver specific devices in order for company B to develop the software, and also company A's failure to pay company B as required under the subcontract. Company A argued: first that the terms of the contract had been changed; and, second, that company B was not entitled to be paid under the subcontract as it failed to meet the requirements of payment under the subcontract.

As to company A's arguments that the contract had been amended, the court referred to UNIDROIT Principles, Article 2.1.18. The contract contained a 'no oral modification clause' but company A argued that they were estopped from enforcing this clause by their own conduct. Referring to Article 2.1.18, which states that a party may be precluded by its conduct from invoking such a clause to the extent that the other party has acted in reliance on that conduct. The tribunal found that the contract was indeed amended and that company B could not invoke the 'no oral modification' clause, since it had already acted in accordance with the oral modification of the contract.

Further, company A argued that the subcontract had contained an 'entire obligation' clause, which the court rejected. The court referred to comment 2 to Article 6.1.4 of the UNIDROIT Principles, which stated that, although as a rule if the performance of only one party's obligation by its very nature requires a certain period of time, that party is bound to render its performance first, circumstances indicating the contrary should be taken into consideration, for example, where the contract provides for payments to be made in agreed instalments throughout the duration of the work.

Company A argued that company B was in breach of its duty to act honestly and in good faith due to its termination of the contract. In this respect, company B argued that due to the 'entire agreement clause', these concepts were not part of the contract. An 'entire agreement clause' is used to indicate that the contract constitutes the whole agreement between the parties, thereby preventing a party from relying on previous agreements and negotiations that are not included in the agreement. Company B argued that a duty of good faith could not be implied in the contract when an 'entire agreement clause' was involved. The court found that an entire agreement clause could not exclude good faith from a contract and that good faith and fair dealing are to be considered implied terms of all contracts, and the court referred to Article 1.7 of the UNIDROIT Principles in its reasoning.

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504 *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd*, FCA 50 (2003).

## 12. *Russia / Arbitration / Petrachkov, Bekker / Unilex 856 / 2002*

**Case:**<sup>505</sup> A claimant, a Russian company, filed a lawsuit against a defendant, a Canadian company, for collection of damages (advance payment) incurred due to the breach of the sale and purchase agreement. The contract for the sale of goods provided that Russian law was the law governing the contract. The arbitral tribunal ruled in favour of the claimant.

The court reasoned as follows:

‘While analysing these provisions of the contract, the arbitral tribunal stated that the provision of the contract for the procedure for payments had not been subject to any changes. A 100 per cent advance payment was to be made by the claimant for each shipment of goods on the basis of the defendant’s invoice indicating the value of the goods, which proves (if otherwise is not evidenced) that the final price of the goods to be paid by the claimant to the defendant is agreed in the prescribed manner. This conclusion is also confirmed by the contract, according to which the term for shipment of goods or the return of advance payment is established from the date of making the advance payment.

‘Thus, the Arbitral Tribunal concluded that by virtue of the agreement the defendant was not entitled to delay the shipment of the goods. Moreover, the arbitral tribunal drew attention to the fact that the actions of the defendant, even if he had the right to delay the shipment, would be contrary to the principles of good faith and fair business practices recognised in international trade (articles 1.7 and 5.2 of the UNIDROIT Principles) and would constitute an abuse of law, which directly contradicts article 10 of the Civil Code of the Russian Federation.’

## 13. *Russia / Arbitration / Petrachkov / Not Unilex / 2002*

**Case:**<sup>506</sup> While analysing these provisions of the contract, the arbitral tribunal stated that the provision of the contract for the procedure for payments had not been subject to any changes. A 100 per cent advance payment was to be made by the claimant for each shipment of goods on the basis of the respondent’s invoice indicating the value of the goods, which proves (if otherwise is not evidenced) that the final price of the goods to be paid by the claimant to the respondent is agreed in the prescribed manner. This conclusion is also confirmed by the contract, according to which the term for shipment of goods or the return of advance payment is established from the date of making the advance payment.

Thus, the arbitral tribunal concluded that by virtue of the agreement the defendant was not entitled to delay the shipment of the goods. Moreover, the tribunal drew attention to the fact that the actions of the respondent, even if he had the right to delay the shipment, would be contrary to the principles of good faith and fair business practices recognised in international trade (Articles 1.7 and 5.2 of the UNIDROIT Principles) and would constitute an abuse of law, which directly contradicts Article 10 of the Civil Code of the Russian Federation.

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505 ICAC, Case No 217/2001, Award, 6 September 2002.

506 ICAC, Case No 11/2002, Award, 5 June 2002.

## IV. Article 1.8: Inconsistent behaviour

### 1. *Italy / National Court / Nunziante / Not Unilex / 2017*

**Case:**<sup>507</sup> Claimant A, a company from country X, advanced a claim for damages against the Defendant B, a municipality. Claimant A claimed to be the owner of several plots of land that had originally been designated for use as a natural park. One of the plots of land became available for construction, after the adoption of a partial variation issued by the administration. The variation was subsequently revoked by the municipality, and the first instance court confirmed the legitimacy of the revocation.

Claimant A sought compensation for the damages suffered due to the ban on building on the land. Claimant A affirmed that the behaviour of the municipality, in the period between the adoption of the partial variation and its revocation, created a legitimate expectation that was to be protected. Defendant B replied affirming that the land was purchased before the adoption of the partial variation and that the latter did not affect claimant A's ability to build on its property.

The court recognised the principle of protection of the legitimate expectation between an administration and a citizen in an administrative procedure and, in doing so, recalled the UNIDROIT Principles, and in particular Article 1.8, according to which '[a] party cannot act inconsistently with an understanding it has caused the other party to have and upon which that other party reasonably has acted in reliance to its detriment.'

The court, on the merits, rejected the claimant's action since claimant had bought the land before the adoption of the administrative measures.

### 2. *Italy / National Court / Martinetti / Not Unilex / 2016*

**Case:**<sup>508</sup> Ms A brought an action against Ms B for the return of the deposit agreed at the conclusion of the 'preliminary contract' for the sale of an immovable property. The sale was subordinated to a condition (the regularisation of a wall from the competent authority). Since the municipality denied such regularisation, Ms A claims the return of the deposit because of the fulfilment of the condition.

The court considers the claim well founded. In particular, in relation to a specific point raised in defendant's legal argument, the court specifies that the condition cannot be considered impossible on the ground of an objective assessment of the events. Moreover, the court notes that Ms B pointed out in the 'preliminary contract' that the request for regularisation had already been filed creating in the counterparty the legitimate expectation that the wall could have been regularised. In this context, the court recalls UNIDROIT Principles in order to affirm that the legitimate expectation is an expressly codified principle, quoting for that purpose Articles 1.7 and 1.8.

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<sup>507</sup> Administrative Regional Court of Piemonte – Torino, Case No 713, 8 June 2017.

<sup>508</sup> Tribunale of Pisa, n 1301/2016.

### 3. *Russia / National Court / Petrachkov, Bekker / Not Unilex / 2014*

**Case:**<sup>509</sup> The Russian individual, the claimant, filed a lawsuit against several defendants on invalidation of the sale and purchase agreement. The sale and purchase agreement provided for sale of the immovable property.

The court rejected the claims on the ground that, inter alia, the claimant previously accepted the agreement and performed its term, thus claimant's behaviour contradicts her previous behaviour. In its resolution, the court additionally referred to the UNIDROIT Principles.

The court reasoned as follows:

'The plaintiff's claims, based on the rejection of the terms of the contract, which she had approved and considered as binding, are in conflict with the previous behaviour of the plaintiff, which is the violation of the principle of international commercial law, enshrined in article 1.8 "Principles of International Commercial Agreements [UNIDROIT Principles]" (1994), according to which the parties are bound by any custom they have agreed upon and practices that they have established in their relations.'

### 4. *Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2013*

**Case:**<sup>510</sup> Company A from country X and company B from country Y entered into a JVA to provide technical assistance to the government of country Z in the framework of a project in country Z. According to the JVA, any net margin of the joint venture company was to be divided equally between company A, which was the manager of the joint venture company, and company B. The JVA provided that the parties could refer their disputes to arbitration (*pourront faire appel à la Cour d'Arbitrage*) and that the FIDIC rules prevailed in such cases.

After the completion of the project, company B sent an invoice to company A for 50 per cent of the joint venture company's net margin. Company A refused to pay, alleging that company B's employees did not provide any assistance to its employees during the project. After first referring the case to the courts in country X, company B initiated arbitration proceedings against company A, which contested the jurisdiction and alleged that the arbitration clause was too vague to constitute a valid agreement to arbitrate and that company B had waived its right to arbitration by first commencing state court proceedings.

In their submissions on jurisdiction, the parties did not specify the rules of law determining the substantive validity of the arbitration agreement. For this reason, the arbitral tribunal seated in Switzerland considered it had, within the boundaries of Swiss law, certain discretion when deciding which rules of law it would apply to this issue. After considering the different sets of rules of law that came into play in determining the applicable law, the arbitral tribunal held that the lack of an agreement of the parties could be interpreted as implied negative choice and that the contract's connection with the different countries was not predominant enough to justify the application of one national law to the exclusion of others. Based on the foregoing, the arbitral tribunal decided

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509 Tenth Arbitrazh Appeal Court, Case No A41-26400/14, Resolution, 14 November 2014.

510 ICC, Case No 19127, Final Award, 2013.

to apply the UNIDROIT Principles and Swiss law to the question of the substantive validity of the arbitration agreement. In determining whether the parties consented to submit their dispute to the arbitral institution, the arbitral tribunal applied Article 4.1 as well as Article 4.3(c) of the UNIDROIT Principles. In the context of interpretation of the subsequent conduct of the parties, the arbitral tribunal considered that company B's statements evidenced the fact that, in its view, the arbitration clause was defective and inoperable. The arbitral tribunal held that claiming the opposite would go against the principle of *venire contra factum proprium*, which is applicable under Article 1.7 and Article 1.8 of the UNIDROIT Principles as well as Swiss law.

The arbitral tribunal further found that both parties revoked the arbitration agreement and accepted the jurisdiction of the state courts. It stated that 'such mutual waiver can be concluded without observing any requirement of form and must be interpreted according to the generally applicable principles for the interpretation of private statements of intent', thereby referring to and applying Article 1.2 of the UNIDROIT Principles.<sup>511</sup>

Based on the foregoing, the arbitral tribunal decided that it had no jurisdiction to decide on company B's claims.

## 5. *Italy / National Court / Nunziante / Unilex 1638 / 2012*

**Case:**<sup>512</sup> Claimant A from country X filed a case against B, the government of country Y, for the failure to pay some part of A's pension. B alleged that, as the claim was time-bared, and A did not have a case.

The court reasoned that, despite the expiry of the limitation period, B was not permitted to raise an objection, owing to its own behaviour. B's failure to adequately inform A of a new law pertaining to the re-evaluation of pensions that had come into force resulted in A believing that there was no such change in the laws of country X. The court went on to illustrate that B should have informed A of the change in law during the issuances of the monthly payment slips that were sent to A. As a consequence of B not doing this, A did not file its case within the supposed limitation period.

The court, in support of its decision, made a reference to Article 1.8 of the UNIDROIT Principles. This article states, '[a] party cannot act inconsistently with an understanding it has caused the other party to have and upon which that other party reasonably has acted in reliance to its detriment.'

## 6. *Italy / National Court / Nunziante / Unilex 1873 / 2012*

**Case:**<sup>513</sup> A dispute arose in country X between a construction company, A, and certain homeowners, B, all from country X who had bought seven apartments in a building constructed by A. B alleged that the common areas in their apartment complex, such as the swimming pool, were not in proper working order due to certain construction defects, and notified A of the same. A agreed to fix the defects promptly but only cured a part of the defects. B instituted a suit requesting cure of all defects or, alternatively the payment of damages for the loss suffered as a result. However, A argued that this

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511 Albert Jan van den Berg, *Yearbook Commercial Arbitration Volume XLII* (Kluwer 2017) 275 et seq.

512 Corte dei Conti - Sezione Giurisdizionale per la Regione Siciliana, Case No 197, 24 January 2012.

513 Tribunale di Varese (Sezione distaccata di Luino), 5 January 2012.

suit was time-barred, as a year had passed, a year being the limit under the Article 1669 of the Civil Code of country X.

The court, while hearing this matter, held that, since A had acknowledged the existence of such construction defects and agreed to fix them pursuant to intimation from B, it would be fair for B to assume that no further action on their part was required. Such is stated in the general principle of good faith, under Article 1175 of the Civil Code of country X.

The court in its decision quoted article 1.8 of the UNIDROIT Principles while discussing both the application of the prohibition of inconsistent behaviour and the general principle of good faith.

#### 7. *Italy / National Court / Nunziante / Unilex 1636 / 2011*

**Case:**<sup>514</sup> A dispute arose between a company, A, and the National Pension Institute, B, of country X. B alleged both that A had failed to discharge the full amount owed as contributions and that it had delayed its communications to B regarding the amount of salaries paid to its employees. A, however, argued that, after the expiry of the prescribed time limit, B had required A to submit certain information that B had not initially required, and then B objected to the delayed submission. Thus, A attributed the delay to B's inconsistent behaviour. The matter reached the court, where the case was decided in favour of A.

The court cited Article 1.8 of the UNIDROIT Principles to justify its decision. It reasoned that, according to the principle of prohibition against *venire contra factum proprium*, private and public subjects must behave consistently, with the consequence that, if they fail to do so, they are allowed no remedy. Thus, B had violated this principle, a principle that had been affirmed at the international level by the UNIDROIT Principles.

#### 8. *Italy / Arbitration / Nunziante / Not Unilex / 2008*

**Case:**<sup>515</sup> Claimant A and defendant B entered into a framework agreement for the supply of steel components (the 'agreement'), according to which defendant was bound to purchase, either directly or through its subsidiaries, components for a certain amount per year. Moreover, while claimant undertook to sell them at 'the best market price', defendant was obliged to place its orders well in advance according to a fixed time schedule.

Soon after the conclusion of the agreement, it became clear that the parties had different views as to how it was actually to be implemented. While claimant insisted that defendant had strictly to follow the agreed procedure for the placement of the orders, defendant objected that it could not reasonably be expected to do so since this would be contrary to the general practice in the trade sector concerned and therefore put it at a severe disadvantage vis-à-vis its competitors. After defendant's failure to fulfill its annual minimum purchase commitments, claimant commenced arbitral proceedings claiming damages for breach of the agreement. Nevertheless, the parties continued their business relationship, defendant placing orders for the components and claimant delivering them, though with considerable delays, until defendant, invoking a special provision of the

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514 Tribunale di Torino – Sez. Lavoro, 2 February 2011.

515 Corte Arbitrale Nazionale ed Internazionale di Milano, Case No 212, March 2008.

agreement, according to which it was entitled to terminate the agreement by mere notice in case of delayed deliveries by claimant, actually terminated the agreement.

The agreement was governed by the law of country X.

As to the merits of the case, the arbitral tribunal had to decide, among others, whether claimant – as argued by defendant – was under a duty to cooperate with defendant in order to allow it to fulfill its annual minimum purchase commitments; whether defendant – as argued by claimant – by continuing the business relationship with claimant despite the delayed deliveries by the latter, was prevented by preclusion to terminate the agreement for that very reason; and whether defendant was entitled to claim damages for alleged breaches by claimant of the agreement requesting that the amount be assessed by the arbitral tribunal at its discretion, without providing sufficient proof that a loss had actually been suffered. In deciding the first and the second issue in favour of defendant and the third against it, the arbitral tribunal based itself primarily on Italian law (and in particular on Articles 1375 and 1226 of the Civil Code of Country X as well as on relevant case law and legal writings), but also referred – as ‘a confirmation of the same principles at international level’ – to Articles 5.1.3, 1.8 and 7.4.3 of the UNIDROIT Principles (2004).

## V. Article 1.9: Usages and practices

### 1. *France / Arbitration / Sierra / Not Unilex / 2016*

**Case:**<sup>516</sup> Company A, of country X and company B, of country Y, entered into a JVA, by which both parties created companies C and D for the production and commercialisation of certain products in country X. The parties agreed that the JVA would be subject to the UNIDROIT Principles, supplemented if necessary by the laws of country X. One of the obligations provided under the JVA, was that the parties would be able to allow the rotation of the chairman of company C.

In the first years of operation of the JVA, company B did not require the rotation of the chairman, entrusting company A to continue holding such position. However, after company A restricted company B with access to certain information pertaining to the JVA, company B required company A that a new chairman be appointed.

Company A did not attend the meeting where the new chairman was to be appointed arguing a deadlock prevented the chairman rotation. The JVA foresaw that if both parties failed to pass a resolution in two shareholder or board of directors meetings, of companies C or D, with no less than 15 days between each other, a ‘deadlock’ provision would be triggered and which would eventually lead to the JVA dissolution.

Furthermore, company A argued that company B’s behaviour was to be interpreted as a waiver to its right to require chairman rotation, given that the parties were bound by the usage and mutual understanding they had established between themselves pursuant to Article 1.9 of the UNIDROIT Principles.

The arbitral tribunal ruled that the fact that company B did not request the strict application of the JVA could not be interpreted as a waiver of its right.

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<sup>516</sup> ICC, Case No 18795/CA/ASM (C-19077/CA).

Furthermore, the arbitral tribunal found that even though the deadlock could lead to the dissolution of the JVA, until the dissolution takes place, the parties were obliged to comply with the JVA in good faith. Consequently, the arbitral tribunal held that company A breached its obligation to renew the chairman position of companies C and D under the JVA and thus breached its good faith obligation, pursuant to Article 1.7 of the UNIDROIT Principles.

## 2. *Russia / National Court / Charrett / Unilex 1775 / 2007*

**Case:**<sup>517</sup> Claimant A from country X entered into a contract with company C from country Y for the supply of materials to be used by A in the manufacture of windows. A used the contract price as the basis for the calculation of the customs value of the goods.

The respondent B, the customs authority of country X, found discrepancies in the customs documents prepared by A, and assessed the customs duty at a higher value than the contract price. B asserted that the contract was invalid because it was signed by a facsimile.

A sought return of overpaid customs duty court proceedings in country X. A submitted that, in accordance with Article 1.9(2) of the UNIDROIT Principles, the use of a facsimile signature is widely known to and regularly observed in the international trade of goods to conclude a valid contract. As the law of country X was silent in respect of whether a facsimile signature could be used to conclude a valid contract, the court relied on Article 1.9(2) to determine that the contract was valid, and that the contract price was therefore appropriate to determine the customs value of the goods imported from country Y.

## 3. *NIA / Arbitration / Charrett / Not Unilex / date unavailable*

**Experience of author:**<sup>518</sup> Contractor A from country X entered into a construction contract with company B to construct a mineral processing plant in country Y. The conditions of contract were based on the general conditions in a widely used standard form international construction contract. Those conditions provided for a time-bar on claims for which the circumstances were not notified within 28 days of the contractor becoming aware, or should have become aware, of circumstances entitling it to claim additional payment. If the contractor failed to provide timely notification, it had no contractual entitlement to additional payment. The contract did not specify the governing law.

During the course of the project, the contractor submitted numerous notices of possible claims within the required 28-day period. Company B's authorised representative had difficulty in responding to these claims within the contractually mandated 42-day period, and requested the contractor to submit a claim only when it knew that it had a contractual entitlement, even if this was after the 28-day notification period. The contractor subsequently submitted claims for additional payment two to three months after it had become aware of circumstances that may have entitled it to a claim.

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517 Commercial Court of Primorsky Territory, Russian Federation, Case No A51-10752/2007, 2007.

518 Case illustration based on writer's experience of circumstances where the UNIDROIT Principles could be applied as the governing law of the contract.

Company B's first authorised representative died, and was replaced by another representative, who rejected the contractor's claims where the circumstances had not been notified within the 28-day period.

The contractor initiated an international arbitration, claiming the payments that had been rejected by company B's second authorised representative. Under the arbitration rules agreed to by the parties, the arbitral tribunal had jurisdiction to determine the governing law of the contract. It determined that, in view of the international nature of the contract, it was not appropriate to adopt the law of either the contractor's country (X), or the law of company B's country (Y). Instead, it adopted the UNIDROIT Principles as the governing law of the contract.

The arbitral tribunal found, pursuant to Article 1.9(1), that the parties had agreed that the time-bar provision in the contract had been superseded by their agreement to waive the 28-day provision for notification of circumstances that might give rise to a claim. Accordingly, the arbitral tribunal found that the contractor was entitled to payment of its claims.

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# Chapter 2: Formation and authority of agents

## I. Article 2.1.15: Negotiations in bad faith

### 1. *Japan / National Court / Toichi, Ueno / Not Unilex / 2015*

**Case:**<sup>519</sup> Company X executed a basic service agreement with company Y in which company X undertook to perform system development services for company Y. In connection to the basic service agreement, there were three-stages of individual service agreements, among which company X and company Y proceeded to the execution of a second-stage individual agreement; however, company Y refused to enter into the third-stage individual agreement.

Company X claimed compensation for damages from company Y based on its bad faith. Company X alleged that company Y promised, or caused company X to expect, that company Y would make an order for operations at the third stage. Company X added that, based on such expectation, company X reduced the amount of fees in the prior stage, etc, but company Y failed to meet such expectation.

The court dismissed the claim made by company X. The court held that the execution of the basic service agreement did not automatically promise the execution of the individual agreements of all three stages. The court added that, if a party to the agreement expressed its intention in the negotiation that the placement of an order in the third stage is provisional, the other party's expectation towards the execution of the third stage individual agreement would not be protected legally. Here, the court ruled that company Y did not act in bad faith when it did not place an order in the third stage. Any expectation by company X would not be protected under the situation that company Y merely made a provisional expectation to placing an order of the third stage.

Article 2.1.15 of the UNIDROIT Principles describes that it would be considered unfaithful for a party to enter into or continue negotiations when intending not to reach an agreement with the other party. Although the court did not make a clear statement, its decision was consistent with Article 2.1.15 of the UNIDROIT Principles. The court did not consider it unfaithful to make orders in the third stage because Company Y intended that it may provisionally make orders at the third stage as well when it entered into the stage one and two of the agreements – meaning that the company did not enter into an agreement when it intended not to reach an agreement.

### 2. *China / National Court / Nunziante / Unilex 1740 / 2008*

**Case:**<sup>520</sup> Two companies in country X, A and B, entered into a preliminary contract, wherein B was to test the quality of components manufactured by A, components that were to be used in the trial production of televisions by B. Subject to this quality check, a formal contract was to be concluded. B began the sale of televisions. One year later when the prices of televisions fell in the market, the parties agreed to a decrease in the price of the components manufactured by A. Later, the prices of such televisions fell much further. Although B agreed that the parts manufactured by A passed

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<sup>519</sup> Tokyo High Court, Judgment, 21 May 2015.

<sup>520</sup> *Shaanxi Xianyang Nebula Machinery Ltd v Rainbow Electronics Group Inc*, Supreme People's Court, Comments, 2008.

the quality test, B requested a steep decrease in the price of the components owing to the fall in the prices of the televisions. Party A refused, and a dispute arose. B then decided to break off the negotiations. Party A subsequently filed suit against B, suing for ‘culpa in contraendo’.

The court of first instance and the appellate court held that B had a right to break off the negotiations. The matter then reached the highest court in country X, where it was published as a ‘guide’ case. Two members of the Supreme Court ‘commented’ that the law of country X dealt only with entering or continuing negotiations in bad faith that may arise while concluding a contract. The law did not deal with the possibility of a party breaking off negotiations in bad faith. In light of this, the two justices mentioned Illustration 5 to Article 2.1.15 of the UNIDROIT Principles, which, it said, was a base for the decision of the first- and second-instance courts.

### 3. *ICSID / Arbitration / Nunziante / Unilex 1670 / 2007*

**Case:**<sup>521</sup> This investor-state dispute arose pursuant to a grant of a concession contract by the government of country Y to A (a company and its wholly owned subsidiary located in country Y). The contract was to build a coal mine and a power plant in country Y. However, pursuant to continuous changes in country Y’s regulations in the energy sector, the negotiations were delayed. Finally, A terminated the investment project.

An International Centre for Settlement of Investment Disputes (ICSID) arbitration was instituted by A, who claimed that country Y had breached its fair and equitable treatment obligations under the bilateral investment treaty between X and Y (X-YBIT). Thus, A claimed compensation for its losses, calculated either in terms of the fair market value of the investment, or lost future profits, or at least the actual investments they had made. Country Y, however, argued that there was no breach of the X-YBIT and as A had not provided any evidence to the contrary, the negotiations should be assumed to be carried out in good faith. Further, country Y took Article 2.1.15 to mean that there was neither an obligation to reach an agreement, nor a liability for the failure to do so. Article 2.1.15 of the UNIDROIT Principles was quoted in this regard.

The tribunal held that country Y had indeed breached its obligations to provide a stable and predictable environment for foreign investors under the fair and equitable standard agreed upon in the BIT with the repeated changes in its laws in the energy sector. Since this claim related to a project in its ‘pre-investment’ or ‘pre-construction’ phase, compensation was awarded by the tribunal of an amount equal to actual expenses related to the investment, rather than an amount equal to the claims for the loss of profits.

### 4. *Lithuania / National Court / Nunziante / Unilex 1185 / 2006*

**Case:**<sup>522</sup> A suit for damages was filed by A against B, based on a preliminary sale contract entered into between them. A alleged that, as per the terms of the preliminary contract, B had an obligation to further finalise the sale but had refused to stipulate the final contract.

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521 *PSEG Global & others v Republic of Turkey*, ICSID Case No ARB/02/5, Award, 17 January 2007.

522 *VŠ v AN*, Supreme Court of Lithuania, Decision, 6 November 2006.

The court ruled in favour of A and finally held that ‘the party which breaks off negotiations without having good reason for this, and having at the same time created “a founded trust and belief” that the contract will be concluded, is to be qualified as a party which breached the principle of good faith, and is therefore obliged to pay damages caused to the other party consisting not only of negotiation expenses, but also of the value of the lost opportunity’. While coming to this conclusion, the court referred to Article 6.165, paragraph 4 of the Civil Code of Country X, the UNIDROIT Principles and the Principles of European Contract Law to analyse whether damages could be granted for the breach of preliminary contracts. Specifically, a reference was made to comments accompanying Article 2.15 (now Article 2.1.15), which relates to negotiations in bad faith.

#### 5. *Lithuania / National Court / Nunziante / Unilex 1181 / 2005*

**Case:**<sup>523</sup> Construction company B had emerged the winner of a bidding procedure for a construction deal conducted by company A, both in country X. After the terms of the agreement had been agreed upon, B broke off the negotiations at the last moment on account of being offered a more profitable deal. A instituted proceedings against B for this *culpa in contrahendo* or ‘fault in conclusion of a contract’ and claimed damages.

The court ruled in favour of the claimant and found that the defendant had acted in bad faith and was liable to pay both expenses incurred as well as the value of the loss of opportunity. This decision was based on the Civil Code of Country X, which mirrors Article 2.1.15 of the UNIDROIT Principles and its accompanying comments.

#### 6. *ECJ / Supranational Court / Nunziante / Unilex 813 / 2002*

**Case:**<sup>524</sup> A, a company in country X, instituted suit against B, a company in country Y, alleging that B had not concluded an agreement with C, a leasing company located in country X. According to A, B had initially agreed to purchase a moulding plant from C that would then be leased to A. A alleged that B had halted the negotiations with C in bad faith and hence infringed A’s legitimate expectations of having a valid sales contract between B and C. Thus, A demanded compensation for losses suffered.

As the defendant argued that courts of country Y did not have jurisdiction over the claim, the claimant approached the Supreme Court of Country Y for a declaration of jurisdiction. The Supreme Court made a preliminary ruling request to the Court of Justice of the EU (CJEU) to answer the question of whether, under the Brussels Convention, an action seeking to establish pre-contractual liability, on the one hand, falls within the scope of matters relating to tort, delict, or quasi-delict, or whether it, on the other hand, falls within the scope of matters relating to a contract.

The Advocate General, while quoting Article 2.1.15(2) of the UNIDROIT Principles, suggested to the CJEU that pre-contractual liability should fall under the ambit of delictual matters. In his view, it is the law that imposes upon parties an obligation to act in good faith during the negotiations and the liability for breaking off negotiations in bad faith. This view, in his opinion, has been enshrined in the

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523 *UAB ‘Vingio kino teatras’ v UAB ‘Eika’*, Supreme Court of Lithuania, 19 January 2005.

524 *Fonderie Officine Meccaniche Tacconi SpA v Heinrich Wagner Sinto Maschinenfabrik GmbH (HWS)*, Court of Justice of the European Communities, Decision, 17 September 2002.

quoted article of the UNIDROIT Principles, as well as in the comments to this article, which details the point in time at which the parties must refrain from discontinuing negotiations abruptly and without proper reasoning.

Though the CJEU in their decision did not quote the UNIDROIT Principles, it agreed with the Advocate General's opinion.

## 7. *France / Arbitration / Nunziante / Unilex 692 / 2000*

**Case:**<sup>525</sup> Company A from country X and company B from country Y entered into two contracts concerning the delivery and installation of industrial equipment from A to B. Then, a dispute arose between the parties following an alleged defective delivery. When B declared its intention to return the equipment, the claimant A filed a request for arbitration. The defendant B argued that the contract was null and void due to the fraudulent representation on A's part and that the claimant had delayed delivery and delivered defective equipment.

The contract contained a provision stipulating that the law applicable to the contract was the law of country Z. B, however, contended that the claimant obtained the contract by fraud and material misrepresentation, which, in B's view, was not covered by the law of country Z. This led the arbitral tribunal to interpret the choice-of-law clause in respect of whether it covered issues other than purely contractual issues.

The arbitral tribunal applied the law of country Z to the interpretation of the said clause. In doing so, it noted that if the law of country Y were to be applied, the issue of fraudulent misrepresentation would not be adjudged otherwise. The tribunal referred to Articles 2.1.15(2) of the UNIDROIT Principles and held that the circumvention of an agreement by willful deception is 'a common understanding of all civilised jurisprudence'.

## 8. *France / Arbitration / Nunziante / Unilex 644 / 1996*

**Case:**<sup>526</sup> Certain pre-bid agreements in the telecoms systems sector were entered into between A (a supplier) and B (a manufacturer), located in country X and Y respectively. These agreements stipulated that a good-faith negotiation for the supply of cables would take place if A succeeded in winning a bid to be the prime contractor in a telecoms expansion project. However, although A won the bid, A and B could not negotiate a final deal for the supply of cables, and, thus, A terminated the preliminary agreements. A dispute arose, and the matter was to be heard by an arbitral tribunal.

The agreements did not provide for a clear choice of law clause and, hence, after a discussion on the appropriate law, the tribunal held that the law would be of a neutral country, J. However, the tribunal also held that it was permitted to apply the general principles of international commercial contracts, which were evidenced in the UNIDROIT Principles.

In particular, Article 2.1.15 of the UNIDROIT Principles was referred to, since, in the tribunal's view, the principles are a useful source for establishing general rules for international commercial

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525 ICC, Case No 9651, Award, 2000.

526 ICC, Case No 8540, Award, Paris, 1996.

contracts. This was done by the tribunal to demonstrate support for its conclusion, under the law of the state of New York, on the issue of the enforceability of the parties' agreement to negotiate in good faith. Thus, it was finally held that A and B were to restart their discussions on the supply of cables in accordance with the pre-bid agreements and aim to reach a consensus.

## II. Article 2.1.17: Merger clauses

### 1. *United States / Arbitration / Piaggio, Cadenas / Unilex 661 / 1998*

**Case:**<sup>527</sup> This dispute involved the alleged breach of a sales contract between A (seller) and B (buyer), established in countries X and Y, respectively. While A could deliver a certain amount of goods during the existence of a valid import licence for country Z, the remainder of such goods was delivered post the expiry of such licence. B alleged that its exclusive right to import goods into country Z had been violated, and A had not transferred the goods in a timely manner. Hence, and B refused to make full payment.

An ICC arbitration was instituted by A in accordance with the dispute resolution clause of the contract. There was no choice of law clause in the contract. The Arbitral Tribunal decided that the relevant usages of trade and the CISG would apply. And for matters not agreed upon in the contract and which were not covered by the trade usages or the CISG, the law of country X would apply. While dealing with the merits of the case, the tribunal referred to the UNIDROIT Principles and held that, although they may not be directly applied, they did 'reflect a worldwide consensus in most of the basic matters of contract law' and, hence, could be taken into account in this case. The tribunal, while quoting the rule laid down in Article 29(2) of the CISG, held that verbal promises, assurances, or written references of any kind, which were not at the same time reflected in an amendment or supplement to the contract, could not be relied upon by B.

The articles of the UNIDROIT Principles cited by the tribunal included Articles 2.17 (merger clauses) and 2.18 (written modification clauses), both of which confirmed the above rule.

### 2. *United States / Arbitration / Piaggio, Cadenas / Unilex 2116 / date unavailable*

**Case:**<sup>528</sup> Company A and B entered into a contract for the supply of gas turbine engines for the construction of two warships. The contract contained a choice of law clause choosing the law of country X. The relationship between the parties worsened when B allegedly transmitted A's proprietary and confidential information to its principal thereby breaching the A's intellectual property rights. Denying the claim, B claimed that it was entitled to the payment of the performance bond as A had supplied defective goods in breach of the contract.

The tribunal found that the B and its principal had acted within the scope of the contract and did not breach the A's intellectual property rights. Taking into account the written contract, the tribunal applied Article 2.1.17 of the UNIDROIT Principles and states that 'the meaning to be derived from the plain contract language shall be presumed to correspond to the common intention of the parties'.

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527 ICC, Case No 9117, Zürich, 1998.

528 ICC, Case No 16314, New York, undated.

It pointed out that this corresponded to the law of country X. The tribunal applied this rule and concluded that the contract as it is could not be contradicted or supplemented, unless the intent of the parties could not be derived from the literal text of the contract. Thus, B had not breached its contractual obligations towards A.

### III. Article 2.1.18: Modification in a particular form

#### 1. *Australia / National Court / Koh / Unilex 845 / 2003*

**Case:**<sup>529</sup> The government of a country and two companies, company A and company B, entered into contracts for software development and systems integration. The contract between the government and company A was the head contract, while the contract between company A and company B was the subcontract.

The dispute arose when company B served a notice of termination of the subcontract on company A on the grounds of company A's alleged failures to comply with its contractual obligations. These included company A's alleged failure to deliver specific devices in order for company B to develop the software, and also company A's failure to pay company B as required under the subcontract. Company A argued first that the terms of the contract had been changed and, second, that company B was not entitled to be paid under the subcontract as it failed to meet the requirements of payment under the subcontract.

As to company A's arguments that the contract had been amended, the court referred to Article 2.1.18 of the UNIDROIT Principles, which states that a party may be precluded by its conduct from invoking such a clause to the extent that the other party has acted in reliance on that conduct. In this case, the discussion evolved around a 'no oral modification' clause and whether a party could be estopped from invoking such a clause in a case where it has already acted upon an oral modification of the contract. The tribunal found that the contract had indeed been amended and that company B could not invoke the 'no oral modification' clause, since it had already acted in accordance with the oral modification of the contract.

Company A argued that company B was in breach of its duty to act honestly and in good faith due to its termination of the contract. In this respect, company B argued that due to the 'entire agreement clause', these concepts were not part of the contract. An 'entire agreement clause' is used to indicate that the contract constitutes the whole agreement between the parties, thereby preventing a party from relying on previous agreements and negotiations that are not included in the agreement. Company B argued that a duty of good faith could not be implied in the contract in case an 'entire agreement clause' was involved. The court found that an entire agreement clause could not exclude good faith from a contract and that good faith and fair dealing are to be considered implied terms of all contracts, and the court referred to Article 1.7 of the UNIDROIT Principles in its reasoning.

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<sup>529</sup> *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd*, FCA 50, 2003.

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# Chapter 3: Validity

## I. Article 3.1.2: Validity of mere agreement

### 1. *Mexico / Arbitration / Moses / Unilex 1149 / 2006*

**Case:**<sup>530</sup> Company A contracts with company B for company B to supply goods to company A. Both company A and company B are residents of different countries. The agreement between the parties is an exclusive one whereby company B is to only supply its product to company A. Meanwhile, under the laws of the country of company A, such exclusivity agreements must be registered and formalised with the relevant state authorities.

Disagreement arose between company A and company B, where company A claimed that company B did not meet its duties and obligations under the contract. Company B counterclaimed that the agreement was invalid because it was never registered and formalised in accordance with the prerequisites as required by company A's country. Nonetheless, the tribunal, relying generally on Article 3.1 of the UNIDROIT Principles, held that the agreement should still be considered valid, since the mere agreement between the parties was sufficient to satisfy the contract's validity.

## II. Article 3.1.3: Initial impossibility

### 1. *Spain / National Court / Moses / Unilex 1215 / 2007*

**Case:**<sup>531</sup> A and B entered into an agreement for the sale of an apartment. A, the owner of the apartment, had not registered the apartment because it was not constructed with the required building permit. B sued A, claiming that the non-registering of the apartment was a breach of the contract between them for the sale of the apartment.

A counterclaimed, stating that since the registering of the apartment was impossible at the outset, the contract for the sale of the apartment was invalid. Regardless of whether A's performance was impossible from the outset, the court generally reasoned under Article 3.1.3 of the UNIDROIT Principles (then cited as Article 3.3), that this does not automatically render the agreement invalid.

## III. Article 3.2.2: Relevant mistake

### 1. *Lithuania / National Court / Moses / Unilex 1891 / 2013*

**Case:**<sup>532</sup> The parties to this dispute were a company, the claimant, and a bank, the respondent. The respondent granted a loan to the claimant secured by both a mortgage on real estate owned by the claimant and a suretyship by the shareholders of the claimant. The suretyship in this case meant that the shareholders of the claimant would perform the claimant's obligations under the loan in case of

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<sup>530</sup> Centro de Arbitraje de México (CAM), Arbitral Award, 30 November 2006.

<sup>531</sup> Audiencia Provincial de Lleida (Cataluña), Case No 289/2007, Decision, 13 September 2007.

<sup>532</sup> *Danske Bank A/S v IJ, et al*, Supreme Court of Lithuania, Case No 3K-3-702/2013, 23 December 2013.

non-payment by the claimant. The dispute arose when the claimant failed to repay the loan and the respondent exercised its security rights.

The shareholders filed a counterclaim arguing that the loan agreement was void, operating under the mistaken belief that the suretyship would only be in effect until the mortgage component was triggered.

The court did not agree with the shareholders of the claimant, holding that the shareholders could not void the agreement based on the ground of serious mistake as they should have understood the consequences of a suretyship. In its reasoning, the court referred to Article 3.2.2 of the UNIDROIT Principles, which states that a contract may be voided on the basis of serious mistake only if the mistake is of such importance that a reasonable person in the position of the mistaken party would not have entered into the contract unless the terms were materially different or would not have entered into the contract at all if the truth of the terms had been known. Accordingly, the court's decision suggested that a party is not entitled to void a contract based on a serious mistake on the grounds that they do not fully understand the effect of each contract clause.

## 2. *Switzerland / Arbitration / Voser, Ninković / Unilex 642 / 1994*

**Case:**<sup>533</sup> Company A entered into a contract with company B for the sale of reinforcing steel bars. Due to problems in respect of the letter of credit to be opened by company B, company A initiated arbitration proceedings against company B, which contested the jurisdiction of the arbitral institution on the basis that the institution was not specifically named in the arbitration clause.

In deciding in favour of company A, the arbitral tribunal seated in Switzerland applied the relevant provisions of the applicable Swiss law and concluded that parties to a contract are bound by the meaning of the contractual provision as must be understood by the average honest and diligent business person. In order to show that this interpretation rule reflects a worldwide consensus, the arbitral tribunal referred to Articles 4.1 and 4.2 of the UNIDROIT Principles 'which have been established by a large international working party consisting of specialists in contract law selected from all different parts of the world [...]'.<sup>534</sup>

Having established that it has jurisdiction, the arbitral tribunal addressed the question of whether company B could invoke a material mistake and thereby invalidate the arbitration clause. The arbitral tribunal denied such a possibility and in that context made again a reference not only to the relevant provision of the applicable Swiss law, but also to the similar rule contained in Article 3.5 UNIDROIT Principles 1994 (ie, now Article 3.2.2).

## IV. Article 3.2.5: Fraud

### 1. *France / Arbitration / Moses / Unilex 690 / 2001*

**Case:**<sup>535</sup> Bank A entered into a contract with company B to print banknotes. Company B's delivery of the banknotes did not satisfy the specifications detailed in the contract. Both parties then entered

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<sup>533</sup> *Europe v The Canadian Affiliate of a Chinese Group*, Zurich Chamber of Commerce, Preliminary Award on Jurisdiction, 25 November 1994.

<sup>534</sup> ASA Bulletin (1996) 14(2), 313.

<sup>535</sup> ICC, Case No 9474, Award, Paris, 1999.

into a second agreement which stipulated that if company B produced banknotes in satisfaction of the contract, bank A would make an order of those banknotes. After the second production of banknotes was completed, bank A claimed that they still did not conform to its specifications.

Bank A sued, claiming that company B failed to meet contractual specifications. Bank A also claimed that the second agreement was void because of fraudulent non-disclosure by company B since person C – a former employee of bank A – promoted the second agreement and was paid by company B.

The tribunal reasoned that the facts in the case did not meet the standard of fraud as set out by the UNIDROIT Principles (then citing to Articles 3.5 and 3.8). Therefore, bank A's claim based on fraudulent non-disclosure was rejected by the tribunal since it was not sufficiently proved that bank A entered into the second agreement through fraudulent inducement by company B because of the mere intervention of person C. The decision suggests that a party must prove concrete fraudulent facts that were intended to mislead them, instead of making general allegations, in order to prevail under this principle.

## V. Article 3.2.6: Threat

### 1. *France / Arbitration / Moses / Unilex 2109 / 2000*

**Case:**<sup>536</sup> Company A and company B entered into a contract where company B agreed to compensate company A for losses incurred due to a loss of goods that were allegedly under company B's care and control. The loss of the goods was attributed to fraud.

Company A threatened company B with business retaliation if it refused to compensate it in accordance to the agreement. Since the contract was signed under coercive pressure, the tribunal reasoned under Article 3.2.6 of the UNIDROIT Principles (then cited as Article 3.9) that this left company B without a reasonable alternative and that the damages should be reduced accordingly. As a result, the tribunal considered that the damages should be reduced, at least in part, due to imminent and serious threat. Moreover, although in theory the tribunal could have found the contract void, the decision demonstrates a tribunal's discretion and flexibility in applying the UNIDROIT Principles, as in this case the tribunal did not void the contract but rather reduced the amount of damages awarded.

### 2. *United Kingdom / Galizzi / Not Unilex / date unavailable*

**Experience of author with a negotiation on a no-names basis:**<sup>537</sup> Company A, of Portugal, entered into a shipbuilding contract for the refurbishment of a vessel with company B, of Italy. This contract was governed by English law.

The refurbishment of the vessel is clearly a material and complex project, where client and contractor assume long-term obligations to each other and bear significant commercial risks. The pertinent

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<sup>536</sup> ICC, Case No 10504, Award, Paris, 2000.

<sup>537</sup> Case illustration based on writer's experience of circumstances where the UNIDROIT Principles could be applied as the governing law of the contract.

contract is a non-maritime contract, because it is insufficiently related to any rights and duties pertaining to sea commerce and/or navigation.

The refurbishment of this vessel, which was done at a yard based in Italy, faced a number of problems and delays, and company A decided to take the ship and bring it to another yard in order to complete the works there. As a matter of fact, every day of delay could cause serious economic problems to company A, which had already signed a contract with a client for the use of such vessel.

Company B threatened not to deliver the vessel if it was not paid a material amount of money, thus compelling company A to sign a settlement agreement.

Once the vessel was out of the yard, company A investigated whether the settlement agreement could be annulled because it was signed under a situation of threat. Unfortunately, under English law, it is very difficult to obtain the annulment of an agreement on the basis that it was signed under duress. Similarly, under Italian law, it is very difficult to obtain the annulment because of a situation of threat, and in any case it is necessary to ask for a decision by a court.

On the contrary, Article 3.2.6 of the UNIDROIT Principles indicates that, in case of threat, 'A party may avoid the contract when it has been led to conclude the contract by the other party's unjustified threat'. In such a case, the annulment of the contract would not need a decision by a judge but a simple notice of annulment. Furthermore, the commentary to the same article clearly indicates that such 'threat need not necessarily be made against a person or property, but may also affect reputation or purely economic interest'.

## VI. Article 3.2.7: Gross disparity

### 1. *Paraguay / National Court / Moses / Unilex 2105 / 2016*

**Case:**<sup>538</sup> A agreed to sell a piece of property to B. A later argued that the agreement for the property purchase should be considered invalid because the sale price reflected in the land sale contract was a small fraction of the true value of the property. A argued that the contract reflected an excessive advantage and a gross disparity between the parties.

However, the court, referring to Article 3.2.7 of the UNIDROIT Principles, found that there was no excessive advantage in the transaction given A's experience as a businessman. As a result, the land sale contract reflected an equitable agreement and therefore was not invalid based on excessive advantage or gross disparity.

### 2. *United States / National Court / Moses / Unilex 1528 / 2007*

**Case:**<sup>539</sup> Person A, while employed for company B, sued company B for injuries sustained. Both person A and company B are residents of different countries. The employment agreement between person A and company B contained an arbitration provision that would govern any potential disputes.

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538 *Sindulfo Ruiz Pavetti v Maria Esther Recalde de Aliendre y Policarpo Ramón Aliendre*, Tribunal de Apelación en lo Civil y Comercial de Asunción, Paraguay, Case No 77/2016, 17 October 2016.

539 *Koda v Carnival Corp* (SD Fla 2007), Case No 06-21088, 30 March 2007.

The arbitration agreement selected country C, a different country from person A's residence, as the place for arbitration.

Person A brought suit against company B and further argued that the arbitration clause was unenforceable, given the economic hardship, excessive advantage, and gross disparity that would run in favour of company B if person A was compelled to seek relief in a different country. However, the court reasoned, that given person A's full acknowledgment of the arbitration provision before agreeing and signing it, this signalled a lack of excessive advantage on the part of company B that would necessitate voiding the agreement. The court did not directly rely or quote from Article 3.2.7 in reaching its conclusion but the motions filed in court generally cited to that UNIDROIT principle.

## VII. Article 3.2.8: Third persons

### 1. *France / Arbitration / Moses / Unilex 2109 / 2000*

**Case:**<sup>540</sup> Company A and company B entered into a settlement in which company A agreed to reimburse company B for the damages brought about through the loss of goods that were in the care of company A. The loss of the goods was attributed to fraud.

Company A then refused to pay the full amount that was agreed to in the settlement and thereafter the dispute went to arbitration. However, the arbitration proceedings revealed that company A had signed the agreement under immediate threat by a third party who was not a legal and valid representative of company B but was acting on the behalf of company B.

The tribunal reasoned, relying in part on Article 3.2.8 of the UNIDROIT Principles (then cited as Article 3.11), that the settlement agreement between company A and company B should be reduced in light of the false statements perpetuated by company B because the third party in this case was not one to which company A owed a responsibility. The case also demonstrates a tribunal's flexibility in applying the UNIDROIT Principles as it did not void the contract but rather reduced the amount of damages awarded.

## VIII. Article 3.3.2: Restitution

### 1. *United Kingdom / National Court / Legum / Not Unilex / 2016*

**Case:**<sup>541</sup> A and B entered into an illegal agreement to trade on insider information. A paid B a large sum of money to bet on the price of certain shares. B was to be granted access to inside information enabling him to predict or anticipate movements in the market price of the shares. However, the inside information never arrived. The bet was not placed and B refused to return the money to A. A sought the return of the money.

As a defence, B claimed that he was under no legal obligation to return the money since the agreement was illegal. B invoked the two traditional principles of *ex turpi causa non oritur actio* (no action arises from a disgraceful cause) and *in pari delicto potior est conditio defendentis* (where both parties are equally

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540 ICC, Case No 10504, Award, Paris, 2000.

541 *Patel v Mirza* (2016) UKSC 42.

in the wrong, the position of the defendant is the stronger, ie, ‘the loss should lie where it falls’). Nonetheless, the court rejected B’s argument and unanimously ordered the return of the money to A, reasoning that the illegal act envisioned by the agreement in fact never took place, due to matters beyond the control of either party. Although the court did not make express reference to Article 3.3.2 of the UNIDROIT Principles, its analysis exemplifies the flexible approach adopted in Article 3.3.2 that holds that ‘restitution may be granted where this would be reasonable in the circumstances’.

## 2. *ICSID / Arbitration / Legum / Not Unilex / 2013*

**Case:**<sup>542</sup> A and state B entered into an investment agreement. Around the time of entry into the agreement, A made payments to several individuals including government officials of state B. These payments were presented as remuneration for various consultancy services.

A brought a claim in arbitration against state B concerning the investment agreement. The tribunal found the supposed consultancy services to be insufficiently supported and the payments to be corrupt. The tribunal declined its jurisdiction because the investment was illegal and therefore not covered by the bilateral investment treaty providing for jurisdiction. However, because state B had also engaged in corruption the tribunal found it should equally share, with A, the arbitration costs.

Although this case does not refer to the UNIDROIT principles, the coordinator is of the view that this case is important to arbitration practice and that it comes close to the background of Article 3.3.2 of the UNIDROIT Principles.

## 3. *United Kingdom / Arbitration / Legum / Not Unilex / 2008*

**Case:**<sup>543</sup> A, a businessman who had many years of experience working with or for the government of state X, entered into a consultancy agreement with B, a US company, to conduct seismic surveys prior to oil extraction off the coast of an African state. The agreement provided for lump sum payments and ongoing payments of commission on sale of procured data pursuant to the surveys conducted by B.

A brought a claim in arbitration for breach of contract and unlawful deductions from the commissions due to him. B argued in response that A had engaged in unlawful activity, including bribing state officials. The arbitral tribunal found that the commission paid by B was intended to be used by the A to bribe officials. The tribunal declared the contract null and void. The tribunal also concluded that B was aware of the true purpose of the commission. It held that B could not recover monies paid under the agreement. It found, inter alia, that ‘what has been given with illegal intent cannot be reclaimed under theories of equity or unjust enrichment’. This decision confirms the trend taken by some arbitral tribunals refusing to order restitution in cases of corruption, when both parties took an equally active part in the illegal practice.

Although this case does not refer to the UNIDROIT Principles, the coordinator is of the view that this case is important to arbitration practice and that it comes close to the background of Article 3.3.2 of the UNIDROIT Principles.

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<sup>542</sup> *Metal-Tech Ltd v The Republic of Uzbekistan*, ICSID Case No ARB/10/03, Final Award, 2013.

<sup>543</sup> ICC, Case No 13914, Final Award, London, 2008.

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# Chapter 4: Interpretation

## I. Article 4.1: Intention of the parties

### 1. *France / Arbitration / Sierra / Not Unilex / 2016*

**Case:**<sup>544</sup> Company A, of country X and company B, of country Y, entered into a JVA by which they agreed to create two joint companies (companies C and D), in which company B would provide the technology and company A the commercial know-how in order to produce and commercialise certain products in country X. The parties agreed that the JVA would be subject to the UNIDROIT Principles, supplemented if necessary by the laws of country X.

The JVA foresaw that if both parties failed to pass a resolution in two shareholders or board of directors meetings of companies C or D, with no less than 15 days between each other, a deadlock provision would be triggered. Whenever a deadlock situation was triggered, according to the JVA, each party was entitled to start a process for the transfer of shares, where the other party was obliged to participate in good faith. In case any party failed to do so, legal arbitration proceedings would be available.

Company A claimed that there was a deadlock because there had been two board of directors meetings where the board had been unable to reach an agreement and pass resolutions on different topics. Company B argued that the deadlock provision was not triggered. It claimed that failure to pass resolutions at two board of directors meetings needed to be on exactly the same topic for the deadlock provision to be triggered.

The arbitral tribunal found that there was indeed a deadlock. The arbitral tribunal determined that under Article 4.1 of the UNIDROIT Principles, in case the intention of the parties is not established, 'the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances'. Thus, the arbitral tribunal held that a reasonable person would be more concerned by the impossibility to decide two different unrelated issues at two consecutive meetings than the repeated impossibility to decide the same issue. According to the arbitral tribunal, such hypothesis may reflect a symptom of the inability of the partners to work together, whatever the matter at stake, while the other hypothesis may only reflect the difficulty to deal with a specific issue.

On the issue of the transfer of shares process, the arbitral tribunal held that the parties had not activated the process to transfer companies C and D's shares.

Company A claimed specific performance under Article 7.2.2 of the UNIDROIT Principles seeking the transfer of companies C and D's shares. On the other hand, company B contended that the arbitral tribunal did not have the power to order the transfer of shares. The arbitral tribunal found that there had been no breach to the deadlock provisions for the transfer of shares because the process for the transfer of shares had never been activated by any of the parties.

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<sup>544</sup> ICC Case No 18795/CA/ASM (C-19077/CA).

The arbitral tribunal held that it could not order company B to transfer any shares. Moreover, it ruled that the parties were entitled to activate the process for the transfer of shares provided for under the JVA, with both parties being obliged to participate therein in good faith, in light of Article 1.7 of the UNIDROIT Principles.

## 2. Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2013

**Case:**<sup>545</sup> Company A from country X and company B from country Y entered into a JVA to provide technical assistance to the government of country Z in the framework of a project in country Z. According to the JVA, any net margin of the joint venture company was to be divided equally between company A, which was the manager of the joint venture company, and company B. The JVA provided that the parties could refer their disputes to arbitration (*pourront faire appel à la Cour d'Arbitrage*) and that the FIDIC rules prevailed in such cases.

After the completion of the project, company B sent an invoice to company A for 50 per cent of the joint venture company's net margin. Company A refused to pay, alleging that company B's employees did not provide any assistance to its employees during the project. After first referring the case to the courts in country X, company B initiated arbitration proceedings against company A, which contested the jurisdiction and alleged that the arbitration clause was too vague to constitute a valid agreement to arbitrate and that company B has waived its right to arbitration by first commencing state court proceedings.

In their submissions on jurisdiction, the parties did not specify the rules of law determining the substantive validity of the arbitration agreement. For this reason, the arbitral tribunal seated in Switzerland considered to have, within the boundaries of Swiss law, certain discretion when deciding which rules of law it will apply to this issue. After considering the different sets of rules of law that came into play in determining the applicable law, the arbitral tribunal held that the lack of an agreement of the parties can be interpreted as implied negative choice and that the contract's connection with the different countries is not predominant enough to justify the application of one national law to the exclusion of others. Based on the foregoing, the arbitral tribunal decided to apply the UNIDROIT Principles and Swiss law to the question of the substantive validity of the arbitration agreement. In determining whether the parties consented to submit their dispute to the arbitral institution, the arbitral tribunal applied article 4.1 as well as Article 4.3(c) of the UNIDROIT Principles. In the context of interpretation of the subsequent conduct of the parties, the arbitral tribunal considered that company B's statements evidenced the fact that, in its view, the arbitration clause was defective and inoperable. The arbitral tribunal held that claiming the opposite would go against the principle of *venire contra factum proprium*, which is applicable under the UNIDROIT Principles, Article 1.7 and Article 1.8 as well as Swiss law.

The arbitral tribunal further found that both parties revoked the arbitration agreement and accepted the jurisdiction of the state courts. It stated that 'such mutual waiver can be concluded without observing any requirement of form and must be interpreted according to the generally applicable principles for the interpretation of private statements of intent', thereby referring to and applying the UNIDROIT Principles, Article 1.2.<sup>546</sup>

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<sup>545</sup> ICC, Case No 19127, Final Award, 2013.

<sup>546</sup> Albert Jan van den Berg, *Yearbook Commercial Arbitration Volume XLII* (Kluwer 2017) 275 et seq.

Based on the foregoing, the arbitral tribunal decided that it has no jurisdiction to decide on company B's claims.

### 3. *Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2012*

**Case:**<sup>547</sup> As a continuation of an earlier agreement, a supply agreement for leasing equipment and licensing technology was concluded by two ministries of country X and the lessor from country Y. The agreement contained an arbitration clause providing for a dispute to '[...] be brought before the International Arbitration Court in Switzerland. This court will proceed in accordance with the international law.'<sup>548</sup> While the lessor initiated arbitral proceedings before the ICC, the ministries of state X initiated arbitration proceedings before the national arbitral institution of country X.

Considering the ambiguous wording of the arbitration clause, the arbitral tribunal seated in Switzerland had to decide whether it was the parties' mutual intention to refer their disputes to the ICC. The arbitral tribunal held in that respect that under Swiss law the arbitration clause may be interpreted under either Swiss or international law and consequently decided to apply both Swiss law and international law in that regard. Considering that both parties invoked the UNIDROIT Principles as internationally recognised principles of law, the arbitral tribunal consulted the UNIDROIT Principles alongside the Principles of European Contract Law and the CISG. In particular, it referred to Articles 4.1, 4.2, and 4.3 of the UNIDROIT Principles.

The arbitral tribunal compared the provisions for the interpretation of contracts as set out in Swiss law and the afore-mentioned sets of rules. Both Swiss and international law, including the UNIDROIT Principles, provide that that parties' common intent is to be established first (subjective interpretation). In case such common intent cannot be established, the Swiss law requires the court or arbitrator to examine and establish 'how an average honest and diligent person had to reasonably understand or interpret the other party's declarations and the particular provisions' (objective interpretation). The arbitral tribunal found this to be in line with Article 4.2(2) of the UNIDROIT Principles which calls for 'the understanding which a reasonable person of the same kind as the parties would give to the term'. Thus, the arbitral tribunal concluded that the provisions for the interpretation of contracts contained in all these sets of rules are very similar and do not lead to conflicting results.

The arbitral tribunal finally held that it has not been properly constituted in accordance with the parties' agreement and that, for that reason, it cannot decide on the request for arbitration.

### 4. *Russia / Arbitration / Petrachkov, Bekker / Unilex 1447 / 2008*

**Case:**<sup>549</sup> A claimant, a German company, filed a lawsuit against a defendant, a Russian company, for collection of indebtedness under a sale and purchase agreement. The contract for the sales of goods provided that Russian law was the law governing the contract.

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547 ICC, Case No 14581, Final Award on Jurisdiction, 2012.

548 Albert Jan van den Berg, *Yearbook Commercial Arbitration Volume XXXVII* (Kluwer 2012) 37, 62.

549 ICAC, Case No 83/2008, Award, 22 December 2008.

The dispute arose when claimant asserted that after the conclusion of the contract the parties had by agreement modified its terms concerning the quantity of the goods and the time of delivery and of payment, and accused defendant, which insisted on performing the contract according to its original terms, of breach of contract and claimed damages. The contract was governed by the law of the Russian Federation, according to which a modification of a written contract must be made in writing. Claimant argued that this formal requirement was met by the exchange between the parties of messages and documents, some of which in electronic form, while defendant objected that the alleged modifications should have been laid down in a single document signed by both parties. The arbitral tribunal ruled in favour of the claimant.

The court's reasoning is explained below.

According to clause 9.2 of the contract, the disputes that may arise out of it or in connection with it 'are subject to consideration in accordance with the legislation of the Russian Federation'.

While interpreting the contract in accordance with Article 431 of the Civil Code of the Russian Federation, the ICAC took the literal meaning of the terms of the contract into account, and in so far as it does not allow to determine the content of the contract, it establishes the actual will of the parties, taking into account the negotiations and correspondence precedent to the contract, the practice as established in the relations between the parties, customary business practices and behaviour of the parties. At the same time, the ICAC took into account the customs in international trade, stipulated in Articles 2.1, 4.1, 4.2, and 4.3 of the UNIDROIT Principles (2004), according to which a contract can be concluded by accepting an offer or as a result of the conduct of the parties that sufficiently indicates the acceptance of the agreement; the contract shall be interpreted in accordance with the common intent of the parties.

On the basis of the foregoing, the ICAC came to the conclusion that after the conclusion of the contract the parties changed the terms of the quantity of goods and the procedure for payments and established such practice in their relations according to which the goods under the contract are not delivered in one instalment in the total amount provided for by the contract, but by separate instalments on the basis of the claimant's orders, while the payment procedure is established by the parties with respect to each individual instalment.

## 5. *India / National Court / Kapoor / Unilex 1454 / 2008*

**Case:**<sup>550</sup> Company A agreed to purchase two floors of a property from company B at an agreed rate per square foot. The offer of purchase and sale was reduced into writing by the exchange of letters between the parties. Company B requested company A to make an initial deposit of ten per cent of the cost calculated on the basis of carpet area. Thereafter, seven instalments of ten per cent and one instalment of five per cent were paid by company A on this basis. However, disputes arose between the parties regarding the actual price payable for the property. In view of the express terms of the letters exchanged between the parties (constituting the agreement between them) and the subsequent conduct of company B, the court concluded that it was evident that the price was to be calculated on the carpet area and not the floor area.

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<sup>550</sup> *Hansalaya Properties and Anr. v Dalmia Cement (Bharat) Ltd*, High Court of Delhi, 2008 SCC, 20 August 2008.

In arriving at the above conclusion, the court relied on Article 4.1 of the UNIDROIT Principles on interpretation of contracts and held that a contract shall be interpreted according to the common intention of parties. The intention of the parties is to be gathered from the words used in the agreement. It is only when such intention cannot be established that contract is to be interpreted according to the meaning that reasonable persons of the same kind would give to it. The court clarified that not only will the terms expressly agreed between the parties be enforceable but also those that are logically implied from those express terms. The court further clarified that the construction of a contract cannot be governed by the belief of one party not communicated to the other.

## 6. *The Netherlands / Arbitration / Taivalkoski / Unilex 2114 / 2008*

**Case:**<sup>551</sup> The parties entered into a contract for sale of goods. The contract required payment for the goods to be effected by an irrevocable letter of credit. The contract also required the buyer to arrange necessary amendments to the letter of credit requested by the buyer. The seller purported to terminate the contract on the basis of the buyer failing to comply with the aforementioned obligations.

The contract provided that the governing law was the CISG and to an extent not covered by the CISG, reference had to be made to the UNIDROIT Principles. By reference to Article 4.1 of the UNIDROIT Principles the sole arbitrator followed the principle that a contract shall be interpreted according to the common intention of the parties. The sole arbitrator also found that the contract itself is the foremost expression of the parties' intention and used the language of the contract in its plain and ordinary meaning as the starting point of its analysis. The sole arbitrator found that the unequivocal language of the contract imposed obligations on the buyer, which it did not comply with.

The sole arbitrator also took into account the fact that earlier the buyer had arranged amendments to the letter of credit requested by the seller. The sole arbitrator found that the buyer's conduct indicated that it was aware of its obligations under the contract.

## 7. *Russia / Arbitration / Petrachkov, Bekker / Unilex 857 / 2002*

**Case:**<sup>552</sup> A claimant, a Russian company, filed a lawsuit against a defendant, a German company, for collection of indebtedness under the marketing services agreement, and incurred interests. The parties submitted different positions as to the interpretation of the marketing services agreement. The arbitral tribunal applied the UNIDROIT Principles to interpret the agreement. The contract provided that the dispute between the parties should be resolved in accordance with general principles of law (*lex mercatoria*).

The court's reasoning is explained below.

In relation to the disagreements between the parties on the interpretation of the terms of the agreement, the arbitral tribunal took into account the nature and purpose of the agreement in accordance with Article 4.3 of the UNIDROIT Principles. The very title of the agreement, which appears in its text, directly indicates that purpose of the agreements is to provide services, the scope of which is defined in clause 1 'Subject of the agreement'. The price for the services and the terms of

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551 ICC, Case No 14633, Final Award, May 2008.

552 ICAC, Case No 11/2002, Award, 5 June 2002.

payment are provided in clause 2 of the agreement, according to which the evidence of the rendered services, which should serve as the basis for the payment, is the act of acceptance of services as signed by the parties to the agreement. These provisions of the agreement provide grounds for concluding that the intentions of the parties were expressed unequivocally, ie, it was their common intention. Taking into account paragraph 1 of Article 4.1 of the UNIDROIT Principles, according to which the contract should be interpreted in accordance with the common intention of the parties, the arbitral tribunal concluded that such common intention was clearly expressed in the agreement.

#### 8. *Undefined / Arbitration / Taivalkoski / Unilex 957 / 2001*

**Case:**<sup>553</sup> The parties concluded two exclusive distribution contracts for the resale of the goods manufactured by the defendant. The defendant terminated the contracts alleging that the plaintiff failed to reach the minimum sales stipulated in the contract which gave rise to the dispute between the parties. One of the questions to be resolved by the arbitral tribunal was whether a poorly drafted jurisdiction clause included in the contracts could be interpreted as an arbitration clause providing for ICC arbitration.

Following its analysis of the said clause, the arbitral tribunal concluded that the parties had not expressly selected the applicable law. In absence of such selection the arbitral tribunal considered that application of *lex mercatoria* was the most appropriate solution. The arbitral tribunal further noted that for questions of general contract law, reference can be made to the UNIDROIT Principles.

By reference to Article 4.1 of the UNIDROIT Principles the arbitral tribunal held that the clause has to be interpreted by searching for the parties' common intention, without dwelling on the literal meaning of the words. The arbitral tribunal considered that in order to understand the meaning of the provision one would have to put oneself in the position that the parties were in or that of a reasonable person of the same kind as the parties. The arbitral tribunal noted that the clause had been negotiated and drawn up by persons without legal training, who did not have a clear idea of the meaning of the concepts of competent forum, arbitration and applicable law from a legal perspective.

The clause also excluded jurisdiction of the courts of the parties' respective countries. Taking these circumstances into account, the arbitral tribunal concluded that the parties' intention was to settle any dispute that might arise in a neutral way, having recourse to the ICC, which they considered an instrument well known to be suitable for that purpose.

The arbitral tribunal also referred to Article 4.5 of the UNIDROIT Principles and held that the above interpretation is in line with the principle that all terms of a contract should be given effect. Since the clause also excluded jurisdiction of the state courts, the arbitral tribunal found that interpreting it not as an arbitration clause would lead to the parties not being able to have recourse to either arbitration or state courts. The arbitral tribunal further held that this would deprive the parties of any possibility to act in the case of a dispute, unless the clause is considered entirely ineffective. Considering the exclusion of state courts' jurisdiction, interpreting the clause not as an arbitration clause would deprive the parties of any possibility to act in the case of a dispute, unless the clause is considered entirely ineffective.

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553 ICC, Case No 10422, Award, 2001.

## 9. *Switzerland / Arbitration / Taivalkoski / Unilex 692 / 2000*

**Case:**<sup>554</sup> The parties entered into a contract concerning supply of industrial equipment. A dispute arose between the parties following loss of promissory notes, agreed as an instrument of payment, delayed delivery of the equipment and malfunctions. The contract contained a provision stipulating that the law applicable to the contract is the law of Switzerland. The defendant, however, contended that the claimant obtained the contract by fraud and material misrepresentation which in the defendant's view was not covered by the choice-of-law clause. This led the arbitral tribunal to interpret the choice-of-law clause in respect of whether it covered other than purely contractual issues.

The arbitral tribunal applied the law of Switzerland to the interpretation of the said clause but also referred to the corresponding articles of the UNIDROIT Principles. The arbitral tribunal stated that no interpretation is needed, when the true and common intention of the parties is clearly expressed in contract. However, it further noted that seemingly clear wording may be shown not to convey the true intention of the parties, wherefore the wording of the clause alone is not decisive.

As it was not clear what the parties had intended by the formulation of the clause, the arbitral tribunal applied the standard of a reasonable third person. The arbitral tribunal stated that it is not obvious that reasonable businesspeople would be aware of the difference between a contractual issue and an issue arising in connection with a contract. Furthermore, the arbitral tribunal noted that it would appear somewhat strange if businessmen as a matter of common intent were to choose two different laws to rule on their relationship. Consequently, the arbitral tribunal found that the choice-of-law clause was intended to cover any issue relating to the conclusion of the contract.

## 10. *Switzerland / Arbitration / Taivalkoski / Unilex 668 / 2000*

**Case:**<sup>555</sup> The parties were members to a worldwide business group. The group consisted of the member firms and the umbrella entity established for the purpose of coordinating cooperation between the member firms. This cooperation enabled the member firms to benefit from technological expertise developed by other member firms. Coordination between member firms was achieved by way of agreements, known as Member Firm Interfirm Agreements (MFIFAs). As skills and services offered by different units evolved, they began to overlap causing a conflict between certain member firms. Consequently, claimants initiated arbitral proceedings against certain member firms and the umbrella entity, alleging that respondents breached their obligations under MFIFAs. The arbitral tribunal found that the UNIDROIT Principles were applicable to the extent a matter is not addressed in the relevant contractual material.

One of the questions addressed by the arbitral tribunal was whether the umbrella entity had an obligation to coordinate the practices of the member firms, which it contested. The arbitral tribunal interpreted the provisions of the MFIFAs in the light of the purposes and policies set out in the preamble thereto and in the umbrella entity's articles and bylaws, finding that the umbrella entity's purpose has been coordination of member firms on an international basis and that the umbrella

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554 ICC, Case No 9651, Award, August 2000.

555 ICC, Case No 9797, Award, 28 July 2000.

entity had to exercise its best efforts to ensure cooperation, coordination and compatibility among member firms' practices.

Another question addressed by the arbitral tribunal was whether the member firms, which did not participate in funding and development of certain technology, had the right to it in the event the member firms, which funded and developed the said technology, left the group. In this respect the arbitral tribunal found that the matter was not addressed in the contractual material and expressly referred to Article 4.1 of the UNIDROIT Principles stating that contracts must be interpreted according to the common intention of the parties and, when it cannot be established, according to the reasonable third-person standard. The arbitral tribunal found that the reasonable persons of the same kind as the parties could not possibly claim that the member firms not paying for or participating in the development of the relevant technology are the joint owners of such technology or that the entities which funded and developed it are bound to forfeit their rights to those who have no title thereto.

#### 11. *France / Arbitration / Taivalkoski / Unilex 694 / 1999*

**Case:**<sup>556</sup> A financial institution entered into a credit contract with a company. The contract was guaranteed by another company. In order to recover payments due to it, the financial institution initiated arbitration proceedings against both companies on the basis of an arbitration clause contained in the credit contract. Both respondents contested the validity of the arbitration clause due to its imperfect formulation.

The credit contract was subject to the law of the country of the financial institution (not specified further). In determining the principles of interpretation of an arbitration agreement the arbitral tribunal sought support from the UNIDROIT Principles alongside other sources.

The arbitral tribunal considered that in the interpretation of an arbitration agreement it had to look for the parties' real intent, taking inter alia into account the consequences, which they have reasonably and legitimately contemplated and to give effect to parties' intent. The arbitral tribunal also referred to Article 4.5 of the UNIDROIT Principles, finding that the contract terms shall be interpreted so as to give effect to all terms. The arbitral tribunal found that, despite defects in the formulation of the arbitration clause, the intention of the parties was to submit their dispute to arbitration under the ICC Rules of Arbitration.

#### 12. *Switzerland / Arbitration / Voser, Ninković / Unilex 642 / 1994*

**Case:**<sup>557</sup> Company A entered into a contract with company B for the sale of a quantity of reinforcing steel bars. Due to a problem in respect of the letter of credit to be opened by company B, company A initiated arbitration proceedings against company B, which contested the jurisdiction of the arbitral institution on the basis that the institution was not specifically named in the arbitration clause.

In deciding in favour of company A, the Zurich Chamber of Commerce arbitral tribunal seated in Switzerland applied the relevant provisions of the applicable Swiss law. The tribunal concluded that

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<sup>556</sup> ICC, Case No 9759, Preliminary Award, August 1999.

<sup>557</sup> *Europe v The Canadian Affiliate of a Chinese Group*, Zurich Chamber of Commerce, Preliminary Award on Jurisdiction, 25 November 1994.

parties to a contract are bound by the meaning of the contractual provision as must be understood by the average honest and diligent business person. In order to show that this interpretation rule reflects a worldwide consensus, the arbitral tribunal referred to Articles 4.1 and 4.2 of the UNIDROIT Principles ‘which have been established by a large international working party consisting of specialists in contract law selected from all different parts of the world [...]’.

Having established that it has jurisdiction, the arbitral tribunal addressed the question whether company B could invoke a material mistake and thereby invalidate the arbitration clause. The arbitral tribunal denied such a possibility and in that context made again a reference not only to the relevant provision of the applicable Swiss law, but also to the similar rule contained in Article 3.5 of the UNIDROIT Principles 1994 (ie, now Article 3.2.2).

## II. Article 4.2: Interpretation of statements and other conduct

### 1. *Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2012*

**Case:**<sup>558</sup> As a continuation of an earlier agreement, a supply agreement for leasing equipment and licensing technology was concluded by two ministries of country X and the lessor from country Y. The agreement contained an arbitration clause providing for a dispute to ‘[...] be brought before the International Arbitration Court in Switzerland. This Court will proceed in accordance with the international law.’<sup>559</sup> While the lessor initiated arbitral proceedings before the ICC, the ministries of state X initiated arbitration proceedings before the national arbitral institution of country X.

Considering the ambiguous wording of the arbitration clause, the arbitral tribunal seated in Switzerland had to decide whether it was the parties’ mutual intention to refer their disputes to the ICC. The arbitral tribunal held in that respect that under Swiss law the arbitration clause may be interpreted under either Swiss or international law and consequently decided to apply both Swiss law and international law in that regard. Considering that both parties invoked the UNIDROIT Principles as internationally recognised principles of law, the arbitral tribunal consulted the UNIDROIT Principles alongside the Principles of European Contract Law and the CISG. In particular, it referred to Articles 4.1, 4.2, and 4.3 of the UNIDROIT Principles.

The arbitral tribunal compared the provisions for the interpretation of contracts as set out in Swiss law and the aforementioned sets of rules. Both Swiss and international law, including the UNIDROIT Principles, provide that that parties’ common intent is to be established first (subjective interpretation). In case such common intent cannot be established, the Swiss law requires the court or arbitrator to examine and establish ‘how an average honest and diligent person had to reasonably understand or interpret the other party’s declarations and the particular provisions’ (objective interpretation). The arbitral tribunal found this to be in line with Article 4.2(2) of the UNIDROIT Principles which calls for ‘the understanding which a reasonable person of the same kind as the parties would give to the term’. Thus, the arbitral tribunal concluded that the provisions for the interpretation of contracts contained in all these sets of rules are very similar and do not lead to conflicting results.

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558 ICC, Case No 14581, Final Award on Jurisdiction, 2012.

559 Albert Jan van den Berg, *Yearbook Commercial Arbitration Volume XXXVII* (Kluwer 2012) 37, 62.

The arbitral tribunal finally held that it has not been properly constituted in accordance with the parties' agreement and that, for that reason, it cannot decide on the request for arbitration.

## 2. *Russia / Arbitration / Petrachkov, Bekker / Unilex 1477 / 2008*

**Case:**<sup>560</sup> A claimant, a German company, filed a lawsuit against a defendant, a Russian company, for collection of indebtedness under sale and purchase agreement. The contract for the sales of goods provided that Russian law was the law governing the contract.

The dispute arose when claimant asserted that after the conclusion of the contract the parties had by agreement modified its terms concerning the quantity of the goods and the time of delivery and of payment, and accused defendant, which insisted on performing the contract according to its original terms, of breach of contract and claimed damages. The contract was governed by the law of the Russian Federation, according to which a modification of a written contract must be made in writing. The claimant argued that this formal requirement was met by the exchange between the parties of messages and documents, some of which in electronic form, while the defendant objected that the alleged modifications should have been laid down in a single document signed by both parties. The arbitral tribunal ruled in favour of the claimant.

The court's reasoning is explained below.

According to clause 9.2 of the contract, the disputes that may arise out of it or in connection with it 'are subject to consideration in accordance with the legislation of the Russian Federation'.

While interpreting the contract in accordance with Article 431 of the Civil Code of the Russian Federation, the ICAC took the literal meaning of the terms of the contract into account, and in so far as it does not allow to determine the content of the contract, it establishes the actual will of the parties, taking into account the negotiations and correspondence precedent to the contract, the practice as established in the relations between the parties, customary business practices and behaviour of the parties. At the same time, the ICAC took into account the customs in international trade, stipulated in Articles 2.1, 4.1, 4.2, and 4.3 of the UNIDROIT Principles, 2004, according to which a contract can be concluded by accepting an offer or as a result of the conduct of the parties that sufficiently indicates the acceptance of the agreement; the contract shall be interpreted in accordance with the common intent of the parties.

On the basis of the foregoing, the ICAC comes to the conclusion that after the conclusion of the contract the parties changed the terms of the quantity of goods and the procedure for payments and established such practice in their relations according to which the goods under the contract are not delivered in one instalment in the total amount provided for by the contract, but by separate instalments on the basis of the claimant's orders, while the payment procedure is established by the parties with respect to each individual instalment.

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560 ICAC, Case No 83/2008, Award, 22 December 2008.

### 3. *Switzerland / Arbitration / Voser, Ninković / Unilex 642 / 1994*

**Case:**<sup>561</sup> Company A entered into a contract with company B for the sale of reinforcing steel bars. Due to a problem in respect of the letter of credit to be opened by company B, company A initiated arbitration proceedings against company B, which contested the jurisdiction of the arbitral institution on the basis that the institution was not specifically named in the arbitration clause.

In deciding in favour of company A, the arbitral tribunal seated in Switzerland applied the relevant provisions of the applicable Swiss law and concluded that parties to a contract are bound by the meaning of the contractual provision as must be understood by the average honest and diligent business person. In order to show that this interpretation rule reflects a worldwide consensus, the arbitral tribunal referred to Articles 4.1 and 4.2 of the UNIDROIT Principles ‘which have been established by a large international working party consisting of specialists in contract law selected from all different parts of the world [...]’.<sup>562</sup>

Having established that it has jurisdiction, the arbitral tribunal addressed the question whether company B could invoke a material mistake and thereby invalidate the arbitration clause. The arbitral tribunal denied such a possibility and in that context made again a reference not only to the relevant provision of the applicable Swiss law, but also to the similar rule contained in Article 3.5 of the UNIDROIT Principles 1994 (ie, now Article 3.2.2).

## III. Article 4.3: Relevant circumstances

### 1. *Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2013*

**Case:**<sup>563</sup> Company A from country X and company B from country Y entered into a JVA to provide technical assistance to the government of country Z in the framework of a project in country Z. According to the JVA, any net margin of the joint venture company was to be divided equally between company A, which was the manager of the joint venture company, and company B. The JVA provided that the parties could refer their disputes to arbitration (*pourront faire appel à la Cour d’Arbitrage*) and that the FIDIC rules prevailed in such cases.

After the completion of the project, company B sent an invoice to company A for 50 per cent of the joint venture company’s net margin. Company A refused to pay, alleging that company B’s employees did not provide any assistance to its employees during the project. After first referring the case to the courts in country X, company B initiated arbitration proceedings against company A, which contested the jurisdiction and alleged that the arbitration clause was too vague to constitute a valid agreement to arbitrate and that company B has waived its right to arbitration by first commencing state court proceedings.

In their submissions on jurisdiction, the parties did not specify the rules of law determining the substantive validity of the arbitration agreement. For this reason, the arbitral tribunal seated in Switzerland was considered to have, within the boundaries of Swiss law, certain discretion when

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561 *Europe v The Canadian Affiliate of a Chinese Group*, Zurich Chamber of Commerce, Preliminary Award on Jurisdiction, 25 November 1994.

562 ASA Bulletin (1996) 14(2), 313.

563 ICC, Case No 19127, Final Award, 2013.

deciding which rules of law it will apply to this issue. After considering the different sets of rules of law that came into play in determining the applicable law, the arbitral tribunal held that the lack of an agreement of the parties can be interpreted as implied negative choice and that the contract's connection with the different countries is not predominant enough to justify the application of one national law to the exclusion of others.

Based on the foregoing, the arbitral tribunal decided to apply the UNIDROIT Principles and Swiss law to the question of the substantive validity of the arbitration agreement. In determining whether the parties consented to submit their dispute to the arbitral institution, the arbitral tribunal applied Article 4.1 as well as Article 4.3(c) of the UNIDROIT Principles. In the context of interpretation of the subsequent conduct of the parties, the arbitral tribunal considered that company B's statements evidenced the fact that, in its view, the arbitration clause was defective and inoperable. The arbitral tribunal held that claiming the opposite would go against the principle of *venire contra factum proprium*, which is applicable under Article 1.7 and Article 1.8 of the UNIDROIT Principles as well as Swiss law.

The arbitral tribunal further found that both parties revoked the arbitration agreement and accepted the jurisdiction of the state courts. It stated that 'such mutual waiver can be concluded without observing any requirement of form and must be interpreted according to the generally applicable principles for the interpretation of private statements of intent', thereby referring to and applying Article 1.2 of the UNIDROIT Principles.<sup>564</sup>

Based on the foregoing, the arbitral tribunal decided that it has no jurisdiction to decide on company B's claims.

## 2. *Spain / National Court / Llevat / Not Unilex / 2012*

**Case:**<sup>565</sup> A buyer purchased a certain amount of shares of a company by means of a loan. The shares and interest of the loan were not paid on time, and hidden liabilities were found in the company, causing two parallel proceedings to arise: the seller and lender claimed the part of shares due and the interest of the loan, whereas the buyer and guarantor of the loan claimed a compensation for the hidden liabilities in the company, and intended to compensate these amounts with the pending debt.

The first court ruling declared a smaller hidden liability than the ones that were claimed, and said buyer and guarantor knew the 'real situation of company' (referencing the liabilities), condemning them to pay the debt.

The second ruling declared that the buyer and guarantor did not know the 'real situation of company', as they only had access to information provided by the seller, and condemned the seller.

In view of the second ruling, the seller appealed in cassation, alleging an incorrect interpretation of the contracts entered into by the parties, as well as a violation of estoppel doctrine by the courts.

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<sup>564</sup> Albert Jan van den Berg, *Yearbook Commercial Arbitration Volume XLII* (Kluwer 2017) 275 et seq.

<sup>565</sup> Supreme Court of Spain, Case No 285/2012 (First Chamber), Ruling, 8 May 2012.

The Supreme Court used Article 4.3 of the UNIDROIT Principles in order to avoid the general principle of literal interpretation which generally prevails in Spanish law, and referred to the importance of the common intention of the parties as an interpretative tool.

The court finally dismissed the appeal for considering that the grounds on which it was based were insufficient and improper for cassation.

### 3. *Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2012*

**Case:**<sup>566</sup> As a continuation of an earlier agreement, a supply agreement for leasing equipment and licensing technology was concluded by two ministries of country X and the lessor from country Y. The agreement contained an arbitration clause providing for a dispute to ‘[...] be brought before the International Arbitration Court in Switzerland. This Court will proceed in accordance with the international law.’<sup>567</sup> While the lessor initiated arbitral proceedings before the ICC, the ministries of state X initiated arbitration proceedings before the national arbitral institution of country X.

Considering the ambiguous wording of the arbitration clause, the arbitral tribunal seated in Switzerland had to decide whether it was the parties’ mutual intention to refer their disputes to the ICC. The arbitral tribunal held in that respect that under Swiss law the arbitration clause may be interpreted under either Swiss or international law and consequently decided to apply both Swiss law and international law in that regard. Considering that both parties invoked the UNIDROIT Principles as internationally recognised principles of law, the arbitral tribunal consulted the UNIDROIT Principles alongside the Principles of European Contract Law and the CISG. In particular, it referred to Articles 4.1, 4.2, and 4.3 of the UNIDROIT Principles.

The arbitral tribunal compared the provisions for the interpretation of contracts as set out in Swiss law and the afore-mentioned sets of rules. Both Swiss and international law, including the UNIDROIT Principles, provide that the parties’ common intent is to be established first (subjective interpretation). In case such common intent cannot be established, the Swiss law requires the court or arbitrator to examine and establish ‘how an average honest and diligent person had to reasonably understand or interpret the other party’s declarations and the particular provisions’ (objective interpretation). The arbitral tribunal found this to be in line with Article 4.2(2) of the UNIDROIT Principles which calls for ‘the understanding which a reasonable person of the same kind as the parties would give to the term’. Thus, the arbitral tribunal concluded that the provisions for the interpretation of contracts contained in all these sets of rules are very similar and do not lead to conflicting results.

The arbitral tribunal finally held that it has not been properly constituted in accordance with the parties’ agreement and that, for that reason, it cannot decide on the request for arbitration.

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566 ICC, Case No 14581, Final Award on Jurisdiction, 2012.

567 Albert Jan van den Berg, *Yearbook Commercial Arbitration Volume XXXVII* (Kluwer 2012) 37, 62.

#### 4. *Singapore / National Court / Koh / Not Unilex / 2010*

**Case:**<sup>568</sup> Company A and company B were initially joint venture partners, each owning 50 per cent of a JVC. Three per cent of company B's shares were owned by its subsidiary, company B1. The terms of the JVA, and the JVC's articles of association stipulated that company A and company B were entitled to appoint three directors each in the JVC as they both held 50 per cent of the shares in the JVC. Subsequently, company A increased its stake to 85 per cent by purchasing 35 per cent from company B under a supplemental agreement. Thereafter, Company A proceeded to appoint another three directors on the board of the JVC, bringing the total number of Company A-appointed directors to six. Thereafter, company B sold its remaining 15 per cent shares to a third party. The JVC's six company A-appointed directors proceeded to pass certain resolutions which had the effect of reducing company B's board influence and executive control in the JVC.

Among other issues, Company A argued that the JVA and JVC's articles of association contained an implied term which has the effect of disapplying certain clauses relating to board representation and control once the 50:50 joint venture proportion changed.

The court discussed various principles, including that of interpretation of contracts. In doing so, the court discussed the contextual approach, and the admissibility of extrinsic evidence in the adoption of this approach. In the discussion on the admissibility of extrinsic evidence, reference was made to Article 4.3 of the UNIDROIT Principles.

#### 5. *India / Statutory Tribunal / Kapoor / Not Unilex / 2010*

**Case:**<sup>569</sup> Company A which was a cable television service provider was receiving signals from company B for its channels and was obliged to report regularly the subscriber base on the basis of which invoices were to be raised by company B for payment of subscription fee by company A. However, company A's failure to make the requisite reporting led to disputes between the parties. Company A approached the tribunal, inter alia, seeking a restraint against company B from disconnecting the signals for its channels. The tribunal directed company A to disclose information concerning its subscriber base to company B and further directed both parties to arrive at a mutual settlement of dues. However, various settlement efforts failed resulting in company B approaching the tribunal again for grant of appropriate relief in terms of enforcing its earlier order.

In determining whether subsequent conduct of parties could be taken into account for determining whether there exists a concluded contract between the parties for settlement of disputes, the tribunal, among others, relied on the text of Kim Lewison QC in *Interpretation of Contracts* which stipulates that UNIDROIT Principles state that in interpreting a contract, regard shall be had to all circumstances including 'any conduct of the parties subsequent to the conclusion of the contract'. The tribunal on considering the emails exchanged between the parties regarding the proposed memorandum of understanding for settlement of disputes between the parties held that such an agreement had been reached.

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<sup>568</sup> *Sembcorp Marine Ltd v PPL Holdings Pte Ltd et al* (2013) SGCA 43.

<sup>569</sup> *Hathway Cable and Datacom Ltd v Neo Sports Broadcast Pvt Ltd*, 2010 SCC.

## 6. *United Kingdom / National Court / Cowan / Unilex 1512 / 2009*

**Case:**<sup>570</sup> A entered into a contract with B for the development of a site owned by A, under which B was granted a licence to construct residential and commercial buildings and to ‘sell’ the properties on long leases, which would be granted by A at the direction of B. B would receive the sale proceeds from the purchasers and would pay a proportion of the proceeds to A, according to an agreed land price per unit. According to the terms of the contract, this had two elements: the basic land price by reference to an agreed price per square foot of area of the relevant residential and commercial development; and an additional payment in respect of the proportion of any increase in residential sale value of the development after the date of the contract. The parties were in dispute over the latter as a matter of contractual interpretation.

A argued by reference to a literal interpretation of the words used in the written contract. B argued for a contrary interpretation, informed by evidence of the factual background to the transaction and the negotiations of the parties.

The House of Lords upheld the long-standing rule in English law that contracts are to be interpreted objectively by reference to what a reasonable observer would regard as the intention of the contractual language, and not by reference to the actual intentions of the parties. As a result, the primary English law rule was to construe contracts according to their written terms, and not by reference to evidence as to what the parties’ subjective intentions actually were, which evidence is consequently inadmissible for the purpose of contractual interpretation.

In emphasising this important distinction, the court made reference to Article 4.3 of the UNIDROIT Principles. It was described as reflective of the French legal philosophy of contractual interpretation which sought to establish and apply the parties’ actual intentions and, thus, permits and requires examination of the evidence needed to determine the parties’ intentions as a matter of fact, such as the negotiations of the contract. This was held up in contrast to the very different philosophy applied in English law.

Nevertheless, having upheld the traditional view of English contract law and contractual interpretation (and ruling that evidence of the parties’ negotiations is inadmissible for the purpose of determining what the contract meant), the court held that such evidence may be admissible for other purposes – such as to establish the general background facts that would have been known to the parties at the time of entering into the contract. This was held to be legitimate as the ultimate objective of the court is to ascertain the meaning of the words in the contract by reference to ‘what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean’.

## 7. *Russia / Arbitration / Petrachkov, Bekker / Unilex 1477 / 2008*

**Case:**<sup>571</sup> A claimant, a German company, filed a lawsuit against a defendant, a Russian company, for collection of indebtedness under a sale and purchase agreement. The contract for the sales of goods provided that Russian law was the law governing the contract.

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<sup>570</sup> *Chartbrook Ltd v Persimmon Homes Ltd* (2009) 1 AC 1101.

<sup>571</sup> ICAC, Case No 83/2008, Award, 22 December 2008.

The dispute arose when claimant asserted that after the conclusion of the contract the parties had by agreement modified its terms concerning the quantity of the goods and the time of delivery and of payment, and accused the defendant, which insisted on performing the contract according to its original terms, of breach of contract and claimed damages. The contract was governed by the law of the Russian Federation, according to which a modification of a written contract must be made in writing. The claimant argued that this formal requirement was met by the exchange between the parties of messages and documents, some of which in electronic form, while the defendant objected that the alleged modifications should have been laid down in a single document signed by both parties. The arbitral tribunal ruled in favour of the claimant.

The court's reasoning is explained below.

According to clause 9.2 of the contract, the disputes that may arise out of it or in connection with it 'are subject to consideration in accordance with the legislation of the Russian Federation'.

While interpreting the contract in accordance with Article 431 of the Civil Code of the Russian Federation, the ICAC took the literal meaning of the terms of the contract into account, and in so far as it does not allow to determine the content of the contract, it establishes the actual will of the parties, taking into account the negotiations and correspondence precedent to the contract, the practice as established in the relations between the parties, customary business practices and behaviour of the parties. At the same time, the ICAC took into account the customs in international trade, stipulated in Articles 2.1, 4.1, 4.2, and 4.3 of the UNIDROIT Principles, 2004, according to which a contract can be concluded by accepting an offer or as a result of the conduct of the parties sufficiently indicating on making of the agreement; the contract shall be interpreted in accordance with the common intent of the parties.

On the basis of the foregoing, the ICAC came to the conclusion that after the conclusion of the Contract the parties changed the terms of the quantity of goods and the procedure for payments and established such practice in their relations according to which the goods under the contract are not delivered in one instalment in the total amount provided for by the contract, but by separate instalments on the basis of the claimant's orders, while the payment procedure is established by the parties with respect to each individual instalment.

#### **8. *Russia / Arbitration / Petrachkov, Bekker / Unilex 857 / 2002***

**Case:**<sup>572</sup> A claimant, a Russian company, filed a lawsuit against a defendant, a German company, for collection of indebtedness under the marketing services agreement, and incurred interests. The parties submitted different positions as to the interpretation of the marketing services agreement. The arbitral tribunal applied UNIDROIT Principles in order to interpret the agreement. The contract provided that the dispute between the parties should be resolved in accordance with general principles of law (*lex mercatoria*).

The court's reasoning is explained below.

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572 ICAC, Case No 11/2002, Award, 5 June 2002.

In relation to the disagreements between the parties on the interpretation of the terms of the agreement, the arbitral tribunal took into account the nature and purpose of the agreement in accordance with Article 4.3 the UNIDROIT Principles. The very title of the agreement, which appears in its text, directly indicates that purpose of the agreements is to provide services, the scope of which is defined in clause 1 ‘Subject of the agreement’. The price for the services and the terms of payment are provided in clause 2 of the agreement, according to which the evidence of the rendered services, which should serve as the basis for the payment, is the act of acceptance of services as signed by the parties to the agreement. These provisions of the agreement provide grounds for concluding that the intentions of the parties were expressed unequivocally, that is, it was their common intention. Taking into account paragraph 1 of Article 4.1 of the UNIDROIT Principles, according to which the contract should be interpreted in accordance with the common intention of the parties, the arbitral tribunal concluded that such common intention was clearly expressed in the agreement.

#### 9. *Belgium / Arbitration / Taivalkoski / Unilex 697 / 2000*

**Case:**<sup>573</sup> The parties concluded a contract, which gave the claimant an exclusive licence to sell and distribute the respondent’s products in Europe. At the same time an identical contract was concluded between the respondent and company X for the North American market. Later the respondent entered into a new contract with company X. The claimant contended that the new contract between the respondent and company X infringed its exclusivity in Europe as the new contract did not contain corresponding limitation of the extent of company X’s distribution.

The arbitral tribunal decided that *lex mercatoria* should be applied noting that the UNIDROIT Principles reflect the rules of law and usages of international trade. The arbitral tribunal found that the predominant principle of interpretation is to consider the intention of the parties and stated further that the intention of the parties can be determined by all circumstances. The arbitral tribunal emphasised that in the case at hand the contractual set-up as a whole and the parties’ conduct before and after the conclusion of the contracts were of particular importance.

In order to determine whether the respondent had breached the exclusive licence given to the claimant, the arbitral tribunal had to interpret the new contract concluded between the respondent and company X. The arbitral tribunal considered that the intention of the parties should be determined in the full context of the whole contractual set-up between the respondent and its two licensees. By assessing the relevant provisions of all of the contracts the arbitral tribunal came to the conclusion that, as opposed to the original contract, the new contract between the respondent and company X was identical to the contract between the claimant and the respondent with regard to indirect sales on the territory of the other licensee. The arbitral tribunal found that the new contractual set-up was the result of a deliberate intent to alter the symmetry of the licensees’ positions, rather than bad drafting. The arbitral tribunal further stated that such interpretation was confirmed by the conduct of the parties as the negotiation of the new contract with the company X was not disclosed to the claimant which can be considered contrary to the parties’ prior practice concerning cooperation and exchange of information. The arbitral tribunal also took into account communication between the respondent and company X subsequent the conclusion of the new contract which pertained to company X’s entrance in the European market via indirect sales.

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573 ICC Case 9875, Award, March 2000.

## IV. Article 4.4: Reference to contract or statement as a whole

### 1. *India / National Court / Kapoor / Unilex 1242 / 2006*

**Case:**<sup>574</sup> Buyer A and seller B had entered into an agreement to buy and sell a certain property for an agreed sale consideration. A certain portion of money was paid upfront. Under the terms of the agreement, seller B was to obtain a no objection letter from a statutory authority and inform buyer A, after which the balance sale consideration was to be paid by buyer A. In the event the balance sale consideration was not paid within ten days from the knowledge of buyer A of the permission having been received, Seller B was entitled to send a notice calling upon buyer A to make the payment within ten days failing which the money paid upfront was liable to be forfeited.

The agreement stipulated that simultaneously, on receipt of payment, seller B was to execute an irrevocable and registered general power of attorney, no objection affidavits for mutation in the records of the statutory authority, an indemnity bond for property tax and other encumbrances, and/or 'any other relevant document requested' by buyer A. Seller B informed buyer A regarding receipt of the no objection letter and requested that the balance payment be made within ten days. Buyer A expressed its willingness to complete the transaction and requested the execution of a sale deed in addition to the other stipulated documents. Due to continued non-payment by buyer A, seller B forfeited the monies received.

The court held that on a harmonious construction of clauses 3, 4 and 5 of the agreement, it was only the irrevocable and registered general power of attorney that was required for completion of this transaction and non-execution of the sale deed would not be fatal to the transaction. In interpreting the agreement, the court relied on the principle that an agreement/deed should be read as a whole to ascertain its true meaning. The court relied on works of various authors including Mulla in *Indian Contract and Specific Relief Acts*, 12th edition at page 267 which in turn relies on Article 4.4 of the UNIDROIT Principles in reaffirming the above position.

## V. Article 4.5: All terms to be given effect

### 1. *France / Arbitration / Taivalkoski / Not Unilex / 2015*

**Case:**<sup>575</sup> The contract between the parties contained an arbitration clause. According to this clause the arbitration institution should be designated in a separate contractual document, which, however, did not contain such designation. Due to lack of reference to an arbitration institution, the respondent contested the validity of the arbitration clause, which led the arbitral tribunal to resolve the question of its interpretation.

The contractual documents did not stipulate the applicable law. As the parties refrained from taking specific positions on the applicable law, the arbitral tribunal found that the existence, validity and scope of an arbitration agreement has to be examined by reference to transnational rules and trade usages. The arbitral tribunal further noted that these rules are the same as those commonly adopted

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<sup>574</sup> *Sandvik Asia Pvt Ltd. v Vardhman Promoters Pvt. Ltd.*, 2006 SCC.

<sup>575</sup> ICC, Case No 17146, Award, 2015.

for the interpretation of contracts in national laws. The arbitral tribunal identified that these rules encompass the principle of good faith, the principle of effective interpretation and the principle of *interpretation contra proferentem* stating that it would interpret the arbitration clause pursuant to these generally accepted principles. With regard to the principle of effective interpretation, the arbitral tribunal also referred to Article 4.5 of the UNIDROIT Principles.

The arbitral tribunal analysed the contractual documents finding that the parties' intention was to resolve possible differences or disputes between them through administered arbitration. In addition to examination of the contractual material and other circumstances as a whole in order to establish the parties' intent, the arbitral tribunal also resorted to the principle of effective interpretation. As a part of its analysis the arbitral tribunal noted that neither of the parties had argued that their intention would have been to have an ad hoc arbitration, which was in line with the arbitration clause, as otherwise it would have deprived a part of the arbitration clause, according to which the seat of arbitration is determined by location of headquarters of selected arbitration institution, of any meaning.

## 2. *India / National Court / Llevat / Unilex 1242 / 2006*

**Case:**<sup>576</sup> Two Indian companies subscribed an agreement for the sale of an apartment. The buyer was to pay 20 per cent of the price immediately and the rest after receiving a liquidation of the seller's tax on income. If the buyer did not pay the remaining amount within 20 days after receipt of the liquidation, he would lose the 20 per cent advance. The contract also required that the seller obtained a registered and irrevocable power of attorney. If the power was not granted within five months, the agreement would be cancelled and the buyer would be reimbursed the 20 per cent.

When the 20 per cent was paid and the seller had handed in the liquidation, the buyer asked to execute the power of attorney together with the sale of deed. When the seller failed to provide the deed within the five months agreed, the buyer demanded the 20 per cent which he had paid, whereas the seller demanded the payment of the remaining 80 per cent or he would keep the advance.

The court ruled in favour of the seller, considering that only the default regarding the execution of the power implied the cancellation of the sale and reimbursement of the advance, whereas the failure in executing the sale deed was not enough to cause the same result. When reaching its ruling, the court decided that in order to interpret the individual clauses, the contract had to be interpreted as a whole, and that the individual clauses should be interpreted in a way that all of them are given effect. For these purposes, the court took into consideration Articles 4.4 and 4.5 of the UNIDROIT Principles as well as Indian and British jurisprudence.

## 3. *Undefined / Arbitration / Taivalkoski / Unilex 957 / 2001*

**Case:**<sup>577</sup> The parties concluded two exclusive distribution contracts for the resale of the goods manufactured by the defendant. The defendant terminated the contracts alleging that the plaintiff failed to reach the minimum sales stipulated in the contract which gave rise to the dispute between

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<sup>576</sup> Supreme Court of Delhi, Case No CS (OS) No 1599/1999, Ruling, 21 August 2006.

<sup>577</sup> ICC, Case 10422, Award, 2001.

the parties. One of the questions to be resolved by the arbitral tribunal was whether a poorly drafted jurisdiction clause included in the contracts could be interpreted as an arbitration clause providing for ICC arbitration.

Following its analysis of the said clause, the arbitral tribunal concluded that the parties had not expressly selected the applicable law. In absence of such selection the arbitral tribunal considered that application of *lex mercatoria* was the most appropriate solution. The arbitral tribunal further noted that for questions of general contract law, reference can be made to the UNIDROIT Principles.

By reference to Article 4.1 of the UNIDROIT Principles the arbitral tribunal held that the clause has to be interpreted by searching for the parties' common intention, without dwelling on the literal meaning of the words. The arbitral tribunal considered that in order to understand the meaning of the provision one would have to put oneself in the position that the parties were in or that of a reasonable person of the same kind as the parties. The arbitral tribunal noted that the clause had been negotiated and drawn up by persons without legal training, who did not have a clear idea of the meaning of the concepts of competent forum, arbitration and applicable law from a legal perspective.

The clause also excluded jurisdiction of the courts of the parties' respective countries. Taking these circumstances into account, the arbitral tribunal concluded that the parties' intention was to settle any dispute that might arise in a neutral way, having recourse to the ICC, which they considered an instrument well known to be suitable for that purpose.

The arbitral tribunal also referred to Article 4.5 of the UNIDROIT Principles and held that the above interpretation is in line with the principle that all terms of a contract should be given effect. Since the clause also excluded jurisdiction of the state courts, the arbitral tribunal found that interpreting it not as an arbitration clause would lead to the parties not being able to have recourse to either arbitration or state courts. The arbitral tribunal further held that this would deprive the parties of any possibility to act in the case of a dispute, unless the clause is considered entirely ineffective. Considering the exclusion of state courts' jurisdiction, interpreting the clause not as an arbitration clause would deprive the parties of any possibility to act in the case of a dispute, unless the clause is considered entirely ineffective.

## VI. Article 4.6: Contra proferentem rule

### 1. *Russia / National Court / Petrachkov, Bekker / Not Unilex / 2016*

**Case:**<sup>578</sup> The Russian company, the claimant, filed a lawsuit against the Russian bank, the defendant, for collection of the indebtedness under the bank guarantee, issued by the Russian bank in favour of the claimant.

The Russian bank refused to pay the indebtedness. In the court hearings the Russian bank referred to the fact that claimant did not apply in writing to the bank with the application to pay the amount under the bank guarantee, which, however, was not indicated as a ground for non-payment in the official reply of the bank to the claimant. The court rejected the arguments of the Russian bank and referred to the applicable provision of the Russian law and legal position elaborated by the

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<sup>578</sup> Ninth Arbitrazh Appeal Court, Case No A40-118358/2015, Resolution 09AP-24129/2016, 23 June 2016.

Supreme Arbitrazh Court (Russia's supreme commercial court). The court also referred to the *contra proferentem* rule as contained in the UNIDROIT Principles.

The court's reasoning is explained below.

As explained in paragraph 11 of the Resolution of the Plenum of the Supreme Arbitrazh Court of the Russian Federation dated 14 March 2014 No 16 'On freedom of contract and its limits', in the event of unclear contract terms and the impossibility to establish the actual common will of the parties, taking into account the purpose of the contract and its wording, previous negotiations, the correspondence of the parties, the practice established in mutual relations between the parties, the customs and also the subsequent conduct of the parties to the contract (Article 431 of the Civil Code of the Russian Federation), the interpretation of the terms of the contract by the court should be in favour of the counterparty of the party that drafted the contract or proposed the wording of the relevant condition; until proven otherwise, it is assumed that such a party was a person who is a professional in the relevant field, requiring a special knowledge (eg, a bank under a loan agreement, a lessor under a leasing agreement and an insurer under an insurance contract). A similar rule is applied as generally accepted rule of interpretation of international commercial contracts (Article 4.6 of the UNIDROIT Principles).

## 2. *Austria / Arbitration / Llevat / Unilex 1659 / date unavailable*

**Case:**<sup>579</sup> An Australian seller and a businessman of unknown nationality (the buyer) engaged in a sales contract, which stated that the goods were to be sent within 60 days, and in the event of a delay, the seller was to pay the buyer 0.1 per cent of the cost of the non-delivered goods for each day of delay, with a maximum of three per cent of the cost. The contract was governed by English law and was submitted to arbitration in Vienna, Austria.

The dispute arose when the seller informed the buyer that they were not able to deliver the goods, and consequently the buyer claimed three per cent of the price paid as liquidation for the default of delivery. The sole arbitrator interpreted the commitment clause applying the *in favorem validitatis* and *contra proferentem* principles and referencing Article 4.6 of the UNIDROIT Principles, which, according to the arbitrator include wider rules that complement the law and help to avoid the uncertainty that poorly drafted contracts cause.

The arbitrator ruled in favour of the buyer, as the agreed clauses were considered to be valid under the applicable law.

## VII. Article 4.7: Linguistic discrepancies

### 1. *Italy / National Court / Martinetti / Not Unilex / 2016*

**Case:**<sup>580</sup> Company A lodged an opposition to an order for payment issued on request of company B for the payment of a service (the research and selection of private surveillance companies and the management and coordination of the security services). Company A based her opposition on various

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579 ICC, Case No 11869, Award, Undated.

580 Tribunale of Brescia, Case No 1990/2016.

grounds, including the lack of competence of the seised court. Indeed, according to company A's defence the competent court is X, as provided by the English version of the contract, and not Y (the court seised) as provided by the version translated in Italian. Company A argues that the English text prevails over the Italian translation according to Article 23 letter (C) Regulation 44/2001 and Article 4.7 of UNIDROIT Principles.

The court dismissed the opposition. In particular, the claim based on Article 23 letter (C) Regulation 44/2001 and Article 4.7 of UNIDROIT Principle is rejected because the provisions mentioned are not applicable to such a case since they imply that the two versions are a mere translations of a common text. On the contrary, in the case under the scrutiny of the court, what can be perceived is not an ambiguity in the translation, but a serious discrepancy corresponding to a changing willing of the parties. Therefore, the criterion to be applied is the chronological order of the contracts that entails the prevalence of the last contract.

## 2. *Russia / Arbitration / Llevat, Petrachkov, Bekker / Unilex 856 / 2002*

**Case:**<sup>581</sup> Claimant (Russian company) and plaintiff (Canadian company) subscribed a sales agreement initially drafted in Russian and later translated into English, determining that both versions were to have the same authority in regards to interpretation of the agreement. However, the clauses referring to the arbitration clause, which were essential to the contract, were contradictory if analysed in both languages, and the official competence of the arbitration court to which the dispute was to be submitted was not explained clearly.

The arbitral tribunal, applied Article 4.7 of the UNIDROIT Principles and decided that the Russian version was to prevail, as it was the one in which the contract had been originally drawn up.

The court's reasoning is explained below.

The contract, made in Russian and English languages, has provisions that both versions have the same legal force; however, it contains different wording of the arbitration clause. The version in Russian language stipulates the transfer of disputes to the Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation. The version in English language provides for the transfer of disputes 'to the Arbitration court of Russia'. The defendant's position that the English version meant transferring of disputes to the Russian State Arbitration Court, cannot be considered as justified. It is generally known that the term 'arbitration court' in English is equivalent in the Russian language to the term 'arbitration court'.

Part 2 of Article 431 of the Civil Code of the Russian Federation provides for the procedure for defining the content of the contract in cases where the literal meaning of the words and expressions contained in it does not allow it to be determined. It states that in determining the general will of the parties, all relevant circumstances shall be taken into account, including, in particular, the business practices. In view of this, considering that in the English wording there is no specific arbitration court, in order to determine it, the arbitral tribunal considered it reasonable to use the rules of interpretation of contracts that are becoming more common as a business practice, widely used in international commercial trade, contained in the UNIDROIT Principles. The application

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581 ICAC, Case No 217/2001, Award, 6 September 2002.

of this document in international commercial practice is frequently covered in foreign and Russian literature and it is used in a number of published ICAC awards.

According to Article 4.7 of these principles, in such cases, preference is given to interpretation in accordance with the version of the text of the contract which was originally drafted. In view of this, it should be concluded that in the English version the words ‘at the Chamber of Commerce and Industry’ mentioned in the Russian version were omitted.

## VIII. Article 4.8: Supplying an omitted term

### 1. *Italy / National Court / Martinetti / Not Unilex / 2017*

**Case:**<sup>582</sup> Ms A lodged an opposition to an order for payment issued by the judge presiding at the bankruptcy procedure of company B on the ground of her failure to pay some tenths of the capital. The grounds of such opposition were the exceeding of the limitation period.

The court considers the opposition well founded. In particular, it stated that, in case of omission of the term for the payment, the limitation period shall be calculated from the capital subscription. Since it is controversial in case law what shall be the starting date for the calculation of the limitation period, the court explains the line of reasoning followed based on the principle of reasonableness. In this context, the court made reference to the UNIDROIT Principles in order to show the various declinations of the use of the principle of reasonableness. In particular, it has been cited Article 4.1 as a criterion for interpreting law and Article 4.8 as a source for the integration of a contract.

### 2. *Austria / Arbitration / Llevat / Unilex 1070 / 2001*

**Case:**<sup>583</sup> Claimant (Swiss company) had received certain exclusive rights from plaintiff (Polish company), which claimant transferred to one of its subsidiaries. Consequently, claimant initiated arbitration proceedings on the grounds of a breach of said rights by plaintiff. During the proceedings, the question arose as to whether only the aforementioned rights or the whole contract had been transferred, including plaintiff’s obligations.

The tribunal applied Article 4.8 of the UNIDROIT Principles together with Polish Civil Law when interpreting the contract, and determined that it was to be interpreted in accordance with the parties’ intention, the nature and purpose of the contract, good faith and fair and reasonable treatment.

### 3. *N/A / Arbitration / Charrett / Not Unilex / date unavailable*

**Case:**<sup>584</sup> Contractor A and company B entered into an engineering, procure and construct (EPC) contract for an offshore gas platform, onshore and offshore pipelines, and an onshore gas plant in country X, a common-law country. The contractor’s design of the facilities was to be based on the specified composition of the gas expected to be supplied from the wells to be drilled by a third-party

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582 Tribunale of Napoli, Case No 3637/2017.

583 ICC, Case No11295, Award, December 2001.

584 Case illustration based on writer’s experience of circumstances where the UNIDROIT Principles could be applied as the governing law of the contract.

contractor, C in gas field Z. The contract provided detailed performance requirements to be met by the completed facilities, with substantial penalties for non-conformance. The governing law of the contract was that of country X.

The contract provided for contractor A to provide access on the offshore platform to contractor C to drill the wells, prior to commissioning of the offshore and onshore gas processing equipment. After contractor C had completed drilling of the wells, an analysis of the well fluids indicated that they contained a contaminant not foreseen or provided for in the contract. The presence of this contaminant required redesign of the facilities, and provision of additional equipment before the well fluids could be introduced into the already installed equipment for commissioning. At the time that this issue arose, contractor A was in serious delay, and there were a number of disputes between the parties in respect of the quality of installed equipment.

Contractor A issued a notice of delay to B as a consequence of the contaminated wells fluids and requested B to issue a variation for the additional design, procurement and installation of the new decontamination equipment. Instead of issuing a variation to A, B terminated the contract with A and engaged another contractor to install the decontamination equipment and commission the facilities designed and installed by A.

A instigated arbitration, claiming that B had wrongfully terminated the contract, and that B was required to issue a variation for the decontamination equipment so that A could complete the contract. B denied that it had wrongfully terminated the contract, or that it had any obligation to issue a variation to A to install the decontamination equipment.

In respect of the variation for the decontamination equipment, the arbitrator noted that, although there were detailed provisions in the contract for the issuing and pricing of variations, there was no contractual provision that determined whether or not B was obliged to issue a variation to A. While the common law provisions in country X provided criteria for the implication of terms in a contract, those provisions did not address whether or not, in the circumstances, a term should be implied that B was obliged to issue a variation for A to install the decontamination equipment.

The arbitrator referred to the UNIDROIT Principles, embodying widely accepted principles of contract law, to supplement the provisions of the common law of country X. She referred to Article 4.8 as providing support for supplying an omitted term that B was obliged to issue a variation to A for the decontamination equipment. She referred to the intention of the parties being that A was to provide a 'turnkey' gas processing plant that could be operated by B, and that the nature and purpose of the contract was for A to provide all of the design, procurement, construction, commissioning and defect rectification as required to process the well fluids from offshore gas field Z into saleable products as specified in the contract. The arbitrator also noted that, in the circumstances, good faith and fair dealing required that A be permitted to complete the contract in accordance with its terms. Furthermore, implication of a term that B was to issue a variation for the decontamination equipment was a reasonable course of action, as the time and cost consequences of issuing a variation was specifically regulated by provisions of the contract.

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# Chapter 5: Content, third-party rights and conditions

## I. Article 5.1.3: Cooperation between the parties

### 1. *Colombia / National Court / Charrett / Unilex / 2000*

**Case:**<sup>585</sup> This arbitration proceeding involved an energy contract for the sale of electricity between the claimant company A, and the respondent company B. The contract was never performed. Company A sued company B for breach of contract. Company A alleged that company B had breached the contract through their failure to perform. Company B countered that the contract was never registered with the public registry, rendering it null and void.

The contract's choice of law clause stated that the contract would be adjudicated under the laws of Country X, a civil law country. The arbitral tribunal applied both the law of Country X and the provisions of the contract. In deciding the case on its merits, the arbitral tribunal applied the relevant provisions of the Country X's Commercial Code and both the black letter rules and comments of the UNIDROIT Principles.

The tribunal rejected company B's line of reasoning and ruled in favour of company A. The tribunal considered the registration of the contract a joint effort by the parties. The requirement of cooperation between the parties to register the contract can be found in both article ZZ of the Commercial Code of country X and also in Articles 5.1.3 and 5.1.8 of the UNIDROIT Principles. Specific actions were required from company B to register the contract with the public registry. Company B did not perform these actions. Company A had a reasonable expectation that company B would perform such actions and failure to do so is a breach of contract. The tribunal found that the invalidity of the contract from the lack of registration due to the respondent's failure to perform their specified duties could not be brought as a defence.

## II. Article 5.1.4: Duty to achieve a specific result

### 1. *ICSID / Arbitration / Silva Romero / Unilex 1533 / 2010*

**Case:**<sup>586</sup> An American investor (the claimant) invested in a radio broadcasting business in Ukraine in 1995, after the government opened that sector to private participation. Although the claimant's company had obtained some radio frequencies for that business, the claimant alleged that, from 1999 to 2008, the respondent improperly and repeatedly denied its bids for additional frequencies, awarded broadcasting licences to other companies, and thereby thwarted its plans of developing several nationwide radio networks. It argued that the above actions and omissions notably breached a prior settlement agreement between the parties. The respondent asserted that the state committee responsible for the tender processes had justifiably awarded frequencies to other applicants.

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<sup>585</sup> ICC, Case No 10346, Award, December 2000.

<sup>586</sup> *Joseph Charles Lemire v Ukraine*, ICSID Case No ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010.

It explained that the claimant lacked the necessary resources and capabilities to prevail in its applications, and that other bidders were more qualified.

Regarding the law applicable to the settlement agreement, the arbitral tribunal noted that the clauses on interpretation and implementation reproduced the UNIDROIT Principles. It held that given the parties' implied negative choice of any municipal system, the most appropriate decision was to submit the settlement agreement to the rules of international law, and within these, to have regard to the UNIDROIT Principles. On this basis, it held that the respondent's obligation to grant frequencies by a certain date was a duty of best efforts – and not to achieve a specific result – pursuant to Article 5.1.4 of the UNIDROIT Principles. Accordingly, the arbitral tribunal found that the claimant had failed to prove that the respondent had not made such efforts as would be made by a reasonable government in the same circumstances.

## 2. *The Netherlands / Arbitration / Silva Romero / Unilex 1661 / 2006*

**Case:**<sup>587</sup> The parties had entered into a sales contract in respect of certain goods to be delivered to a Spanish port. Payment was to be made by an irrevocable letter of credit to be opened by the respondent on a certain date and payable 90 days from the date mentioned on the bill of lading. The contract provided for arbitration in the Netherlands. Two conflicting bills of lading were issued for the same shipment, a clean bill and a bill mentioning defects as per an independent surveyor's report. In view of this discrepancy, delivery of the goods was not completed. Several domestic court actions ensued, following which the parties signed a settlement agreement, whereby the contract was terminated and compensation agreed. The claimant started an arbitration and claimed, inter alia, that the respondent had violated its duty to achieve a specific result under the contract, that is, to take the goods physically, in breach of Article 5.1.4 of the UNIDROIT Principles.

The arbitral tribunal dismissed the claimant's argument under Article 5.1.4 of the UNIDROIT Principles, noting that the respondent could not take delivery of the goods, because their ownership had been transferred to the 'end buyer' on the termination of the contract, and in any event taking delivery was physically impossible since the master of the vessel had ordered the closing of the hatches.

## 3. *France / Arbitration / Silva Romero / Unilex 1662 / 2006*

**Case:**<sup>588</sup> A joint venture and a state entered into a production sharing agreement (PSA) to explore and develop the geological resources of a specific area. It was concluded for 20 years, included an option for a five-year extension by mutual agreement of the parties, and provided for arbitration in Paris. A subsequent written agreement providing for the contract's extension was prepared. Following the respondent's assurances that the extension had been granted, the claimant commenced a new exploration programme. The respondent's parliament, however, refused to ratify the extension, and the claimant was evicted from the area. The claimant started an arbitration, arguing that the PSA had been validly extended, and sought damages for breach of said extension. The claimant further

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587 ICC, Case No 13009, Final Award, 2006.

588 ICC, Case No 14108, Final Award, 2006.

argued that the respondent was estopped from denying that the contract had been extended because of its failure to use its best efforts to have said extension ratified.

The arbitral tribunal held that the PSA had not been renewed and accordingly denied the claim for damages, noting that the PSA did not in itself provide for an extension, but merely allowed the parties to agree on an extension in a subsequent contract. The extension agreement provided that it would be binding upon exhaustion of the respondent's constitutional procedures, which was not the case here, as it had not been ratified by parliament. The arbitral tribunal found that the claimant's argument relating to the duty of best efforts was based on the concept of estoppel, which was generally applicable here as part of the principle of good faith. As the respondent's law was silent on the content of the duty of good faith, it referred to the UNIDROIT Principles. On this basis, the arbitral tribunal held that the argument that the respondent did not use its best efforts to have the extension ratified was factually wrong. The respondent did submit the extension agreement to parliament, and even wrongly stated that the extension was already binding to encourage parliament to ratify the agreement. It was found that the respondent had used its best efforts to obtain the ratification. This being said, the arbitral tribunal ultimately found that the respondent had breached its duty to act in good faith under Articles 1.8 and 5.1.4 of the UNIDROIT Principles and the claimant was compensated for the costs of the exploration programme.

### III. Article 5.1.5: Determination of kind of duty involved

#### 1. *Australia / Arbitration / Charrett / Not Unilex / 1968*

**Case:**<sup>589</sup> Government rail authority A took out a policy of insurance with insurance company B. The policy covered loss or damage arising out of or in connection with a contract for the supply and erection of a railway bridge, and it excluded 'loss or damage arising from faulty design'.

A sustained loss when certain bridge piers collapsed in an unprecedented flood, due to the inadequacy of their design to withstand the forces experienced. The design of the piers complied with the standards expected of designing engineers at the time of their design.

B refused to indemnify A for the loss of the bridge, relying on the faulty design exclusion. A referred this refusal to arbitration, asserting that the designers had fulfilled their duty of best efforts, and that accordingly the design was not faulty. B submitted that the insurance contract would only indemnify A if it achieved the specific result of a design that was not faulty, and that as the bridge piers did not resist the flood forces, the design was faulty even though the designers had fulfilled their duty of best efforts.

The arbitral tribunal expressed the opinion that in modern international practice of many arbitration courts, the UNIDROIT Principles are viewed as the recommended source of rules governing general issues of performance and interpretation of contracts of an international character. The arbitral tribunal referred to Article 5.1.5(a) and noted that that the exclusion against loss from 'faulty design', was more comprehensive than 'negligent design', a term frequently used in contract works insurance contracts. It should therefore be construed as referring to loss from a design which did achieve the specific result of not being defective, even though the designers had not breached their duty of best efforts in preparing the design.

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<sup>589</sup> Case illustration based on the facts in *Manufacturers Mutual Insurance Ltd v The Queensland Government Railways* (1968), 118 CLR 314, and cases where an arbitral tribunal has referred to the UNIDROIT Principles as guidance on the law to be applied to international contracts.

## IV. Article 5.1.8: Termination of a contract for an indefinite period

### 1. *Colombia / National Court / Charrett / Unilex 700 / 2000*

**Case:**<sup>590</sup> This arbitration proceeding involved an energy contract for the sale of electricity between the claimant company A, and the respondent company B. The contract was never performed. Company A sued company B for breach of contract. Company A alleged that company B had breached the contract through their failure to perform. Company B countered that the contract was never registered with the public registry rendering it null and void.

The contract's choice of law clause stated that the contract would be adjudicated under the laws of country X, a civil law country. The arbitral tribunal applied both the law of country X and the provisions of the contract. In deciding the case on its merits, the arbitral tribunal applied the relevant provisions of the country X's Commercial Code and both the black letter rules and comments of the UNIDROIT Principles.

The tribunal rejected company B's line of reasoning and ruled in favour of company A. The tribunal considered the registration of the contract a joint effort by the parties. The requirement of cooperation between the parties to register the contract can be found in both Article ZZ of the Commercial Code of country X and also in Articles 5.1.3 and 5.1.8 of the UNIDROIT Principles. Specific actions were required from company B to register the contract with the public registry. Company B did not perform these actions. Company A had a reasonable expectation that company B would perform such actions and failure to do so is a breach of contract. The tribunal found that the invalidity of the contract from the lack of registration due to the respondent's failure to perform their specified duties could not be brought as a defence.

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<sup>590</sup> ICC, Case No 10346, Award, December 2000.

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# Chapter 6: Performance

## I. Article 6.1.1: Time of performance

### 1. *N/A / Arbitration / Charrett / Not Unilex / date unavailable*

**Experience of author:**<sup>591</sup> A construction contract for a power station provides for the following time for completion: ‘The contractor shall complete the whole of the works within the time for completion for the works’. The contract data specifies a time for completion of two years from the date that the contractor is provided with full access to the site. After the contractor has completed the whole of the works in accordance with the contract and handed the site over to the employer, the employer is responsible for the works.

Pursuant to Article 6.1.1 of the UNIDROIT Principles, if the contractor completes the works in accordance with the requirements of the contract at the end of one year, they may hand the site over to the employer, notwithstanding that the contract for the transmission lines to distribute the generated power will not be completed for another year. The employer would incur additional expenses for insurance and maintenance for the second year, even though it would not derive any commercial benefit from the power station.

## II. Article 6.1.3: Partial performance

### 1. *N/A / Arbitration / Charret / Not Unilex / date unavailable*

**Experience of author:**<sup>592</sup> Contractor A enters into a contract with company B to construct 100 houses by a certain date, with liquidated damages payable for every day that the houses have not been handed over to company B.

On the specified date for completion, the contractor has completed 98 houses, and offers to hand these over to B, with the remaining two houses to be completed within a month. Completion of the two incomplete houses will not affect B’s ability to market and sell the completed 98 houses. B has no legitimate interest in refusing to accept the 98 completed houses, and pursuant to Article 6.1.3(1) must do so.

**Variation:** The facts are the same, except that the two incomplete houses are in a very prominent position, affecting the ambience of and access to the 98 completed houses. In this situation B has a legitimate interest in refusing to accept the 98 completed houses pursuant to Article 6.1.3(1).

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591 Case illustration based on writer’s experience of circumstances where the UNIDROIT Principles could be applied as the governing law of the contract.

592 Case illustration based on writer’s experience of circumstances where the UNIDROIT Principles would provide an appropriate contractual outcome to specific factual circumstances.

### III. Article 6.1.4: Order of performance

#### 1. *Australia / National Court / Koh / Unilex 845 / 2003*

**Case:**<sup>593</sup> The government of a country and two companies, company A and company B, entered into contracts for software development and systems integration. The contract between the government and company A was the head contract, while the contract between company A and company B was the subcontract.

The dispute arose when company B served a notice of termination of the subcontract on company A on the grounds of company A's alleged failures to comply with its contractual obligations. These included company A's alleged failure to deliver specific devices in order for company B to develop the software, and also company A's failure to pay company B as required under the subcontract. Company A argued first that the terms of the contract had been changed and, second, that company B was not entitled to be paid under the subcontract as it failed to meet the requirements of payment under the subcontract.

As to company A's arguments that the contract had been amended, the court referred to article 2.1.18 of the UNIDROIT Principles, which states that a party may be precluded by its conduct from invoking such a clause to the extent that the other party has acted in reliance on that conduct. In this case, the discussion evolved around a 'no oral modification' clause and whether a party could be estopped from invoking such a clause in a case where it has already acted upon an oral modification of the contract. The tribunal found that the contract had indeed been amended and that company B could not invoke the 'no oral modification' clause, since it had already acted in accordance with the oral modification of the contract.

Company A argued that company B was in breach of its duty to act honestly and in good faith due to its termination of the contract. In this respect, company B argued that due to the 'entire agreement clause', these concepts were not part of the contract. An 'entire agreement clause' is used to indicate that the contract constitutes the whole agreement between the parties, thereby preventing a party from relying on previous agreements and negotiations that are not included in the agreement. Company B argued that a duty of good faith could not be implied in the contract in case an 'entire agreement clause' was involved. The court found that an entire agreement clause could not exclude good faith from a contract and that good faith and fair dealing are to be considered implied terms of all contracts, and the court referred to Article 1.7 of the UNIDROIT Principles in its reasoning.

### IV. Article 6.1.8: Payment by transfer of funds

#### 1. *Russia / Arbitration / Petrachkov, Bekker / Not Unilex / 2013*

**Case:**<sup>594</sup> A claimant, a Cypriot company, filed a lawsuit with the International Commercial Arbitration Court of the Russian Federation Chamber of Commerce and Industry (ICAC) against a defendant, an Austrian company, for collection of purchase price for shares in accordance with the terms of the

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593 *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd*, FCA 50, 2003.

594 ICAC, Case No 218/2012, Award, 1 July 2013.

share purchase agreement (SPA). The SPA for shares provided that Russian law was the law governing the contract.

The court's reasoning is explained below.

The ICC received a statement of claim of the Cyprus Company (the claimant) against the Austrian company (the defendant) for recovery of the debt.

As it follows from the statement of claim and the documents attached thereto, on 14 June 2012 the claimant and the defendant entered into a contract for the sale of shares in the limited liability company (the Contract), according to which the claimant (seller) was obliged to transfer the shares in the limited liability company, registered in the territory of the Russian Federation, with the nominal value of X rubles, which represented 18.96 per cent of the share capital of the limited liability company (the share).

In the statement of claim, the claimant submitted that the ICAC had the competence to hear the dispute, the legislation of the Russian Federation was the applicable law and nominated the arbitrators.

The ICAC stated that in the civil legislation of the Russian Federation there were no direct indications as to when the monetary obligation should be deemed to have been performed when the payments were made by payment orders – on the date when the funds were wrote off from the debtor's account or on the date when the funds were debited to the creditor's account. State *arbitrazh* courts proceeded from rule that creditor's bank should be deemed as a proper place of performance of the monetary obligation, the date of performance of monetary obligation was the date when the funds were debited to the creditor's account, and not the date when the funds were wrote off from the debtor's account (Resolution of the Seventeenth Arbitrazh Appeal Court as of 18.10.2012 N PAP-10585/2012-GK in case N A50-7303 / 2012).

Considering that payments between the parties were made through two foreign banks, the ICAC concluded that it is possible to apply the UNIDROIT Principles (1994), a document of unification of private law, which in the practice of majority of international arbitration centres, including the ICAC, is considered as a recommended document, regulating general issues of the performance of international contractual obligations.

According to paragraph 2 of Article 6.1.8 of the UNIDROIT Principles, in case of payment by a transfer the obligation of the obligor is discharged when the transfer to the obligee's financial institution becomes effective. Thus, the monetary obligation to pay the purchase price for a share should be considered as performed by the defendant 3 September 2012, when the funds were debited to the claimant's bank account. The defendant himself adhered to the same position, the defendant's representative at the arbitration hearing admitted that they had been in arrears in paying the first price for three days.

## V. Article 6.1.9: Currency of payment

### 1. *Ukraine / National Court / Charrett / Unilex 1706 / 2010*

**Case:**<sup>595</sup> Respondent, the government of country X, issued a guarantee for a loan granted by a foreign bank to claimant, a company situated in country X. The dispute arose when the claimant failed to repay the loan and the respondent consequently became liable for repayment of the loan. After the respondent paid the foreign bank, it claimed repayment from the claimant at an increased amount. The increase was due to changes in the exchange rates between the currencies of country X and the country of the foreign bank.

The claimant initiated a suit over this increased amount, asking the court to invalidate the respondent's request. The court held that the respondent was permitted to claim payment at the increased exchange rate. In its decision, the court referred to Article 6.1.9 of the UNIDROIT Principles, which states that, to the extent the debtor of a loan does not repay the loan when payment is due, the creditor 'may require payment according to the applicable exchange rate prevailing either when payment is due or at the time of the actual payment'. In this case, therefore, the increased amount requested by the respondent was appropriate, as actual disbursement of the loan payment had been made at the increased exchange rate.

## VI. Article 6.1.11: Cost of performance

### 1. *United Kingdom / National Court / Charrett / Not Unilex / Several Dates*

**Case/experience of author with several cases:**<sup>596</sup> In a line of cases arising from a seminal case from 1876, the courts have increasingly made reference to Article 6.1.11 of the UNIDROIT Principles.

In the original 1876 case, contractor A contracted with B to take down an old bridge and build a new one. B provided plans and a specification to A, prepared by B's engineer. A was required to obey the directions of B's engineer. The descriptions given in the plans and specification were stated as 'believed to be correct', but were not guaranteed. Part of the plan showed the use of caissons. These turned out to be of no value, and the work done in attempting to use them was wasted, and the bridge had to be built in a different manner. Considerable labour and time were expended in attempting to use the caissons. A issued court proceedings, seeking compensation for its loss of time and labour occasioned by the failure of the caissons, and alleged that B had warranted that the bridge could be built inexpensively according to the plans and specification. There was no express warranty to that effect in the contract.

The court held that no warranty could be implied that the bridge could be built according to the engineer's plans and specifications. A had contracted to build the bridge, and had to bear the cost of performing its obligations, even though these were more onerous than expected because the use of caissons was not feasible.

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<sup>595</sup> *Dnipropetrovsk company Dnepryanka v Inter-state Tax Administration of Dnipropetrovsk city and Department*, Dnipropetrovsk Regional Administrative Court of Ukraine, Judgment, 21 June 2010.

<sup>596</sup> Facts are based on *Thorn v Mayor and Commonality of London* (1876) 1 App Cas 120.

More recent decisions of courts applying this precedent have made their decisions in accordance with the governing English law but have also made reference to the principles in Article 6.1.11 of the UNIDROIT Principles as support for the widely-accepted principle that each party shall bear the costs of performance of its obligations.

## VII. Article 6.1.14: Application for public permission

### 1. *Ukraine / National Court / Charrett / Unilex 1700 / 2010*

**Case:**<sup>597</sup> Company A, located in country X, and company B, located in country Y, entered into a contract for the supply of 14,000 tonnes of corn for industrial processing. At a later point, company B sent company A, the supplier, a letter request to halt its export of corn, as a government authority in country Y had not issued the requisite import quarantine permit. Company B then followed with a notice seeking termination of the contract, citing non-receipt of this import permit.

Company A refused to terminate the contract and instead initiated a suit for damages, including penalties, for breach of contract by company B. Although the contract specified the law of country X as governing law, the UNIDROIT Principles were applicable in practicality, as the High Court of country X had previously issued an explanatory note incorporating the UNIDROIT Principles as trade customs within the country.

The court ruled in favour of company A, finding that company B had indeed breached the contract. The court reasoned that company B should have been aware that the amount of corn it had contracted for was beyond its permitted import amount and that the government authority was unlikely to grant it a second permit for an excess quantity. In knowingly entering into a contract for an excess quantity, company B had contributed, by its own actions, to the authority's subsequent refusal to grant a new permit. In reaching its decision, the court cited Articles 6.1.14 and 6.1.15 of the UNIDROIT Principles, as supplements to domestic law.

## VIII. Article 6.1.15: Procedure in applying for permission

### 1. *Unknown / Arbitration / Charrett / Unilex 863 / 2002*

**Case:**<sup>598</sup> Party A (two individuals from country X) and party B (a company from country Y) entered into a contract under which party A was required to provide party B with certain information pertaining to the production and marketing of its products.

Party B later alleged that party A had breached the contract by failing to obtain certain specific results in its product sales. Party B subsequently terminated the contract and instituted an arbitration proceeding in country Z in accordance with the European Convention on Commercial Arbitration (1961), pursuant to the contract's dispute resolution clause. Parties A and B agreed to application of the UNIDROIT Principles as governing law, as the contract did not contain a clear mention of

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<sup>597</sup> *Arcada PP v Hobotovske enterprise Krahmaloproduct*, High Commercial Court of Ukraine, Case No 42/90-10, Decision, 30 November 2010.

<sup>598</sup> Arbitration Court of the Lausanne Chamber of Commerce and Industry, Award, 25 January 2002.

choice of law. In its decision to apply the UNIDROIT Principles, the arbitration tribunal noted that none of countries X, Y or Z had a mandatory law forbidding application of such principles. The tribunal additionally noted that the UNIDROIT Principles were more appropriate than any domestic law, since the contract at hand involved both the manufacture and marketing of new products in approximately a dozen countries and the principles are applicable to contracts for services, as well as for sale of goods.

The tribunal held that party A did not have an obligation to obtain any explicit results, merely to communicate its experiences in manufacturing and marketing the products. In so doing, the tribunal relied on Article 5.1.4(2) of the UNIDROIT Principles.

The tribunal noted that party B had failed to request the official authorisation necessary for marketing of the product and, subsequently, had failed to inform party A of its inaction, thereby breaching Article 6.1.15(2) of the UNIDROIT Principles. The tribunal further held that both parties, but particularly party B, had to exercise good faith in performing the contract pursuant to Article 1.7 of the UNIDROIT Principles. Since party B had not acted in good faith by breaching the contract itself, the tribunal determined that, per Article 1.7.2, party B was barred from invoking allegedly unsatisfactory performance on the part of party A.

## 2. *Unknown / Arbitration / Charrett / Unilex 1660 / date unavailable*

**Case:**<sup>599</sup> Party A, a company from country X, and party B, a state agency from country Y, entered into a JVA for the cultivation of agricultural products. A disagreement arose when party A subsequently alleged that party B had transferred the land which had been granted to party A under the contract to an international organisation for the purpose of accommodating refugees from a neighbouring country. Party A initiated an arbitration proceeding seeking damages for breach of contract.

The tribunal held the laws of country Y to be applicable to the substance of the dispute. In deciding the case on its merits, the tribunal noted that party B had indeed failed to provide party A with the land and other facilities as stipulated in the joint venture agreement. The tribunal held that party B could not claim a defence of force majeure for failure to perform its obligations, as party B was aware that the social climate of country Y could make its performance under the contract infeasible. In the opinion of the tribunal, party B, as a national public partner, bore the responsibility of ensuring that the necessary verifications, including an assessment of the social climate, had been made such that performance would be possible at the promised time. As the tribunal noted, any national public partner failing to perform such duty ‘must bear all consequences towards its foreign contractual partner’. The tribunal cited Articles 6.1.14–6.1.17 of the UNIDROIT Principles in support of its decision.

The tribunal also referred to Article 6.1.15(1) of the UNIDROIT Principles in holding that the contract could not be performed due to party B’s default, which resulted from party B’s failure to obtain permission. Party B was therefore liable for breach under Article 7 of the UNIDROIT Principles.

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<sup>599</sup> ICC, Case No 12112, Award, Undated.

## IX. Article 6.1.17: Permission refused

### 1. *Unknown / Arbitration / Charrett / Unilex 1660 / date unavailable*

**Case:**<sup>600</sup> Party A, a company from country X, and party B, a state agency from country Y, entered into a JVA for the cultivation of agricultural products. A disagreement arose when party A subsequently alleged that party B had transferred the land which had been granted to party A under the contract to an international organisation for the purpose of accommodating refugees from a neighbouring country. Party A initiated an arbitration proceeding seeking damages for breach of contract.

The tribunal held the laws of country Y to be applicable to the substance of the dispute. In deciding the case on its merits, the tribunal noted that party B had indeed failed to provide party A with the land and other facilities as stipulated in the joint venture agreement. The tribunal held that party B could not claim a defence of force majeure for failure to perform its obligations, as party B was aware that the social climate of country Y could make its performance under the contract infeasible. In the opinion of the tribunal, party B, as a national public partner, bore the responsibility of ensuring that the necessary verifications, including an assessment of the social climate, had been made such that performance would be possible at the promised time. As the tribunal noted, any national public partner failing to perform such duty ‘must bear all consequences towards its foreign contractual partner’. The tribunal cited Articles 6.1.14–6.1.17 of the UNIDROIT Principles in support of its decision.

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## X. Article 6.2.1: Contract to be observed

### 1. *Spain / National Court / Meijer / Unilex 1694 / 2013*

**Case:**<sup>601</sup> Party A, an advertising company in country X, and party B, a first-division football club also in country X, entered into a marketing agreement. Party A later brought a civil claim against party B seeking renegotiation of the terms of the agreement. Party A argued that, due to substantial change in the economic climate of country X, the contract had become more onerous. Party A also argued that a number of key terms had been altered over the course of the relationship and, therefore, party B should pay a higher price to account for these changes.

The court ruled that party A’s request for modification could not be granted. In its reasoning, the court noted that, under the law of country X, the doctrine of *rebus sic stantibus* (hardship), the argument upon which party A relied, is permitted only in exceptional circumstances where the equilibrium of the contract has been altered. The court held that party A had failed to prove either that a shift in equilibrium had occurred or that exceptional circumstances had caused the alleged alteration. As the court noted, simply because one party is at a disadvantage is not sufficient reason

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600 ICC, Case No 12112, Award, Undated.

601 *Grupo Santa Monica Sports v Real Club Deportivo de la Coruña*, Audiencia Provincial de A Coruña, February 2013.

for that party to no longer have to comply with the terms of the contract. In support of its decision, the court cited Articles 6.2.1 and 6.2.2 of the UNIDROIT Principles, among others.

## 2. *Colombia / National Court / Polkinghorne / Unilex 1709 / 2012*

**Case:**<sup>602</sup> Citizen A had entered into a loan agreement with bank B for buying a house. During the 1998 crisis in the country, the loans for buying houses became significantly more expensive and the contract between A and B more onerous. In view of this change in circumstances, A invoked hardship to revise the contract. The lower courts rejected A's claim on the basis that A did not bring the necessary evidence to demonstrate that the events in question caused an alteration of the contract's equilibrium. The Supreme Court later upheld the lower courts' decisions, deciding that the plaintiffs did not bring sufficient evidence that the contract had become excessively onerous. The Supreme Court further recalled that the government had implemented measures with a view to mitigate the economic effects of the crisis on existing contracts.

## 3. *United Kingdom / National Court / Cowan / Not Unilex / 2010*

**Case:**<sup>603</sup> Company A contracted with company B for the sale and delivery of a new executive jet aircraft. After A had procured the aircraft from the manufacturer, B failed or refused to take delivery of the aircraft or to pay the balance of the purchase price. A exercised its contractual right to terminate the contract due to B's breach and claimed financial compensation from B. B defended by reference to the 'unanticipated, unforeseeable and cataclysmic downward spiral of the world's financial markets' and claimed that this triggered the force majeure provision in the contract.

The court determined that it is well established under English law that a change in economic/market circumstances, affecting the profitability of a contract or the ease with which the parties' obligations can be performed, is not regarded as being a force majeure event. The court cited with approval previous case law which had held that: 'It does not at all follow that the supplier is entitled to rely upon an increase in the market price in comparison to the contract price as a force majeure circumstance. ...This conclusion is consistent with a line of cases, both on force majeure clauses and on frustration, ...to the effect that the fact that a contract has become expensive to perform, even dramatically more expensive, is not a ground to relieve a party on the grounds of force majeure or frustration.'

As force majeure does not exist in English law as an independent substantive doctrine (cf the English law doctrine of frustration), its application depends on the parties introducing it by express contractual provision. As such, the scope of force majeure is not a term of art but instead depends on the terms of the contract and the application of ordinary principles of contractual interpretation. In this case, the wording of the force majeure referred to various events, such as acts of God, wars, government action and fire. There was also a wider category in respect of 'other causes', but these were limited to other causes beyond A's reasonable control. The court held that B was not entitled to rely on this clause for such 'other causes' and, in any case, interpreting this *ejusdem generis* with

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602 *Rafael Alberto Martínez Luna y María Mercedes Bernal Cancino v Granbanco SA*, Supreme Court of Columbia, Judgment, 21 February 2012.

603 *Tandrin Aviation v Aero Toy Store* (2010) EWHC 40.

the earlier examples, there was nothing that suggested that this should include circumstances of economic downturn, market circumstances or the financing of the deal.

Reflecting the contrary stance of English law following a significant line of prior case law from the English courts, the court did not cite to the UNIDROIT Principles, such as Article 6.2 or Article 7.1.7.

#### 4. *Ukraine / National Court / Charrett / Unilex 1703 / 2009*

**Case:**<sup>604</sup> Party A, an insurance company in country X, and party B, a bank in country X, entered into an insurance contract for the bank's loan portfolio. Party A later terminated the contract on the grounds that party B had breached the agreement and that there had been a substantial change in circumstances due to an ongoing global economic crisis. Party A argued that it was as a result of this crisis that a number of party B's clients had become insolvent. Party B then, instead of attempting to collect against those clients, had merely relied upon insurance payouts from party A.

The court held that party A could not rely on the economic crisis as a basis for proving the substantial change of circumstances necessary for termination of the contract. In support of its decision, the court referred to Article 6.2.1 of the UNIDROIT Principles, which states that a party to a contract is obligated to perform its duties even when performance under the contract has become more burdensome for that party.

#### 5. *Brazil / National Court / Charrett / Unilex 1530 / 2009*

**Case:**<sup>605</sup> In May 2006, A and B, both energy traders in Country X, entered into a long-term agreement. It was agreed that A would supply B an average of 22 megawatts of electric energy on a monthly basis from 1 January 2007 until 31 December 2011 for an agreed-upon price, which was to be decided annually. A suspended the delivery of power in January 2008 and commenced arbitration proceedings against B.

A argued for termination of the contract on the grounds of hardship and claimed damages for exposure to the 'spot price' imposed by country X's Chamber of Trade on Electric Energy (CTEE) for short-term energy transactions. Based on energy market regulations in country X, delivery of power is made directly to the seller in the national integrated system. The buyer, however, could withdraw the energy at any other point of the system. A 'liquidation price' or 'spot price' established by the CTEE reflects any difference in the amount supplied or withdrawn from the system. A fine would then be levied on the party who had provided less power than promised.

A argued that the year 2007 had seen a large and unexpected increase in short-term power prices and claimed that, as a result, B had been unjustly enriched by the supply agreement in a manner which amounted to a fundamental modification of the contractual balance between the two parties. A argued that this shift had led to the contract terms being unfairly onerous to it, thus permitting it to terminate the contract for 'excessive onerousness' under Article ZZ of country X's Civil Code.

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604 Kyiv Regional Commercial Court, Case No 17/059/060/061-09, Judgment, 17 October 2009.

605 Câmara FGV de Conciliação e Arbitragem, São Paulo, Judgment, February 2009.

The arbitral tribunal rejected A's claim. The tribunal noted that, given the constantly shifting nature of the positions held by energy market participants, it can be expected that such participants harmonise their positions so as to assure both compliance with their contractual undertakings and maximisation of their results, and that any deviations from this position are the result of risk-taking on the part of parties in a marketplace corresponding with ordinary contractual risk. The tribunal reasoned that, as the code's fundamental principles were legal certainty and binding character of contract, and there had been no disruption in the economic environment of country X, the contract could not be terminated on the basis of Article ZZ of the Civil Code. The tribunal held that, not only had there not been an 'excessively onerous' change in circumstances, but also that any change had not been to the extreme advantage of B, as required cumulatively by law.

The tribunal made reference to Article 6.2.1 of the UNIDROIT Principles, which states that the fact that the performance of a contract becomes more onerous for one party does not necessarily constitute a 'hardship'.

#### 6. *Switzerland / Arbitration / Voser, Ninković/ Unilex 630 / 1996*

**Case:**<sup>606</sup> Company A from country X entered into a contract with Company B from country Y by means of an order confirmation for the sale of a plant for manufacturing a certain product for the market of country Y. Due to financial difficulties caused by a sudden fall in the price of the product on the market of country Y, company B made an advance payment in the amount of only three per cent of the contractual price and did not open the letter of credit within the agreed time limit, which was a condition for the delivery of the equipment by company A. Nonetheless, company A offered to deliver half of the equipment and following company B's acceptance of the offer, issued an invoice in the amount of 50 per cent of the contractual price. However, company B was not ready to pay the amount as invoiced and offered to pay approximately 60 per cent of the invoiced amount. Company A did not accept this and reserved its rights under the original contract concerning the full delivery. Company A initiated arbitration proceedings against company B and claimed damages. In addition to the compensation for the part of the equipment which it could not sell to other buyers because they have been made according to the special requirements of company B, company A requested payment of interest and legal fees. Company B argued that it was discharged from payment because of the sudden fall in the price of the relevant product on the market of country Y, which amounted to hardship, and counterclaimed its advance payment to company A.

The general conditions to the contract provided for the application of Dutch law and the arbitral institution chose Zurich (Switzerland) as the seat of the arbitration. The arbitral tribunal granted the claim for damages of company A, denied in part its claim for interest and denied the counterclaim of company B. In particular, the arbitral tribunal found that the circumstances raised by company B fell within the economic risk to be borne by company B and did not constitute unforeseen circumstances in the sense of the hardship provision; thus, the requirement for discharge from payment was not met. In reaching its decision, the arbitral tribunal held that the relevant mandatory provisions of Dutch law must be applied with utmost restraint. It stated that 'Dutch common opinion of law' is 'replaced by the common opinion in international contract law when the provision is applied in

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606 ICC, Case No 8486, Final Award, 1996.

an international context’, both of which are ‘influenced in a decisive manner by the principle of contractual good faith (*pacta sunt servanda*) expressed in Article 1.3 of the UNIDROIT Principles.’<sup>607</sup> According to the arbitral tribunal, ‘this common opinion of law must also be taken into account for the application of national law to international relationships’.<sup>608</sup>

The arbitral tribunal held that ‘the termination of a contract for unforeseen circumstances (hardship, *clausula rebus sic stantibus*) should be allowed only in truly exceptional cases’ and that, in international commerce, ‘one must rather assume in principle that the parties take the risks of performing under and carrying out the contract upon themselves, unless a different allocation of risk is expressly provided for in the contract’.<sup>609</sup> In that context, while not directly applying the provision, the arbitral tribunal referred to Article 6.2.1 of the UNIDROIT Principles, which expressly provides that the mere fact that the performance of the contract entails a higher economic burden for one of the parties does not suffice to assume that there is hardship.

## **XI. Article 6.2.2: Definition of hardship**

### **1. France / National Court / Polkinghorne / Not Unilex / 2018**

**Case:**<sup>610</sup> State entity A had entered into a loan agreement with bank B, in order to finance landscaping projects on a lake. State entity A then entered into a swap agreement with bank C, whereby the loan’s interest rate in currency from country X would be exchanged with the interest rate in currency from country Y. Following a twofold increase of the interest rate of currency from country Y, state entity A refused to pay the remaining of the cancellation balance and argued that the cancellation balance should be revised in the light of the unpredictable events which caused the increase in country Y’s interest rate.

The lower court rejected state entity A’s claims that bank C had failed in its obligation to advise A on the risks, and to renegotiate the cancellation balance. According to the lower court, the disclaimers in the swap agreement excluded any advisory duty on the part of bank C. The judge also found that state entity A was not entitled to claim that bank C had failed to give proper advice and inform on the risks, as A had a long experience of this type of financing transactions, what is more acting of part of public interest. The appeal judge upheld the lower court’s judgment, finding that state entity A could not rely on changed circumstance as the new Article 1195 of the French Civil Code provided that the disadvantaged party could not invoke hardship when it was the one bearing the risk. The appeal judge further found that the swap agreement should be characterised as an ‘aleatory contract’ (*contrat aléatoire*), which is a category of contracts under French law whose outcome depends on the unpredictable occurrence of an event. In such a contract, each party bears its part of the risk, and the appeal judge thus concluded that state entity A could not rely on hardship to claim that the cancellation balance should be reduced. There is no express reference to the UNIDROIT Principles in this case, but it is clear that Article 1195 of the French Civil Code mirrors the provisions of Article 6.2.2 on risk allocation.

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607 Albert Jan van den Berg, *Yearbook Commercial Arbitration Volume XXIVa* (Kluwer 1999) 24, 166 et seq.

608 *Ibid* at 167.

609 *Ibid*.

610 Paris Court of Appeal, Case No 16/08968, 16 February 2018.

## 2. *France / National Court / Polkinghorne / Not Unilex / 2017*

**Case:**<sup>611</sup> Company A acted as the subcontractor of company B for the installation of windows in the context of the construction of a new building for archives in country X. Company B refused to pay for one of the invoices sent out by company A, claiming that the work done for this invoice had not been contractually agreed upon by the parties. Company A therefore started litigation against company B, requesting for payment of the amount left unpaid. The lower court judge found that company B failed to define the services under the contract precisely, and that it should pay for all of the work performed by company A. Company B filed an appeal of this decision, claiming that the lower court judge had made an erroneous application of hardship in considering that the additional work performed by A had affected the equilibrium of the contract, creating an unforeseeable debt that should be paid by B. The appeal judge quashed the lower court's decision, finding that there was no alteration of the equilibrium, as the agreed price remained unchanged and company A had in any case the responsibility to evaluate precisely the amount of work necessary and communicate any change thereof to its contractor. This decision comes before the entry into force of the French contracts law reform admitting hardship. However, this decision illustrates the French judge's acceptance of the theory of changed circumstances (even though not found here) and its use of the notion of fundamental alteration of the equilibrium of the contract.

## 3. *United States / National Court / Popova / Not Unilex / 2017*

**Experience of author:**<sup>612</sup> A and B enter into a settlement agreement, pursuant to which B is to pay agreed sums to members of a class. After B falls behind on payments, B seeks to renegotiate its payment schedule on the grounds of an industry-wide downturn that has affected its revenue stream. B's performance is not excused by economic hardship.

**Case:**<sup>613</sup> The parties concluded a settlement agreement following a class action lawsuit alleging violations of the Fair Labor Standards Act. The settlement agreement required defendant to pay a certain amount to each member of the class within ten days of plaintiffs' counsel filing a notice with the court. The defendant fell behind on its payment schedule and sought to amend the timetable for making payments pursuant to the settlement agreement. The plaintiffs refused to grant this amendment and filed a motion to enforce the settlement order.

The defendant argued that it was financially unable to fulfil its contractual obligation because of low demand from its customers during an industry-wide downturn. The defendant petitioned the court to modify the terms of the settlement agreement to allow it to pay in compliance with the amended agreement.

The court rejected the defendant's argument, holding that economic hardship did not excuse the defendant from fulfilling its contractual obligations or entitle it to a renegotiation or court-mandated revision of those obligations. The court relied on state common law of contractual obligations and did not cite the UNIDROIT Principles.

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611 Lyon Court of Appeal, Case No 15/0798827, June 2017.

612 Case illustration based on writer's experience of circumstances where the UNIDROIT Principles could be applied as the governing law of the contract.

613 *Bergeron v Benton Energy Serv Co*, 15-cv-1006 (WD Pa, 7 February 2017).

#### 4. Canada / National Court / Charrett / Unilex 1968 / 2016

**Case:**<sup>614</sup> A power contract was entered into between A and B, a corporation operating a hydroelectric power station, and a public utility company distributing electricity, respectively. The terms of the contract stated that A would sell B all of the electricity output of its station at a fixed price for a period of 40 years, with an option to renew for another 25 years. The agreed-upon price was calculated based upon a schedule which permitted A to recover costs incurred from the construction of the power station and B, which had assisted A in obtaining financing for the construction, to avoid risk of inflation by virtue of the fixed price model.

Due to various supervening circumstances over a period of years, the market price of hydroelectric energy in the country increased considerably. As a result, A requested a renegotiation of the contract price based on the principle of good faith as stated in certain articles of the Civil Code, in order to adapt the contract price to the changed market price. A argued that a price revision was justified, as it would restore the original equilibrium of the contract and keep B from obtaining an unjust profit. B argued that both parties had been aware that the market price of hydroelectric energy was subject to considerable fluctuations and, after lengthy negotiations, had still decided upon on a fixed price for the entire duration of the contract, agreeing that the amount was a fair allocation of the risks undertaken by both parties.

Both the court of first instance and the Court of Appeal ruled in favour of B, holding that only the conduct of the parties in the course of performance of the contract was within the scope of ‘good faith’ as laid out in the Civil Code. That is to say, the principle could not be invoked to support a revision of the contract terms once they had already been agreed upon. Furthermore, both courts found the *théorie de l'imprévision* (or doctrine of hardship) to be far from generally accepted within the law of the country and, at any rate, could also not be cited in this case, as the conditions required for its application had not been met.

In support of its reasoning, the Court of Appeal referred to Articles 6.2.1, 6.2.2 and 6.2.3 of the UNIDROIT Principles, and noted that the two basic requirements (the fundamental alteration of the equilibrium of the contract and the unpredictability of the event causing hardship) had not been met. The first requirement had not been met because the increase in market price of hydroelectric energy did not result in either an increase in the cost of A’s performance or a decrease of the value of B’s performance, but merely less profit realised by A. The second requirement had not been met because, at the time the contract was finalised, both parties were aware that the price of hydroelectric energy was subject to change over the years; by accepting a fixed price term, A assumed the risk of such fluctuations.

#### 5. France / National Court / Polkinghorne / Not Unilex / 2015

**Case:**<sup>615</sup> Companies A and B entered into a contract whereby company A ensured the maintenance of plane engines for company B. The contract contained a hardship clause that enabled A to put an end to the contract in the case the contract became excessively onerous or the conditions for the

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614 Cour d’Appel, Province de Québec, District of Montreal (Canada) Case No 500-09-024690-141, 8 August 2016.

615 Paris Court of Appeal, Case No 15/0002019, March 2015.

performance of the contract substantially changed. Company A triggered the hardship clause and terminated the contract on the basis that the cost of the manufactured parts for the maintenance had become too expensive to buy. The lower court did not find that company A had rightly triggered the hardship clause. The appeal judge upheld the lower court's judgment, finding that company A failed to demonstrate that the price for the manufactured parts had increased more than 7.5 per cent (threshold to trigger hardship, as provided by the clause) and that the manufactured parts had become increasingly rare on the market, inducing a rise in their price. While not making express reference to UNIDROIT Principles, this decision is nevertheless a clear illustration that, even before the entry into force of the French law on contract admitting hardship, the French judge was following the UNIDROIT Principles' notion of fundamental alteration of the equilibrium of the contract.

## 6. *Spain / National Court / Polkinghorne / Unilex 1950 / 2015*

**Case:**<sup>616</sup> Madam A had entered into a contract with company B for the sale of a farm property. The contract negotiations were based on the expectations that there would be urban development in the zone where the farm was situated, and the contract contained a hardship clause. Following the fall in property prices resulting from the 2008 financial crisis, B refused to pay the sale price, and requested a reduction of the price provided in the contract, on the basis of hardship clause contained therein.

The lower court declared that, at the time the parties entered the contract, it was impossible to foresee the subsequent financial crisis. The court therefore ordered that the price for the sale shall be reduced as a result of the exceptional changes of circumstances having arisen after the conclusion of the contract. The appellate judge later annulled this decision, considering that the fall in property prices did not qualify as an exceptional or unforeseeable event, but was merely a simple risk.

Following an appeal by company B, the Supreme Court upheld the appellate judge's decision that no revision of the price should result from the changes in circumstances, making express reference to the UNIDROIT Principles. The Supreme Court found that the simple fact that the financial crisis occurred did not suffice to trigger the application of the hardship clause, and that the appellant failed to demonstrate the real incidence of such crisis on the contract between the parties. Applying Article 6.2.2 of the UNIDROIT Principles, the Court further stated that it was not demonstrated that the costs of the appellant's performance had increased or that the value of performance it received had diminished. Indeed, the appellant did not prove the causal link between the financial crisis and the cost of the performance of the contract, notably the impact of the crisis on the conditions for financing the price of the sale. The appellant did not either demonstrate the significant decrease in the value of performance received, the price of the property being in line with the average price of property in the sector.

## 7. *France / National Court / Meijer, Popova / Unilex 1923 / 2015*

**Case:**<sup>617</sup> The parties to this dispute were active in a cooking-stove business. The claimant and the respondent, respectively the buyer and the seller, concluded a contract for the sale of stoves, whereby it was agreed that the claimant would not only buy the stoves, but would also become the exclusive

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616 Supreme Court of Spain, Case No 64/2015, 24 February 2015.

617 *Dupiré Invicta industrie (D21) v Gabo*, French Cour de Cassation, Case No 12-29.550 13-18.956 13-20.230, February 2015.

distributor of the respondent's stoves in both the claimant's country and one of the claimant's neighbouring countries. During the course of the agreement, the price of raw materials, which were required to fabricate the stoves, increased. As a consequence, the respondent refused to deliver the stoves for the agreed price, invoking hardship. Eventually, the claimant initiated proceedings, claiming incurred damages, losses of profits, and the payment of a penalty for a delay in delivery, all of which were based on the contract.

Proceedings before several courts followed. In the first instance the respondent relied on the CISG and Article 6.2 of the UNIDROIT Principles. The respondent in turn argued that the claimant did not comply with its contractual obligations because the claimant refused to renegotiate the terms of the contract after the increase in price. The respondent disputed the applicability of the UNIDROIT Principles, arguing that they could not be deemed to be trade usages under Article 9 of CISG. The court of first instance found that the respondent was not entitled to withhold performance, although it did not make any references to the UNIDROIT Principles.

The Court of Appeal confirmed this decision. It did not say anything about the applicability of the UNIDROIT Principles, but it referred to them to interpret and supplement the CISG, thereby implicitly stating that the CISG and the UNIDROIT Principles can indeed be used to define hardship.

Eventually, the case reached the Supreme Court level. The main legal issue in this phase of the proceedings was whether there was a case of 'excusable hardship'. The respondent argued that the increase in costs of raw materials exceeded normal fluctuations in the relevant marketplace. It stated that this issue was not assessed properly by the Court of Appeal. The Supreme Court agreed with the respondent that indeed the Court of Appeal had not assessed properly whether the price fluctuations had transformed the additional burden on the respondent on excusable hardship. However, it confirmed the ruling of the Court of Appeal since the respondent was not able to prove the existence of a situation that substantially affected the balance of the contract. By confirming the decision of the Court of Appeal, the Supreme Court seemed to imply that the CISG governs situations of hardship and that the UNIDROIT Principles can be used to define its scope and consequences.

## 8. *Spain / National Court / Meijer / Unilex 1950 / 2015*

**Case:**<sup>618</sup> A, the seller, entered into a contract with a company, B, for the sale of building plots. The contract negotiations were based on the expectation that there would be urban development in the zone where the plots were situated, and the contract contained a hardship clause. Following the fall in property prices, which resulted from the 2008 financial crisis, B refused to pay the price of the sale. B requested a 50 per cent reduction of the price provided in the contract on the basis of the hardship clause contained therein.

The lower court declared that, at the time when the parties entered the contract, it was impossible to foresee the subsequent financial crisis. The court, therefore, ruled that B had breached the contract, which entitled A to either terminate the agreement or to require its performance. But it also found that B was entitled to have the price of the sale reduced as a result of the exceptional changes of circumstances that had arisen after the conclusion of the contract. The appellate judge later

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618 Supreme Court of Spain, Case No 64/2015, February 2015.

annulled this decision, considering that the fall in property prices did not qualify as an exceptional or unforeseeable event, but was merely a risk.

Following an appeal by B, the Supreme Court upheld the appellate judge's decision that no revision of the price should result from the changes in circumstances, making express reference to the UNIDROIT Principles. The Supreme Court found that the simple fact that the financial crisis occurred did not suffice to trigger the application of the hardship clause, and that the appellant failed to demonstrate the real incidence of such crisis on the contract between the parties. Applying Article 6.2.2 of the UNIDROIT Principles, the court further stated that there was no demonstration that the costs of the appellant's performance had increased, nor that the value of performance it had received had diminished. Indeed, the appellant did not prove the causal link between the economic crisis and the cost of the performance of the contract, notably not proving the impact of the crisis on the conditions for financing the price of the sale. The appellant also did not demonstrate a significant decrease in the value of performance received, the price of the property being in line with the average price of property in the sector.

#### 9. *Spain / National Court / Popova / Not Unilex / 2015*

**Case:**<sup>619</sup> Company A, an owner of real estate, sold real estate properties to company B, a developer, with payment due three years later, after the project had been developed. Two years after the sale, however, a serious economic crisis led to a crash in the housing market and company B was unable to pay the price agreed in the contract.

Company A filed a claim for specific performance, seeking payment of the agreed price. company B, in turn, filed a counterclaim asking for a revision of the price. B argued that the economic crisis had a direct impact on the real estate market and had critically changed the circumstances that originally motivated the agreement, which included the expectation that the area in which the properties were located would be urbanised.

The Supreme Court affirmed the decision of the Court of Appeal, allowing the claim and dismissing the counterclaim. With a general reference to the UNIDROIT Principles, the court held that there was no grounds for revision of the contract on the grounds of hardship. The court held that, for a change of the circumstances to qualify as hardship, it must affect the objective purpose of the contract and its economic goal and cause a substantial change in the equilibrium of the contract. In this particular case, the fluctuation in the housing market was a risk assumed by the buyer, not an unforeseen change of circumstances, and the temporary decrease in value was not such as to cause the buyer to operate at a loss or deprive the buyer of any benefit from the transaction. As a result, the conditions for revision of the contract on the grounds of hardship were not met.

#### 10. *Brazil / National Court / Popova / Not Unilex / 2015*

**Case:**<sup>620</sup> A physician, A, contracted to buy ultrasound equipment for his practice from General Electric, the equipment's manufacturer. The parties agreed to peg the contract price to the \$US,

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619 *Gregoria y otros v Riocerezo Green SL*, Case No 64/2015 (2015) [www.poderjudicial.es/search/openDocument/ae2d1df7cde06d1e/20150511](http://www.poderjudicial.es/search/openDocument/ae2d1df7cde06d1e/20150511), accessed 1 April 2019.

620 Superior Court of Justice (STJ), REsp 1321614/SP, Rel. Ministro Paulo de Tarso Sanseverino, Rel. p / Acórdão Ministro Ricardo Villas Bóas Cueva, Terceira Turma, Case No DJe 03/03/2015, 16 December 2014.

to be paid in five yearly instalments in Brazilian reais (BRL). Halfway through the instalment plan, Brazil devalued the BRL vis-à-vis the US dollar, causing the outstanding instalment amounts, in BRL, to rocket. A invoked the ‘economic basis of the contract’ doctrine, seeking to revise the contract price in light of the BRL’s crash.

The Superior Court of Justice, by majority, held that A could not revise the price. Outside the scope of protected consumer relationships (as was the case here), hardship requires not only a fundamental alteration of the burden of one party’s outstanding obligation, but also that this alteration be caused by an unforeseeable event. Given Brazil’s long history of currency volatility, the recent period of stability, during which the contract had been executed, was insufficient to place a drastic devaluation beyond the realm of foreseeable events. The parties chose to allocate risk between them accordingly, and the court would not revise the contract’s terms. The court did not cite the UNIDROIT Principles, but reasoned by reference to analogous provisions in Articles 317 and 478 of the Brazilian Civil Code, which address unforeseen changes in circumstances that cause one of the parties’ obligation to become unduly onerous.

#### 11. *Lithuania / National Court / Meijer / Unilex 1892 / 2014*

**Case:**<sup>621</sup> Two companies in country X agreed in a works contract that the contract would not be paid in money, but with goods produced by the customer (plastic windows). The contractor later requested renegotiation of this term when it became insolvent and ended its activity, seeking revision of the payment method to money and asking to be paid in money for the work it had already done.

A dispute arose and the court rejected the contractor’s claim. The court referred to Article 6.2.2 of the UNIDROIT Principles, as well as the civil code of country X, in holding that, in order for a party to claim hardship, there must be a fundamental alteration of the equilibrium of the contract. The court stated that the contractor’s insolvency was not a sufficient reason to change the agreed method of payment, as the contractor had not demonstrated that the originally agreed-upon method of payment had resulted in a fundamental increase in its cost of performance or had diminished the value of the counter-performance.

#### 12. *Spain / National Court / Polkinghorne / Unilex 1949 / 2014*

**Case:**<sup>622</sup> Company A entered into a contract with company B for the operation of advertising space on the city’s buses. According to the contract, company A was to perceive all revenues from the advertisement and pay a monthly fee to company B. The contract was validly executed during two years, but in May 2009, company A unilaterally decided to pay only 70 per cent of the perceived revenues to company B. Company A did so following a severe drop in revenues that year, arguing that the contract’s equilibrium had been fundamentally altered and that the fee needed to be revised.

The judge of first instance followed A’s reasoning and decided that company A should only pay company B in the amount of 80 per cent of the perceived revenues. This decision was annulled by the appellate judge, which decided that the first instance judge failed to show that the decrease in

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621 Supreme Court of Lithuania, Case No 3K-3-514/2014, November 2014.

622 Supreme Court of Spain, Case No 333/2014, 30 June 2014.

revenues of the advertising market was an extraordinary alteration of the circumstances at the time the parties entered the contract, and that these changes were radically unforeseeable. The Supreme Court overruled the appeal decision, stating that the appellate judge had not considered the degree of alteration of the circumstances for the performance of the contract. Through an express reference to Article 6.2.2(c) of the UNIDROIT Principles, the Supreme Court found that it cannot be considered that the risk was assumed by company A, as this risk was outside that party's sphere of control. The judge found that any company, just like company A, and despite its consciousness of the commercial risk linked to business operations, would have been faced with an unforeseeable and extraordinary change of circumstances.

### 13. *Ukraine / National Court / Meijer / Unilex 1738 / 2012*

**Case:**<sup>623</sup> An agreement between A and B was entered into for the transformation of natural gas in country X. The gas was to be ultimately converted into heat for a local community. As A was a public utility company, it made a request to the authority supervising the public utilities sector in country X (the National Commission) to ensure compliance of the agreement with X's regulations. On hearing that the tariffs for the supply of heating were above the normal rate, A sought the termination of the agreement. A claimed that there was a substantial change in circumstances and cited the civil code of the country which it argued allowed termination of the contract.

The court, while hearing this matter held that A's reliance on the opinion of the authority was not valid as such opinion could not be regarded as forming a 'substantial change of circumstances'. Even otherwise, the court held that as A knew of the risk of a change in circumstance when it entered into the agreement, A was not entitled to terminate the agreement. It reasoned that the concept of 'substantial change of circumstances' (as referred to in X's civil code) was a flexible concept, and in this context referred to Article 6.2.2 of the UNIDROIT Principles. It defines hardship caused by a fundamental alteration of the equilibrium of a contract as one which arises either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished. Thus, the court rejected A's request for termination.

### 14. *Colombia / National Court / Charrett, Polkinghorne / Unilex 1709 / 2012*

**Case:**<sup>624</sup> Party A (two citizens from country X) entered into a loan agreement with party B (a bank with its place of business in country X) for the purpose of buying a house. A then brought a civil claim against B in relation to that loan agreement. A claimed that the 1998 crisis in country X had affected the economy and the liquidation of loans for buying houses, resulting in the contract becoming more onerous for A to perform. The lower courts rejected A's claim on the basis that A did not bring forth sufficient evidence showing that the 1998 crisis had caused an imbalance under the contract.

The case was appealed before the Supreme Court. The Supreme Court affirmed the lower courts' decisions, finding that A did not bring sufficient proof that the contract had become more onerous.

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623 *Public utility company Lytskteplo v TOV Zakhidna teploenergetychna grupa*, Volyn Regional Commercial Court, Ukraine, Case No 5004/579/12, June 2012.

624 *Rafael Alberto Martínez Luna y María Mercedes Bernal Cancino v Granbanco SA*, Supreme Court of Columbia, Judgment, 21 February 2012.

The Supreme Court further noted that the government of country X had made arrangements to mitigate the economic effects of the crisis on existing contracts.

The Supreme Court recognised a general principle of contract revision in the case of supervening exceptional circumstances under the law of Country X. The court reasoned that this principle is part of the *lex mercatoria*, referring to Articles 6.2.1 and 6.2.3 of the UNIDROIT Principles in support of its conclusion. The court went on to add that, under the laws of country X, parties may choose soft law as the law applicable to their contracts, as long as such law does not contradict the mandatory provisions of applicable domestic law. Further, in order to interpret international instruments and domestic legal concepts, judges are permitted to use the UNIDROIT Principles. In its interpretation of the contract in this case, the Supreme Court referred to Article 6.2.1 of the UNIDROIT Principles to determine that a supervening event should be exceptional and to Article 6.2.2(a) of the UNIDROIT Principles to determine that relevant events must be supervening (as opposed to pre-existing).

#### 15. *Brazil / Domestic Administrative Instance / Meijer / Unilex 1655 / 2011*

**Case:**<sup>625</sup> A number of agreements were entered into between a state-run oil company (in country X) with foreign companies for the construction of oil platforms off the coast of country X. The consideration for this was to be paid in US dollars. The terms of the agreement stipulated that a portion of the work would be allocated to local companies in country X and the payment of such portion would be calculated in X's local currency. Due to some significant fluctuations in foreign exchange rates (substantial increase of X's currency against the US dollar), the foreign companies claimed that there was a sizeable decrease in their profits and asked for a renegotiation of the contract price. The oil company agreed to revise the price to re-establish the original proportion between it and the work allocated to the companies. However pursuant to such amendments, the tax authorities of country X filed a case before the Federal Accountability Court in country X stating that the conditions for the principles of hardship as set out in country X's Civil Code had not been adhered to.

The court while hearing the matter observed that it was English law that governed the contracts by choice of the parties and hence an analysis had to be undertaken on whether the civil code of country X (national public order) or international public order, as set forth in the *lex mercatoria*, were applicable. Without taking a final decision on the applicable law point, the court held that even if the *lex mercatoria* – and in particular Articles 6.2.1–6.2.2 of the UNIDROIT Principles which represent one of its main sources – were applied, the decision that it arrived at would be the same, that is, in the case at hand the requirements for hardship had not been established. The appreciation of X's currency against the US dollar was indeed foreseeable at the time of entering into the agreements and hence such risk would be said to have been assumed by the parties. Thus, the foreign companies were ordered to pay back the sum that corresponded to the increase in profit that they had obtained due to the change in the contract price.

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625 Tribunal de Contas da União, Brazil, Case No TC 007.103/2007-7, December 2011.

## 16. *ICSID / Arbitration / Meijer / Unilex 1658 / 2011*

**Case:**<sup>626</sup> This case related to an investor-state dispute between A, a company in country X and B, the government of country Y. A number of investments were made by A in the energy sector. However, pursuant to a financial and economic crisis in country Y, A was directly affected by certain emergency measures taken by B to mitigate the effects of the crisis.

An ICSID arbitration followed the ensuing dispute. A argued that the bilateral investment treaty between X and Y was breached by B and claimed damages for the losses suffered due to such breach. B took the defence of Article XI of the treaty which stated that ‘[t]his Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests’.

The tribunal rejected B’s objection and decided the matter in favour of A. The tribunal reasoned that B could not invoke the plea of necessity as it had created that necessity or substantially contributed to it. This was the basis of the general principle of ‘preclusion of wrongfulness’ which was also enshrined in UNIDROIT Principles, particularly in Article 6.2.2. The tribunal described the UNIDROIT Principles as ‘a sort of international restatement of the law of contracts reflecting rules and principles applied by the majority of national legal systems’.

While analysing the issue at hand the tribunal noted that under the UNIDROIT Principles, an exemption from liability for an inability to perform the contract is excluded if the party taking such defence was ‘in control’ of the situation or if it would be ‘grossly unfair’ to allow for such exemption. It went on to add that an event causing hardship must be, according to Article 6.2.2 ‘beyond the control of the disadvantaged Party’. Further, the tribunal also cited Article 7.1.6 which ‘prescribes that a party may not claim exemption from liability if it would be grossly unfair to exempt it having regard to the purpose of the contract’. Article 7.1.7 was quoted by the tribunal to state that non-conformity with a contract could be excused in the case of a force majeure event ‘[...] if that party proves that the non-performance was due to an impediment beyond its control and that it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences’.

## 17. *Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2011*

**Case:**<sup>627</sup> Company A from country X entered into a contract for the supply of a commodity with company B from country Y, which provided for several deliveries and a purchase price formula with fixed and variable parameters. The contract was governed by ‘the substantive law of Switzerland’. A few days after, company B entered into a contract with a third company C for the onward sale of the commodity. On the date the first shipment was to be loaded, the price of the commodity collapsed and consequently the purchase price was minimal and even negative in respect of certain deliveries. Since company A did not deliver the agreed quantities, company B could not fulfil its obligations towards company C. Company B initiated arbitration proceedings against company A claiming loss

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626 *El Paso Energy International Company v The Argentine Republic*, ICSID Case No ARB/03/15, October 2011.

627 ICC, Case No 16369, Final Award, 2011.

of profit, damage to its reputation, reimbursement of contractual penalties paid to company C and compensation for consultancy and legal fees and the time spent in connection with attempts to remedy the situation.<sup>628</sup>

The arbitral tribunal seated in Switzerland addressed the issue of hardship. It stated that under the CISG parties are free to include in their contracts hardship clauses, which ‘address an unforeseen shift in the economic equilibrium, not unforeseen (factual, legal etc) impediments’ [emphasis omitted].<sup>629</sup> After pointing out that such a distinction is not always made in commercial practice, the arbitral tribunal stated that the distinction was introduced to transnational commercial law by the UNIDROIT Principles, which may be used, according to its preamble, as an interpretation help or as a supplement to international uniform law instruments. Consequently, the arbitral tribunal applied the requirements as set out in Article 6.2.2 of the UNIDROIT Principles. After it found that these requirements were met, the arbitral tribunal addressed the effects of hardship as set out in Article 6.2.3 of the UNIDROIT Principles and found that the requirements of Article 6.2.3 were met as well since the parties failed to reach an agreement during their negotiations. For this reason, according to Article 6.2.3(3) of the UNIDROIT Principles, it was up to the arbitral tribunal to take the adequate measure pursuant to subsection (4) of the same article. The arbitral tribunal held that it enjoys substantial discretion in this regard and decided that adaptation, rather than termination, was both ‘reasonable’ and ‘fair’.

In the context of the loss of profit claim, the arbitral tribunal applied interest at the statutory rate provided for in Swiss law, as requested by company B, starting from the time when the loss occurred. Yet, the arbitral tribunal mentioned in an aside that it saw much merit in the uniform law approach taken by some arbitral tribunals which have applied, in light of CISG’s silence on the issue of the rates of interest, the rate provided for in Article 7.4.9 of the UNIDROIT Principles.

#### 18. *Ukraine / National Court / Charrett / Unilex 1736 / 2009*

**Case:**<sup>630</sup> This case arose in relation to a dispute based on an agreement between A, a bank in country X, and B, an individual entrepreneur in country X, for A’s lease of office space from B. A claimed that, due to the economic meltdown in 2008 and resulting difficulties in the rental market, there was a substantial change in circumstances from the conclusion of the contract, and it was unable to make the agreed-upon rental payments to B. A sought the termination of the agreement through court proceedings, relying on the civil code of country X, which provided for change or termination of a contract due to substantial change of circumstances, to support its claim. The court ruled in favour of A and terminated the lease agreement.

The court reasoned that neither of the parties could foresee changes such as the steep fall of prices in the real estate rental market or the appreciation of the US dollar (the currency in which the rental rate was calculated in the contract) at the time of entering into the agreement. The court further added that A could not reasonably overcome the circumstances that caused the financial crisis, as such circumstances were outside of A’s control. The court illustrated this point with the choice of the

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628 Albert Jan van den Berg, *Yearbook Commercial Arbitration Vol XXXIX* (Kluwer 2014) 39, 170 et seq.

629 *Ibid* at 201.

630 Cherkasy Regional Commercial Court (Ukraine), Case No 02/2625, 30 November 2009.

parties to rely on the stable US dollar, which later sharply appreciated due to the devaluation country X's currency. The court noted that performance of the agreement in this instance would deny A the expectations it had had at the conclusion of the agreement. The financial crisis not only led to a devaluation of country X's currency, resulting in a doubling of the rental cost, but had also had an adverse effect of A's business as A's customers were diminished.

The court held that neither the substance of the agreement nor applicable trade customs, such as the UNIDROIT Principles, allocated the risk of the change in circumstances at stake to A. The court referred to Article 6.2.2 of the UNIDROIT Principles as sufficient grounds for termination of the contract.

#### 19. *Mexico / Arbitration / Polkinghorne / Unilex 1149 / 2006*

**Case:**<sup>631</sup> Company A entered into a supply agreement with company B, whereby company A would buy the vegetables grown by company B. Various climatic events, among which was a major hurricane, have precluded company B from delivering the products to company A. Company A therefore started arbitration proceedings against company B, which based its defence on force majeure and hardship. In order to determine whether hardship could be upheld, the tribunal referred to Article 6.2.2 of the UNIDROIT Principles and determined that a vegetable grower typically takes on the risk of crop destruction by rainstorms and flooding and cannot therefore invoke hardship. According to the tribunal, the supply agreement is, in essence, an agreement by which the risk is dissipated. The bidder no longer has to worry about the market situation, since this risk is now borne by the buyer (who has undertaken to acquire a certain volume); and the buyer no longer has to worry about the existence of the product, since this risk is borne by the seller (who has committed to produce the product and volume in question). However, the tribunal goes on by stating that the risk of occurrence of an event affecting the production is the responsibility of the producer. To understand why, the tribunal considers the reverse invocation of hardship: if there had been a decrease in demand for the product, company A could not (validly) argue this circumstance as a reason not to fulfil its obligation to pay for the products provided by company B. The tribunal concluded that the risk of the meteorological event was borne by company B, which cannot invoke hardship pursuant to Article 6.2.2 of the UNIDROIT Principles.

#### 20. *Brazil / Arbitration / Charrett / Unilex 1532 / 2005*

**Case:**<sup>632</sup> A dispute arose between parties to a domestic contract pertaining to carriage by sea. The contract, which was subject to the law of country X, contained a hardship clause but did not list out the elements and conditions in relation to adapting the clause in the event of hardship. Subsequent to devaluation in the currency of country X, the parties concluded an agreement to share the costs of the devaluation, expressly indicating that the agreement would be applicable to performance of the contract in 2005. Dissatisfied with the agreement, however, A instituted an arbitration proceeding.

A requested that the tribunal consider country X's Civil Code and amend the contract to account for the devalued currency. B objected that the agreement that had been reached was merely an application of the hardship clause that had been contained in the contract and that, therefore,

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631 Centro de Arbitraje de México (CAM), Award, 30 November 2006.

632 Ad hoc arbitration, Brazil, 21 December 2005.

country X's Civil Code could not be applied. Both parties cited the UNIDROIT Principles in support of their respective arguments.

The arbitral tribunal noted that the UNIDROIT Principles set out elements defining hardship as a state of adversity that, by imposing substantial onerousness on one of the parties, results in a fundamental alteration of the equilibrium of the contract. As observed by the tribunal in the case at hand, the hardship clause in the contract complied with international standards and the laws of country X. The tribunal also noted that the parties, on the basis of freedom of contract, had the ability to agree on circumstances that were not contemplated by the applicable domestic law and establish flexible criteria for hardship to be constituted under their contract, stating that 'once the hardship clause is inserted in the contract, it must be observed in deference to party autonomy and the constitutional principle of free initiative'. The tribunal concluded that the agreement for the year 2005 was a fair indication of the parties' joint intention to share costs arising from the devaluation of the domestic currency – thus fulfilling the parties' intention to re-establish the equilibrium of the contract – until the end of the contract.

## 21. *Lithuania / National Court / Charrett / Unilex 1183 / 2003*

**Case:**<sup>633</sup> A, a company in country X, entered into a contract with B, an individual in country X, for the sale of its shares. B made a down payment of 20 per cent, but a dispute arose when B subsequently refused to pay the balance. A filed a court proceeding requesting payment of the outstanding amount. B claimed hardship owing to the fact that the company had become insolvent and the value of its shares considerably diminished as a result.

The courts of both first and second instance decided in favour of B. The Supreme Court however, reversed and decided in favour of A. The court held that, in this case, B was not entitled to invoke the doctrine of changed circumstances or hardship, as hardship does not apply to monetary obligations. The court further noted that, regardless, B had assumed the risk of fluctuation in the price of shares when it entered into the contract. In its reasoning, the court referred to Article ZZ of the Civil Code of country X, which substantively corresponds to Articles 6.2.1 to 6.2.3 of the UNIDROIT Principles.

## 22. *Lithuania / Arbitration / Charrett / Unilex 832 / 2000*

**Case:**<sup>634</sup> A and B entered into a shareholders' agreement governed by the law of country X for the purpose of ensuring cooperation between the parties to improve the production and export of cement. B later declared the agreement terminated and started negotiating with a competitor. A requested the arbitral tribunal order B to abide by the agreement. B argued that it had a right to unilaterally terminate the agreement and that the disruption of the relationship between the parties constituted hardship.

In deciding the case, the tribunal referred to both the relevant provisions of the Civil Code of country X and, in accordance with Article 17 of the ICC Rules of Arbitration on the relevant trade usages, the UNIDROIT Principles, which it declared to be 'codified trade usages', though 'of persuasive [rather] than binding nature'.

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633 *G Brencius v 'Ukio investicine grupe'*, Supreme Court of Lithuania, Case No 3K-3-612, 19 May 2003.

634 ICC, Case No 10021, Award, 2000.

With respect to unilateral termination, the tribunal noted that neither the shareholders' agreement nor the civil code permitted unilateral termination with immediate effect. Article 5.1.8 of the UNIDROIT Principles merely states that contracts for an indefinite period of time may be terminated by either party only by giving advance notice within a reasonable timeframe. With respect to hardship, the tribunal did not accept B's argument that the disruption of the relationship between the parties constituted a hardship, as the principle of hardship implies an advantaged and a disadvantaged party. Regardless, however, under both Article ZZ of the Civil Code and Article 6.2.3 of the UNIDROIT Principles the disadvantaged party in a hardship situation is not permitted to terminate an agreement on its own accord. Rather, the party must request the court or arbitral tribunal terminate such agreement. Moreover, additionally under Article 6.2.3 of the UNIDROIT Principles, the party can only make such a request for termination after it has requested renegotiation and the renegotiation has failed.

### 23. *Indonesia / Arbitration / Polkinghorne / Not Unilex / 1999*

**Case:**<sup>635</sup> Project company A from country X entered into an energy sales contract with energy company B from country Y to explore and develop geothermal resources in country Y. The contract entitled the project company to build two power plants in country Y and sell the power to company B. In the wake of the economic crisis which befell country Y, Company B failed to purchase the energy supplied by company A. Company A thus started arbitration proceedings against company B, in order to recover damage resulting from the non-performance of the contract. Invoking the calamitous economic crisis and a drastic change in circumstances, company B requested that the tribunal should leave the parties to renegotiate the contract. In order to decide on such renegotiation, the tribunal found that the risk of the event causing the change in circumstances should not be borne by the disadvantaged party. The tribunal further found that the risk was precisely being borne by company B, as the parties had agreed on a price in the currency of company A's country, rather than in the currency of company B's country. Consequently, the tribunal found that the parties had unambiguously allocated the risk of a depreciation of the local currency to company B, and that company B could thus not invoke the change in circumstances to request a renegotiation of the terms of the contract.

### 24. *France / Arbitration / Polkinghorne / Unilex 680 / 1999*

**Case:**<sup>636</sup> Company A entered into an agreement with company B on the use of a dissolved company's name. The contract provided that A would use the name as a registered trademark and that B would use it as manufacturer of goods. Company A started arbitration proceedings against company B, alleging that company B had voluntarily created confusion between its name and company A's trademark. Company B contended that the European Directive on Trademarks (89/104/EEC) had introduced more liberal terms than those agreed with A and that the contract with A should thus be revised.

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635 *Himpurna California Energy Ltd (Bermuda) v PT (Persero) Perusahaan Listrik Negara (Indonesia)*, Final Award, 4 May 1999.

636 ICC, Case No 9479, Award, February 1999.

The arbitral tribunal rejected B's counterclaim and found that the European Directive on Trademarks may not be characterised as hardship, as the evolution of the legislative context of a contract does not represent a fundamental alteration of the contract's equilibrium. According to the tribunal, company B failed to demonstrate that the change introduced was sufficiently substantial.

## 25. *Italy / Arbitration / Polkinghorne / Unilex 660 / 1998*

**Case:**<sup>637</sup> In search of the capital required to finance an aeronautical manufacturing and marketing project, company A entered into a shareholder agreement with company B. Arguing that the contract had become excessively onerous, company B unilaterally decided to withdraw from the agreement. Company A later started arbitration proceedings against company B for breach of the contract. The arbitral tribunal rejected the respondent's defence that hardship entitled respondent to withdraw from the contract. Citing Article 6.2.2 of the UNIDROIT Principles, the tribunal found that hardship may only be upheld insofar as the disadvantaged party did not have knowledge of the event at the time of the conclusion of the contract. Even though the tribunal found that it did not matter whether the event effectively took place before or after the conclusion of the contract, the tribunal observed that company B did not demonstrate it was ignorant of the event at the time it entered the contract.

## 26. *France / Not Unilex / date unavailable*

**Experience of author:**<sup>638</sup> Company A, of France, as contractor, entered into a lump-sum contract for the construction of a regasification plant with company B, of Belgium, as client. The contract was governed by French law.

During the works, the price of steel, which was fundamental for the construction of the plant, increased in a way that was completely unforeseeable.

Company A asked to review the lump-sum price of the contract. A's request was rejected by the client. At that time, in 2011, the only remedy available under French law was the *revision pour imprévision*, which has almost never been applied by the courts.

UNIDROIT Article 6.2.2 indicates that, if there is a fundamental alteration of the equilibrium between the parties, the court may: (1) terminate the contract at a date and on terms to be fixed; or (2) adapt the contract with a view to restoring its equilibrium. The solution available under the UNIDROIT Principles would be in line with the needs of the relevant market. It is important to highlight that the French Commercial Code introduced the same principle of hardship in 2016.

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637 ICC, Case No 9029, Award, March 1998.

638 Case illustration based on writer's experience of circumstances where the UNIDROIT Principles could be applied as the governing law of the contract.

## XII. Article 6.2.3: Effects of hardship

### 1. *Italy / National Court / Martinetti / Not Unilex / 2017*

**Case:**<sup>639</sup> Mr A claimed that the default and statutory interests related to a loan agreement concluded with bank B were extortionate. Indeed, Mr A considered that the sum of the default and statutory interests would lead to an exorbitant interest rate or, in alternative, he submitted that in any case the rates respectively from the first half of 2003 and 2004 shall be considered above such a threshold.

The court dismissed the first claim in the light of the well settled case law establishing that is not possible to sum up default and statutory interests in order to determine the exceedance of the threshold. In relation to the second claim, the court stated that such a circumstance shall be qualified as ‘intervening usury’. In relation to this peculiar type of usury, the exceedance of the threshold shall be assessed on the date of the agreement on interests. Prevailing case-law established that in such cases the borrower can claim the exception *doli generalis* with the consequence that the payment of the ‘intervening’ extortionate interest cannot be required. Against this backdrop, the court referred to European Contract Law and UNIDROIT Principles to establish the duty for renegotiating interest rates.

### 2. *Italy / National Court / Martinetti / Not Unilex / 2017*

**Case:**<sup>640</sup> As a result of a public tender, municipality A concluded a contract with company B conferring to the latter the revenue collecting service, including the voluntary collection of ICI (Italian municipality tax). In 2011, an amendment of the tax system introduced a new tax called IMU intended to replace ICI. The law introducing this new revenue also provided for a compulsory collecting method differing from the one used previously that rendered the collecting service carried out by company B inappropriate and ineffective, exclusively in relation to that specific revenue. Company B claims that municipality A shall be declared the defaulting party because of the breach of the obligation to renegotiate the contract.

The court dismissed the claim on the following grounds. The parties agreed a renegotiation clause that was included into the contract. The court referred to the UNIDROIT Principles and to the Principles of European Contract Law in order to mention soft law sources that provide for hardship clauses, considered a good contractual technique aimed at avoiding the termination of the contract. The court considered that municipality A fulfilled its obligation to carry out the renegotiation of the contract and therefore the claim was dismissed.

### 3. *France / National Court / Polkinghorne / Not Unilex / 2017*

**Case:**<sup>641</sup> The contract entered into between companies A and B provided that company A would buy a certain quantity of food flavouring substances from company B over the period of one year, with defined quantities for each of the quarters of that year. After having duly executed the terms of the

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639 Tribunale of Salerno, Case No 2698/2017.

640 Tribunale of Bergamo, Case No 2342/2017.

641 Paris Commercial Court, Case No 20160760927, April 2017.

contract for the first six months of the year, Company A contended that an unforeseeable change in legislation had caused very important costs to the company, and that it could no longer meet its commitment to buy the agreed volume. Company A therefore requested a renegotiation of the contract's terms with company B.

Following a failure in the negotiations, Company B started litigation against company A for breach of contract. As a defence, Company A invoked hardship and the unforeseeable change in circumstances which caused it to request a renegotiation and company B's bad faith in this negotiations. On the basis of the new Article 1195 of the French Civil Code, which provides that the disadvantaged party must continue to perform its obligations during the renegotiations, the judge found that company A was liable for not performing its obligations under the contract at the time it requested the renegotiations. No express reference was made to the UNIDROIT Principles in this case, but it is clear that Article 1195 of the Civil Code mirrors the provisions of Article 6.2.3(2), excluding that the disadvantaged party may withhold performance of its obligations when renegotiating.

#### 4. *Spain / National Court / Polkinghorne, Charrett / Unilex 1949 / 2014*

**Case:**<sup>642</sup> Company A entered into a contract with company B for the operation of advertising space on the city's buses. According to the contract, company A was to perceive all revenues from the advertisement and pay company B a monthly fee. The contract was validly executed for two years, but in May 2009, company A unilaterally decided to pay company B only 70 per cent of the perceived revenues. Company A did so because of a severe drop in revenues that year, arguing that the contract's equilibrium had been fundamentally altered and that the fee needed to be revised.

The judge of first instance followed A's reasoning and decided that company A should only pay company B 80 per cent of the perceived revenues. This decision was annulled by the appellate judge, who decided that the first instance judge failed to show that the decrease in revenues of the advertising market was an extraordinary alteration of the circumstances at the time the parties entered the contract, and that these changes were radically unforeseeable. The Supreme Court overruled the appeal decision, stating that the appellate judge had not considered the degree of alteration of the circumstances for the performance of the contract. Through an express reference to Article 6.2.2(c) of the UNIDROIT Principles, the Supreme Court found that it cannot be considered that the risk was assumed by company A, as this risk was outside that party's sphere of control. The judge found that any company, just like company A, and despite its consciousness of the commercial risk linked to business operations, would have been faced with an unforeseeable and extraordinary change of circumstances.

#### 5. *India / Regulatory Commission / Kapoor / Not Unilex / 2014*

**Case:**<sup>643</sup> Company A incorporated in country X successfully won the bid for the development and implementation of a power project based on linked captive coal mine in state Y of country X and entered into power purchase agreements (PPAs) with certain utilities for distribution of electricity. However, the currency of country X subsequently depreciated significantly. Company A consequently

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642 Supreme Court of Spain, Case No 333/2014, 30 June 2014.

643 *Sasan Power Ltd v M P Power Management Company Ltd and Others*, (2014) SCC OnLine CERC 20.

filed a petition before the central regulator of country X seeking a declaration that unprecedented, unforeseeable and uncontrollable depreciation of the currency was a force majeure event under the PPA, and company A ought to be restituted to the same economic condition as if the force majeure event never occurred.

The central regulator took note of the fact that company A had relied on UNIDROIT Principles in support of its contention that the international practices provide for and allow readjustment of terms of contract in comparable situations. Although the central regulator held that depreciation in currency of country X is not a force majeure event under the PPA, it noted that the unprecedented and unforeseen foreign exchange rate variations were beyond company A's control and beyond normal expectations, and therefore may need to be considered for quantification and compensation by the procurers appropriately. It however reserved its final decision to be determined based on company A's project records.

#### 6. *Lithuania / National Court / Charrett / Unilex 1893 / 2013*

**Case:**<sup>644</sup> This case is related to the principle of contract equilibrium alteration as justification for contract adaptation, as well as supervening hardship within the same context. A, two individuals, and B, a bank, entered into a loan agreement. A did not repay the loan, because the interest of the loan increased due to a financial crisis. B refused to grant A's request to revise the repayment terms of the contract. After withholding performance, A brought action, claiming that the financial crisis was a supervening hardship.

The court rejected A's claim, invoking not only Civil Code Article Z of country Z, but also Articles 6.2.2 and 6.2.3 of the UNIDROIT Principles. The court reasoned that the required justification for contract adaptation, that its original equilibrium be fundamentally altered, was absent. The court concluded that A's withheld performance was not permitted.

#### 7. *India / Regulatory Commission / Kapoor / Not Unilex / 2013*

**Case:**<sup>645</sup> Company A which was incorporated in country X was declared as the successful bidder for supply of power to certain state utilities in country X on the basis of the non-escalable tariff quoted by it. In order to fulfil its obligations under the PPAs entered into with the state utilities, company A was procuring coal from country Y. However, due to changes in certain regulations in country Y, the cost of such procurement increased considerably.

Consequently, company A approached the central regulator requesting a mitigation of the hardship caused by the said regulations through either a discharge from performance of the PPA due to frustration of contract or evolving a mechanism to restore company A to the same economic position prior to the occurrence of such event which it claimed was in the nature of a 'force majeure/change in law' event under the PPA. The central regulator took note of the submissions and reliance placed by counsel for company A on the UNIDROIT Principles which recognise 'hardship' as the basis of renegotiation of the long-term contracts. The central regulator held that while the terms of the PPA

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644 Supreme Court of Lithuania, Case No 3K-3-523/2013, 13 November 2013.

645 *Adani Power Ltd v Uttar Haryana Bijli Vitaran Nigam Ltd and Others*, (2013) SCC OnLine CERC 180.

could not be altered, the parties should work out a compensation package to deal with the impact of the change in regulations solely for the intervening period of the hardship, over and above the applicable tariff as per the PPA.

## 8. *Lithuania / National Court / Charrett, Meijer / Unilex 1896 / 2012*

**Case:**<sup>646</sup> This dispute is related to a debtor, A, who was a party to a loan agreement and who claimed that the termination of the loan agreement by B, the bank, was ineffective. A had previously requested on multiple occasions that B revise the repayment terms of the loan agreement, due to a change in the country's financial climate. However, B, pursuant to its having turned down this request, terminated the agreement. A then brought action against B, asking the court to declare the termination invalid. The court ruled in favour of B.

While citing the Civil Code of country X and Articles 6.2.1, 6.2.2, and 6.2.3 of the UNIDROIT Principles, the court held that a claim for amending a contract would have to be submitted within a reasonable time of receipt of the refusal for alteration of another party. However, the request for renegotiation does not restrict the right of the other party to terminate the contract for non-performance.

## 9. *Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2011*

**Case:**<sup>647</sup> Company A from country X entered into a contract for the supply of a commodity with company B from country Y, which provided for several deliveries and a purchase price formula with fixed and variable parameters. The contract was governed by 'the substantive law of Switzerland'. A few days after, company B entered into a contract with a third company C for the onward sale of the commodity. On the date the first shipment was to be loaded, the price of the commodity collapsed and consequently the purchase price was minimal and even negative in respect of certain deliveries. Since company A did not deliver the agreed quantities, company B could not fulfil its obligations towards company C. Company B initiated arbitration proceedings against company A claiming loss of profit, damage to its reputation, reimbursement of contractual penalties paid to company C and compensation for consultancy and legal fees and the time spent in connection with attempts to remedy the situation.<sup>648</sup>

The arbitral tribunal seated in Switzerland addressed the issue of hardship. It stated that under the CISG parties are free to include in their contracts hardship clauses, which 'address an unforeseen shift in the economic equilibrium, not unforeseen impediments [factual, legal, etc]' [emphasis omitted].<sup>649</sup> After pointing out that such a distinction is not always made in commercial practice, the arbitral tribunal stated that the distinction was introduced to transnational commercial law by the UNIDROIT Principles, which may be used, according to its preamble, as an interpretation help or as a supplement to international uniform law instruments. Consequently, the arbitral tribunal applied the requirements as set out in Article 6.2.2 of the UNIDROIT Principles. After it found that these requirements were met, the tribunal addressed the effects of hardship as set out in Article 6.2.3 of the UNIDROIT Principles and found that the requirements of Article 6.2.3 were also met since the

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646 Supreme Court of Lithuania, Case No K-7-306/2012, Judgment, 26 June 2012.

647 ICC, Case No 16369, Final Award, 2011.

648 Albert Jan van den Berg, *Yearbook Commercial Arbitration Vol XXXIX* (Kluwer 2014) 39, 170 et seq.

649 *Ibid* at 201.

parties failed to reach an agreement during their negotiations. For this reason, according to Article 6.2.3(3) of the UNIDROIT Principles, it was up to the arbitral tribunal to take the adequate measure pursuant to subsection (4) of the same article. The tribunal held that it enjoys substantial discretion in this regard and decided that adaptation, rather than termination, was both ‘reasonable’ and ‘fair’.

In the context of the loss of profit claim, the tribunal applied interest at the statutory rate provided for in Swiss law, as requested by company B, starting from the time when the loss occurred. Yet, the arbitral tribunal mentioned in an aside that it saw much merit in the uniform law approach taken by some arbitral tribunals which have applied, in light of CISG’s silence on the issue of the rates of interest, the rate provided for in Article 7.4.9 of the UNIDROIT Principles.

#### 10. *The Netherlands / Arbitration / Meijer / Unilex 1534 / 2010*

**Case:**<sup>650</sup> The claimants (two oil companies in country X) and the respondent (the government of country B) entered into several agreements for the exploration and exploitation of oil in a designated area of country B. In short, the agreements held that the claimants had to provide a percentage of its oil extraction to country B for domestic use and against a price that was set by the respondent. The claimant was allowed to export the rest of the oil against market value. The relationship between the parties worsened and resulted in several court and arbitral proceedings.

One proceeding was about the effects of an earthquake. The earthquake caused a decrease in the extraction of oil. The claimants’ stance on the matter was that the contribution of oil to country B was relative to their own production and not a fixed amount. This meant that if the claimant’s own production was lower, its contribution to the respondent would be lower as well. The respondent, however, argued that it was entitled to the difference in contribution in relation to the ‘normal’ contribution as compensation for the reduced contribution after the earthquake. The tribunal agreed with the claimant on the basis of a contractual clause and made a reference to the UNIDROIT Principles. The contract contained a clause that explicitly stated that the contribution was to be a proportion of quarterly production, thereby excluding further obligations to contribute beyond the maximum amount produced in a given quarter. Moreover, the tribunal referred to and indicated that UNIDROIT Principles Articles 7.1.7, 6.2.2 and 6.2.3 (3) (b), which govern unforeseen events, are designed to distribute the effects of unforeseen events, in a just and equitable manner, between contracting parties.

#### 11. *Belgium / National Court / Meijer / Unilex 1456 / 2009*

**Case:**<sup>651</sup> A dispute arose in relation to multiple sales contracts for the purchase of steel tubes by A (buyer), a company in country X, from B (seller), a company in country Y. Since the contracts did not provide a price adjustment clause, A was affected by a sudden increase in the price of steel by about 70 per cent. The matter was taken to court, where it was held that B did not have a right to renegotiate the price.

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650 *Chevron Corporation & Texaco Petroleum Corporation v Ecuador*, ad hoc arbitration, Award, 30 March 2010.

651 *Scafom International BV v Lorraine Tubes sas*, Court of Cassation of Belgium, Case No C.07.0289.N, June 2009.

The court agreed that B would have been disadvantaged were the contract to be performed at the original agreed price, due to the sudden surge in the price of steel. However, the court noted that the CISG governed the contract, and CISG did not contain any provisions on the issue of hardship. The appellate court reversed this decision, reasoning that, in such a scenario, the general principle of good faith could be applied and, using this, the court was permitted to impose an obligation to renegotiate the contract. Thus, in spite of the applicable law not providing for remedies in the case of hardship, an exception could be made for situations that give rise to a significant imbalance in contractual obligations.

The matter reached the Supreme Court, where the appellate court's decision was upheld. The court observed that though the CISG in Article 79(1) clearly provided for force majeure events, this did not imply that it excluded the significance of hardship or the possibility of price renegotiation, as requested by B. A major alteration of the contractual equilibrium, caused by an unexpected change of circumstances, could, in some cases, be regarded as an exempting event under Article 79 (1), the court noted. Further, the court observed that, since it was the CISG that governed the contract, it was important while interpreting the provisions to keep in mind the international character and outlook of the CISG, as well as the need to promote consistency in its application, as provided by Article 7 of the CISG. In the opinion of the court, were there any inconsistencies or gaps, they would have to be addressed by taking help from the general principles underlying the CISG, and in the absence of such principles the relevant domestic law applicable. To address gaps and inconsistencies in a uniform manner, one must also consider the general principles governing the law of international commerce. The UNIDROIT Principles, for example, lay down that a party has a right to renegotiate the contract if the party invokes a change in circumstances that fundamentally disrupts the contractual equilibrium. In conclusion, B was permitted to renegotiate the contract price, and the decision of the appellate court was upheld.

## 12. *Costa Rica / National Court / Charrett / Unilex 1781 / 2006*

**Case:**<sup>652</sup> A, a company, and B, the aviation authority of country X, agreed to make repairs to an airport in country X. B decreased the hours of night-time work permissible to A. This increased A's cost of performance. A ceased performance to initiate renegotiations. B sought arbitration in aversion to A's cessation.

The tribunal granted B's claim. It used country X administrative law and Article 6.2.3 of the UNIDROIT Principles to deem hardship-based renegotiation requests insufficient to permit performance cessation. The Supreme Court of country X ruled confirming the decision of the tribunal. Contrary to A, the Supreme Court asserted that the tribunal did apply country X administrative law, not merely the UNIDROIT Principles, in reaching its decision.

## 13. *France / Arbitration / Charrett / Unilex 1062 / 2001*

**Case:**<sup>653</sup> The claimant, from country X, and the respondent, from country Y, entered into a contract for the claimant to sell and licence to the respondent the use of products derived from raw materials

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652 Judgment of Sala Primera de la Corte Suprema de Justicia, San José, Case No 05-000097-0004-AR, 23 March 2006.

653 ICC, Case No 9994, Award, December 2001.

that had been extracted from human placentae. During the period of the agreement, the conditions for the collection of human placentae changed, due to stricter government regulations in country X. In consequence, the claimant increased the price. After the price increase, the respondent terminated the contract.

The claimant initiated arbitral proceedings and argued that the termination of the contract was unlawful, since the respondent should have agreed to renegotiate the price in light of the changed circumstances. The tribunal ruled in the claimant's favour, substantiating its ruling under the law of country X, the governing law of the contract. It referred to Articles 6.2.2 and 6.2.3 of the UNIDROIT Principles, which affirm that it is a prevailing principle of international law that good faith require both parties to renegotiate and adapt the agreement should the circumstances change under which the contract was concluded, especially when a long-term contract is at stake and could lead to the ruin of one of the parties. Since the respondent made no effort to act accordingly, the tribunal ruled in favour of the claimant.

#### 14. *France / Arbitration / Charrett, Polkinghorne / Unilex 680 / 1999*

**Case:**<sup>654</sup> A and B, each a company of country X, agreed to a regulation of the right to use an original company name, wherein A could use it as a registered trademark, B, only to identify itself as a worldwide distributor and manufacturer of certain goods. A sought arbitration in accusation of B's having created confusion between its name and A's, asserting this creation was both intentional and a breach. B counterclaimed hardship.

B's counterclaim relied upon the 1989 adoption of the European Directive on Trademarks, which introduced terms more liberal than those to which A agreed. B argued for the revision or termination of the contract to the extent that this argument regarded the territory of the EU, and in this context made reference to Article 6.2 of the UNIDROIT Principles.

The tribunal rejected B's counterclaim. The tribunal did not see that, because the balance of the obligations of the parties had not been destroyed, hardship resulted merely because legislation had developed in such a way as to change the context of the contract. Although the tribunal indicated that there was a chance that B would not have entered into the agreement if the terms of the EU Directive had already been adopted, it ruled that the influence of such regulation on the balance of the obligations of the parties was not substantial. In fact, the agreement covered the territory not only of the EU, but of the world. Although the contract provided for New York law to govern the validity of the agreement, the tribunal found that the lack of relevant provisions in relation to other issues should be understood as an indication of the intention of the parties not to have such matters governed by any specific municipal law. Therefore, the tribunal applied 'the usages of international trade', 'international public policy' and the UNIDROIT Principles, an 'accurate representation, although incomplete, of the usages of international trade'.

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654 ICC, Case No 9479, Award, February 1999.

15. *Switzerland / Arbitration / Polkinghorne / Unilex 653 / 1997*

**Case:**<sup>655</sup> Company A from country X entered into two contracts with state entity B from country Y, for the sale and the installation of sophisticated military equipment. The contracts were duly performed until the advent of a revolution in country Y. The parties entered into a series of negotiations but were unable to reach an agreement.

B started arbitration proceedings against A, claiming reimbursement of payments made to A. A objected that it was B which, by not paying the remainder of the price, had breached its contractual obligations and presented a counterclaim for damages. As a consequence of the chaotic events which preceded and followed the revolution in country Y, the arbitral tribunal made express reference to Article 6.2.3 of the UNIDROIT Principles and found that each party was entitled unilaterally to request termination of the contracts or adaptation of their terms.

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655 ICC, Case No 7365/FMS, 1997.

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# Chapter 7: Non-performance

## I. Article 7.1.2: Interference by the other party

### 1. *Singapore / National Court / Koh / Not Unilex / 2011*

**Case:**<sup>656</sup> A construction subcontract was entered into between a main contractor and subcontractor. Under the contract, the subcontractor was obliged to complete its works by a certain date. Three months before the completion date, both parties agreed to a three-month extension to be given to the subcontractor.

After the extended completion date had passed, the main contractor terminated the subcontract on the basis of the subcontractor's failure to proceed with its contractual obligations, and engaged other subcontractors to complete the project. The main contractor brought a claim against the subcontractor in arbitration, and among other issues, the arbitrator found that time for completion of the subcontract works was not set at large.

The main contractor appealed to the national court on three questions of law, one of which was whether, for time to be set at large, it was necessary for there to be delay in completion. In the court's consideration on this issue, reference was made to Article 7.1.2 of the UNIDROIT Principles.

## II. Article 7.1.7: Force majeure

### 1. *Russia / National Court / Petrachkov, Bekker / Not Unilex / 2017*

**Case:**<sup>657</sup> In this case the Russian claimant filed a claim for damages for injuries inflicted to the horse which was held in the stable under the services agreement with the Russian defendant. The court of the first instance denied the claims on the ground that, inter alia, the injuries were inflicted under force majeure circumstances.

The Court of Appeal cancelled the judgment of the court of the first instance and partially recovered the damages. While reasoning its ruling the Court of Appeal referred to the applicable Russian law and additionally referred to Article 7.1.7 of the UNIDROIT Principles.

The court's reasoning is explained below.

The defendant, individual entrepreneur IVA, performed services for storage of the horse in frames of its business activities which were aimed at gaining profit.

Thus, considering the provision of law, the aforementioned provisions of the storage contract and the specific circumstances of this case, the only ground for exempting the defendant's liability for the injuries inflicted to the item would be the force majeure circumstances, which, however, is not applicable to the present case of inflicting harm to the horse's eye.

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<sup>656</sup> *Lim Chin San Contractors Pte Ltd v LW Infrastructure Pte Ltd* (2011) SGHC 162.

<sup>657</sup> Sverdlovsk District Court, Case No 33-17761/2017, Appeal, 18 October 2017.

By virtue of Article 7.1.7 of the UNIDROIT Principles, having the status of an intergovernmental organisation, the provisions of paragraph 3 of Article 401 of the Civil Code of the Russian Federation, the legal qualification of a certain circumstance as a force majeure event is possible in case the following essential requirements are met: emergency and unavailability.

Emergency means exclusivity, something that is going beyond the ordinary conduct, certain extraordinary life events, something which does relate to common risks of living and which cannot be taken into account under any circumstances. Any event of life cannot be qualified as a force majeure, as force majeure is an extraordinary event which has objective, not subjective, basis.

Thus, force majeure events are understood as extraordinary and unavoidable circumstances, events, which come from outside and which do not depend on subjective factors: floods, natural disasters, earthquakes, hurricanes, avalanches, other natural disasters, as well as military actions and epidemics.

Considering that the defendant was aware of the particularities of behaviour of the animal (combing the head with the straw bedding), the injury inflicted to the claimant's horse does not indicate the presence of force majeure circumstances, but rather indicates defendant's failure to take all reasonable measures to prevent the occurrence of harm. This is indicated by the testimony of witness 4, who confirmed that in the stable, where the horse *Hendrik* was kept, there were blinkers worn on the horse's head specifically to prevent eye injuries, but they were applied only after the animal's eye was injured.

## 2. *Russia / National Court / Petrachkov, Bekker / Not Unilex / 2016*

**Case:**<sup>658</sup> A Russian company, the claimant, filed a claim for collection of the damages. The claims were based on the storage agreement. In accordance with the storage agreement the claimant transferred certain equipment to the defendant for storage. In the defendant's warehouse the defendant there was a fire which destroyed the equipment. The court accepted the claims and partially collected damages from the defendant in favour of the claimant.

The court's reasoning is explained below.

In accordance with the legal position of the Supreme Arbitrazh Court of the Russian Federation, contained in the Resolution of the Presidium dated 21 June 2012 N 3352/12 in case N A40-25926/2011-13-230, the legal qualification of a circumstance as a force majeure event is possible in case the following essential requirements are met: emergency and unavailability.

Emergency means exclusivity, something that is going beyond the ordinary conduct, certain extraordinary life events, something which does relate to common risks of living and which cannot be taken into account under any circumstances. Any event of life cannot be qualified as a force majeure, as force majeure is an extraordinary event which has objective, not subjective, basis. The qualification of circumstances as a hardship (force majeure) is also widely recognised in the international practice.

According to Article 7.1.7 UNIDROIT Principles, having the status of an intergovernmental organisation, the circumstances of force majeure, in the case of which the party is exempted from liability for non-performance of obligations, are called an obstacle 'beyond reasonable control of a

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658 Ninth Arbitrazh Appeal Court, Case No A40-61219/15, Resolution 09AP-55092/2015-GK, 09AP-57756/2015-GK, 26 January 2016.

person', since it could not reasonably be expected to take this obstacle into account when concluding a contract or to avoid or overcome this obstacle or its consequences.

Such circumstances are extraordinary and unavoidable under the given circumstances.

Thus, force majeure events are understood as extraordinary and unavoidable circumstances, events, which come from outside and which do not depend on subjective factors: floods, natural disasters, earthquakes, hurricanes, avalanches, other natural disasters, as well as military actions and epidemics.

At the same time, the respondent did not present evidence that the fire occurred on 24 November 2014 in the warehouse located at Moscow, ul. Kotlyakovskaya, 6, p. 1, on the territory of JSC 'Experimental Plant No 1', as a result of which the disputed goods were destroyed, was due to natural phenomena of a spontaneous nature and has signs of emergency and objective unavoidability.

### **III. Article 7.2.1: Performance of monetary obligation**

#### *1. Russia / Arbitration / Petrachkov, Bekker / Not Unilex / 2010*

**Case:**<sup>659</sup> A claimant, an Uzbekistani company, filed a lawsuit against a defendant, a Russian company, for collection of advance payment for goods, which were not delivered.

The court's reasoning is explained below.

On the issue of the law applicable to the relations between the parties under the contract, the ICAC found that according to Article 28 of the Law of the Russian Federation 'On International Commercial Arbitration' and paragraph 1 of article 26 of the ICAC Rules, the dispute shall be resolved in accordance with such rules of law as the parties have chosen as applicable to the merits of the dispute.

Since the Russian Federation and the Republic of Uzbekistan are parties to the CISG, the ICAC considered the provisions of the CISG to be applicable to the relations between the parties.

According to paragraph 2 of Article 7 of the CISG questions concerning matters governed by this convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the applicable law. The ICAC ruled that provision of the Russian civil law, in particular, the Civil Code of the Russian Federation is to be applicable to the relations between the parties as a subsidiary statute.

Relying on paragraph 3 of Article 28 of the Law of the Russian Federation 'On International Commercial Arbitration' and paragraph 1 of Article 26 of the arbitration rules, the sole arbitrator considered it expedient to apply the UNIDROIT Principles when considering a dispute.

Based on the foregoing, the sole arbitrator decided to follow the CISG, the Civil Code of the Russian Federation and the UNIDROIT Principles when considering the dispute.

As follows from the materials of the case, the parties concluded the contract, according to which the defendant undertook an obligation to transfer the products into the ownership of

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<sup>659</sup> ICAC, Case No 224/2009, Award, 30 June 2010.

the claimant in the agreed assortment, and the claimant undertook an obligation to pay for the products on an advance basis.

Before proceeding to the merits of the case as submitted by the claimant, the sole arbitrator found it necessary to determine the legal nature of the contract and concluded that it was a contract for the supply of goods subject to the provisions of paragraph 3 of chapter 30 of Part Two of the Civil Code of the Russian Federation; and, in the unregulated parts, general provisions applicable to contract for the sale of goods as such.

Paragraph 1 of Articles 486, 487 and 516 of the Civil Code of the Russian Federation grant the buyer with the right to pre-pay the goods in the manner as provided for in the contract.

In accordance with Article 466 of the Civil Code of the Russian Federation the buyer has the right to demand the return of the advance payment, if the seller in breach of the terms of the contract provides less quantity of goods than it was paid for. Article 7.2.1 of the UNIDROIT Principles also reflects a widely recognised rule that it is always possible to demand due amounts under a contractual obligation and, if this demand is not met, to recourse to available remedies in the court.

The sole arbitrator qualified the defendant's actions as a material breach of the contract in the sense of Article 25 of the CISG, since the claimant was largely deprived of what he was entitled to rely on the contract, that is, he received less goods than he paid for.

Since the fact of breach of the contract by the defendant is confirmed by the case materials, the sole arbitrator concluded that the defendant's failure to fulfil the obligation to supply the products was proved by the claimant, and recognised the claimant's claim is reasonable and subject to satisfaction in full.

#### **IV. Article 7.2.2: Performance of non-monetary obligation**

##### **1. *France / Arbitration / Sierra / Not Unilex / 2016***

**Case:**<sup>660</sup> Company A, of country X and company B, of Country Y, entered into a JVA by which they agreed to create two joint companies (companies C and D), in which company B would provide the technology and company A the commercial know-how in order to produce and commercialise certain products in country X. The parties agreed that the JVA would be subject to the UNIDROIT Principles, supplemented if necessary by the laws of country X.

The JVA foresaw that if both parties failed to pass a resolution in two shareholders or board of directors meetings of company C or D, with no less than 15 days between each other, a deadlock provision would be triggered. Whenever a deadlock situation was triggered, according to the JVA, each party was entitled to start a process for the transfer of shares, where the other party was obliged to participate in good faith. In case any party failed to do so, legal arbitration proceedings would be available.

Company A claimed that there was a deadlock because there had been two board of directors meetings where the board had been unable to reach an agreement and pass resolutions on different

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<sup>660</sup> ICC, Case No 18795/CA/ASM (C-19077/CA).

topics. Company B argued that the deadlock provision was not triggered. It claimed that failure to pass resolutions at two board of directors needed to be on exactly the same topics for the deadlock provision to be triggered.

The arbitral tribunal found that there was indeed a deadlock. The arbitral tribunal determined that under Article 4.1 of the UNIDROIT Principles, in case the intention of the parties is not established, ‘the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances’. Thus, the arbitral tribunal held that a reasonable person would be more concerned by the impossibility to decide two different unrelated issues at two consecutive meetings than the repeated impossibility to decide the same issue. According to the arbitral tribunal, such hypothesis may reflect a symptom of the inability of the partners to work together, whatever the matter at stake, while the other hypothesis may only reflect the difficulty to deal with a specific issue.

On the issue of the transfer of shares process, the arbitral tribunal held that the parties had not activated the process to transfer of companies C and D’s shares.

Company A claimed specific performance under Article 7.2.2 of the UNIDROIT Principles seeking the transfer of companies C and D’s shares. On the other hand, company B contended that the arbitral tribunal did not have the power to order the transfer of shares. The arbitral tribunal found that there had been no breach to the deadlock provisions for the transfer of shares because the process for the transfer of shares had never been activated by any of the parties.

The arbitral tribunal held that it could not order company B to transfer any shares. Moreover, it ruled that the parties were entitled to activate the process for the transfer of shares provided for under the JVA, with both parties being obliged to participate therein in good faith, in light of Article 1.7 of the UNIDROIT Principles.

## 2. *France / Arbitration / Rojas Elgueta / Unilex 1177 / 2006*

**Case:**<sup>661</sup> The claimant, the lessee of an aircraft, sold that aircraft to the respondent with the permission of the lessor, a financial institution who owned the aircraft. However, it took the claimant longer than expected to arrange the deregistration of the aircraft in its country of origin, a necessary step for exporting an aircraft. The respondent, in reaction to the delay, decided to buy the aircraft directly from the owner. In response to this conduct, the claimant initiated arbitral proceedings claiming the lost profits from the original contract. The contract’s arbitration clause stated Swiss law as the applicable law for the adjudication of this case.

The sole arbitrator awarded damages in favour of the claimant. He found that it was impossible for the claimant to perform the contract due to the respondent’s actions. However, referring to comment 3(a) of Article 7.2.2 of the UNIDROIT Principles and Swiss law, the arbitrator found that impossibility does not nullify a contract. Since the contract between the claimant and the respondent was not nullified due to the impossibility to perform and that the failure to perform was caused by the actions of the respondent, the arbitrator awarded the claimant damages due to a breach of contract by the respondent.

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661 ICC, Award, 9 October 2006.

## V. Article 7.3.1: Right to terminate the contract

### 1. *Spain / National Court / Doria / Not Unilex / 2017*

**Case:**<sup>662</sup> A Spanish individual filed a claim against two Spanish insurance companies for compensation, holding the companies jointly liable for the damages caused to an elder relative who was institutionalised in a residence and died as consequence of injuries suffered from the breach of the duties of care and supervision of the residence.

The Court of Appeal's ruling overruled the previous ruling of the judge of first instance and declared the joint and several responsibilities of the insurance companies due to the fundamental non-performance of the contractual obligations of the residence which were the essence of the contract. In its ruling the Court of Appeal referred, among other decisions of the Supreme Court, also to Article 7.3.1 (2) (b) of the UNIDROIT Principles.

### 2. *Spain / National Court / Popova / Unilex 1935 / 2015*

**Case:**<sup>663</sup> Company A entered into a contract with company B, for A to transfer to B 18 real estate properties, in exchange for the construction of a housing project on ten other properties. The first four houses were to be built within three years. The parties agreed that if company B did not meet this deadline, a penalty would apply for every six months of delay.

After the first three years, company B had not built any of the houses. Company A sought to terminate the contract, based on B's failure to deliver within the time stipulated by the parties. It also claimed for damages based on the penalty agreed. B argued that timely performance was not an essential condition of the contract that permitted termination.

The Supreme Court held that not having built any of the houses within the time agreed by the parties was a fundamental non-performance giving rise to the right to terminate. From the terms of the contract, it could be concluded that the specific three-year time period was of the essence for the parties. In reaching its decision, the court expressly referred to Article 7.3.1 of the UNIDROIT Principles.

### 3. *Poland / National Court / Wardynski, Przygoda / Not Unilex / 2014*

**Case:**<sup>664</sup> The parties were in dispute over, among other issues, whether a failure to submit a certificate was an incidental non-performance or a fundamental non-performance allowing the other party to withdraw from the contract. The court found that such failure did not warrant a withdrawal from the contract.

The court stated that legal scholars take the stance that a withdrawal from a contract is allowed only if there is a delay in the performance of a fundamental contractual obligation. In this context, the court referred to Article 7.3 of UNIDROIT Principles, according to which a party may terminate a

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662 Court of Appeal of Baleares, Ruling 139/2017, 5 May 2017.

663 *Maria Antonieta y otros v Victorino*, Supreme Court of Spain, Case No 333/2015, 15 June 2015.

664 Supreme Court of Poland, Case No I CSK 392/13, Judgment, 24 June 2014.

contract where the failure of another party to perform an obligation under the contract amounts to a fundamental non-performance. However, the court did not discuss the rule in detail

#### 4. *Spain / National Court / Popova / Not Unilex / 2013*

**Case:**<sup>665</sup> Company A concluded a contract with company B, for B to perform certain consulting services in the real estate sector, including representing company A before certain boards, developing real estate properties, advertising real estate projects designed by A, and assisting A in buying and selling properties. Company A would pay a fixed rate of US\$100 monthly and a commission of 2.5 per cent on each sale B concludes on behalf of A.

After 18 months, B had only attended a few boards, had missed others and had ordered one person to look for potential buyers of one specific property. Company B also never reported on its activities. A terminated the contract for non-performance, and B sued for wrongful termination.

The Supreme Court, affirming the Court of Appeal, held that A's termination was justified because B's performance was insufficient in light of A's interest in the contract. Recognising the role that the UNIDROIT Principles have had in shaping national law on this point, the court held that only a fundamental non-performance gives rise to grounds for termination. It further held that a failure to perform will be fundamental when the interest of the creditor, objectively derived from the contract, is not fulfilled. B's performance was not sufficient in the circumstances, including in regard to what company A might reasonably expect and what it had paid in exchange.

#### 5. *Spain / National Court / Doria / Not Unilex / 2013*

**Case:**<sup>666</sup> A Spanish individual claimed, as buyer, against a real estate developer company, as seller, for termination of a sale and purchase agreement of a property for breach of the fundamental obligations of the latter to deliver the property and grant the public deed of transfer within the terms agreed.

Both the judge of first instance and the Court of Appeal ruled that the seller of a property which was under construction was not finalised and ready to be occupied within the term agreed, being the seller in breach of its obligations under the agreement, which were considered fundamental and essential, thus declaring the contract terminated and the right of the buyer to be compensated. The Court of Appeal in its reasoning refers, among other principles in Spanish law and jurisprudence, to those contained in article 7.3.1 (2) (b) of the UNIDROIT Principles and in the Convention of Vienna of 1980 of International Sales of Goods.

#### 6. *Spain / National Court / Doria / Not Unilex / 2013*

**Case:**<sup>667</sup> Company A supplied to company B a robotised automated system. The system was later modified, extended and assembled by company A following the request of Company B. Shortly after the system was installed, company B notified company A of termination for breach of contract

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665 *Lunagar Promoción y Gestión SL v Urbanizadora Castellana SA*, Case No 638/2013, 18 November 2013.

666 Court of Appeal of Barcelona (Spain), Ruling 289/2013, 13 May 2013.

667 Supreme Court of Spain, Ruling 266/2013 (First Chamber), 3 May 2013.

and offered to return the system to the supplier given that the system did not comply with the specifications of the contract.

Company A filed a claim against Company B for payment of amounts due under the agreement. Company B as defendant counterclaimed filing for the resolution of the agreement for breach of the claimant's obligations. The Court of Appeal ruled that company B was entitled to terminate the agreement and to be reimbursed with the amounts paid.

The Supreme Court confirmed the ruling of the Court of Appeal based on the breach of fundamental or essential obligations of a party to an agreement. The ruling, in addition to Spanish jurisprudence and the Civil Code, makes reference specifically to the modern codes of contractual obligations which are based on the line of thought of English law which may be summarised as the right of a party to terminate an agreement in case of non-performance of the other party may be considered as an essential breach, as in Article 7.3.1 of the UNIDROIT Principles.

### 7. *Spain / National Court / Doria / Not Unilex / 2012*

**Case:**<sup>668</sup> Two Spanish individuals claim, as buyers, against a real estate developer company, as seller, for termination of a sale and purchase agreement of a property for breach of the latter's obligations.

Both the judge of first instance and the Court of Appeal ruled that the seller of a property which was under construction and finalised within the term agreed, in spite of the delay in obtaining the necessary licences for occupation of the property which was not attributable to the seller, was actively and timely complying with its obligations under the agreement. And, considering that there was not a specific date considered as essential for granting the public deed of transfer of the property, should not be held in breach of fundamental or essential contractual obligations. The Court of Appeal in its reasoning refers, among other principles in Spanish law and jurisprudence, to those contained in Article 7.3.1(2)(b) of the UNIDROIT Principles, in this case to conclude that there was no fundamental breach.

### 8. *Spain / National Court / Popova / Unilex 1682 / 2012*

**Case:**<sup>669</sup> Company A sells B a number of real estate properties, in exchange for which B would construct a building on one of the properties and transfer it to A. The contract provided that, the building had to be constructed within six years, in a condition to obtain a regulatory permit to use the building for residential purposes. The parties agreed that if the building was not constructed within that period, company A could terminate the contract.

Permitting was delayed and B could not deliver the building by the time agreed, but it would be in a position to do so soon thereafter. A sued to terminate the contract, arguing that the parties had expressly agreed that if the deadline was not met, the contract could be terminated.

Invoking the UNIDROIT Principles as well as the Principles of European Contract Law, the Court of Appeal held that B's failure to perform was not a fundamental breach giving rise to the right to

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668 Court of Appeal of Las Palmas (Spain), Ruling 581/2012, 19 December 2012.

669 *Eulogio v Bahía Planning SL*, Case No 92/2012, 7 March 2012.

terminate. B's performance did not fall short of the legitimate expectations A could objectively have from the contract and its economic purpose, the non-performance was not intentional or reckless and there was no reason to believe that B would fail to perform in the future. Indeed, the relevant permits were subsequently obtained.

## 9. *Switzerland / Arbitration / Voser, Ninković / Unilex 1513 / 2009*

**Case:**<sup>670</sup> Company A and company B are both engaged in international trade and active in the chemicals sector. Company A entered into an agreement with company B for the supply over a period of time of a certain chemical product necessary for the production of company B's end product. According to the agreement, the price was to be determined annually on the basis of certain data to be provided by company B. The agreement also provided for the right of termination '[...] if either party is in material breach of the agreement, which breach remains uncured following 30 days written notice from the non-breaching party [...]'.<sup>671</sup> In addition, the agreement contained a choice of law clause stating '[t]his agreement shall be construed and interpreted in accordance with the laws of Switzerland as applied between domestic parties provided, however, that the express agreements, understandings and provisions contained herein shall always prevail'.<sup>672</sup>

After some years of regular performance, company A terminated the agreement on the grounds that company B had committed a material breach by failing to pay two invoices in full and to provide the necessary data for determining the price for the following year. Company B initiated arbitration proceedings against company A.

As the agreement did not specify what the parties considered to be a 'material breach' and the very concept of 'material breach' is unknown to the Swiss legal system, the arbitral tribunal seated in Switzerland had to interpret this term. Swiss law provides that (partially) unclear contracts shall be interpreted in accordance with the parties' mutual intent at the time the contract was concluded. If the parties' intent cannot be established, the wording and context of the contract (or its clauses) have to be understood in the way a reasonable third party acting in good faith would have understood it. As the arbitral tribunal could not establish the parties' mutual intent and both parties were active in international trade, it, however acknowledged that the parties by their choice of law clause had implicitly excluded the application of the CISG, resorted to Article 25 of the CISG and Article 7.3.1 of the UNIDROIT Principles as sources of common understanding in international trade to interpret the concept of 'material breach'. On this basis the arbitral tribunal found that company B's non-performance did not amount to a 'material breach' in the sense of the agreement and that company A therefore was not entitled to terminate the agreement.

The Swiss Supreme Court, upon appeal against the award, stated that by interpreting the concept of 'material breach' in accordance with both Article 25 of the CISG and Article 7.3.1 of the UNIDROIT Principles, the arbitral tribunal did not apply foreign laws excluded by the parties, but rather interpreted an unclear contractual provision in accordance with the principles of Swiss law.

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670 Supreme Court of Switzerland, Case No 4A\_240/2009, Decision, 16 December 2009.

671 *Ibid.* Fact Section A.

672 *Ibid.*

## 10. *Spain / National Court / Doria / Not Unilex / 2007*

**Case:**<sup>673</sup> Various individuals purchased an apartment, a parking space and a storage room in the same building from a real estate developer company. The storage room proved not to be apt for its use due to the existence of damp.

The judge of first instance and the Court of Appeal ruled in favour of the buyers granting them the right to compensation. The Supreme Court also ruled in their favour. The interest of the ruling is that the Supreme Court declares that the storage room could not be considered as an independent object of the contract but as an annex to the parking space, thus not making it possible to terminate the contract for fundamental breach and, therefore, limiting only the claim to compensation for the works to be performed in the room to enable its use due to the seller's non-performance of its obligation under the agreement.

In the ruling the court refers to Spanish jurisprudence and to Article 7.3.1(2)(b) of the UNIDROIT Principles.

## 11. *Spain / National Court / Doria / Not Unilex / 2002*

**Case:**<sup>674</sup> Two Spanish companies entered into an agreement for the sale of building rights on a piece of land owned by the seller. According to the contract the buyer was to pay part of the price at the time of the conclusion of the contract and the remainder once the required authorisations by the municipality were granted.

When the buyer failed to pay the remainder, notwithstanding that the authorisations had been granted, the seller brought an action requesting termination of the contract for breach or alternatively the payment of the remainder. The buyer objected that the seller had not transferred all the building rights required under the contract so that there was no longer an outstanding price to be paid.

While the court of first instance decided in favour of the buyer, the Court of Appeal overturned the verdict and decided in favour of the seller. The court however rejected the seller's request for termination and ordered the buyer to pay the remainder. Indeed, according to the court, the buyer's refusal to pay the remainder did not amount to a fundamental breach necessary for termination and in this context it referred, among others, to the ruling of the Supreme Court 1092/2008 (First Chamber) of 3 December 2008, which referred to Article 7.3.1 of the UNIDROIT Principles as well as to Articles 8:101 and 8:103 of the Principles of European Contract Law and to Article 49(1) of the Vienna Convention of International Sales of Goods, to conclude that a fundamental breach of contract is a breach which deprives the aggrieved party of what it was entitled to expect under the contract.

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673 Supreme Court of Spain, Ruling 812/2007 (First Chamber), 9 July 2007.

674 Supreme Court of Spain, Ruling 2919/2002 (First Chamber), 3 December 2002.

## 12. Switzerland / Arbitration / Voser, Ninković / Unilex 668 / 2000

**Case:**<sup>675</sup> The worldwide organisation A is a network of member firms and is divided in two business units, A1 and A2. The cooperative entity B acts as the administrative organ of A. Every member firm and its practice partners enter into an agreement with entity B pursuant to which the member firm and/or its practice partners agree to adhere to the professional standards and principles coordinated by entity B. The relevant arbitration clause in the agreement stated that ‘[t]he arbitrator shall decide in accordance with the terms of this agreement and of the articles and bylaws of [entity B]. In interpreting the provisions of this agreement, the arbitrator shall not be bound to apply the substantive law of any jurisdiction but shall be guided by the policies and considerations set forth in the preamble of this agreement and the articles and bylaws of [entity B], taking into account general principles of equity [...]’.<sup>676</sup>

As the organisation A developed through the years, various difficulties began to strain the relationship between the business units A1 and A2. The member firm of the business unit A1 initiated arbitration proceedings against the member firms of the business unit A2 as well as entity B and asserted that both have breached their obligations under the agreement. Allegedly, A2 member firms unduly interfered with A1’s own business practices and entity B failed to coordinate the activities of member firms of the two business units and to implement guidelines to ensure compatibility among them.

The arbitral tribunal seated in Switzerland held that ‘[t]he UNIDROIT Principles 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’.

The arbitral tribunal came to the conclusion that the members of the business unit A2 did not breach its obligations under the agreement. For this reason, it concluded that A1 member firms cannot claim any harm from the alleged breach and are not entitled to any compensation and referred in that regard to Article 7.4.2 of the UNIDROIT Principles. On the other hand, the arbitral award held that entity B was in breach of its material obligations under the agreement, which amounted to a fundamental non-performance, and applied in that regard the criteria set out in Article 7.3.1(2) of the UNIDROIT Principles. It further held that such a fundamental non-performance, in accordance with Articles 7.3.1(1) and 7.3.5(1) of the UNIDROIT Principles, justified the termination of the agreement and release of A1 member firms from all their obligations towards entity B and A2 member firms under the agreement for the future.

With respect to the request for restitution of the transfer payments already made to A2 member firms, the arbitral tribunal made a reference to Article 7.3.6(1) of the UNIDROIT Principles 1994 (ie, now Article 7.3.6) and noted that upon termination of the contract either party may claim restitution of whatever it has supplied provided that such party concurrently makes restitution of whatever it has received. However, since A1 member firms were unable to return the benefits they had received under the agreement, the arbitral tribunal finally found that they were not entitled to the restitution of the transfer payments.

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<sup>675</sup> ICC, Case No 9797, Final Award, 28 July 2000.

<sup>676</sup> ASA Bulletin (2000) 18(3), 518.

## VI. Article 7.3.3: Anticipatory non-performance

### 1. *United Kingdom / Galizzi / Not Unilex / date unavailable*

**Experience of author with a negotiation on a no-names basis:**<sup>677</sup> Company A, of Portugal, entered into a shipbuilding contract for the construction of a floating production storage and offloading (FPSO) vessel with company B, of South Korea. This contract was governed by English law.

The construction of a FPSO is clearly a material and complex project, where builder and buyer assume long-term obligations to each other and bear significant commercial risks. The shipbuilding contract is a non-maritime contract, because it is insufficiently related to any rights and duties pertaining to sea commerce and/or navigation.

In this case, parties had only agreed on a fixed delivery date, without including any milestone dates in the contract. The performance by the delivery date was fundamental for company A, which had signed material contracts with clients in order to use the FPSO.

One year before the contractual delivery date, it was clear that company B could not complete the construction of the vessel by that same date and thus guarantee the correct performance of the contract. Being the contract governed by English law, company A could not terminate the contract and had to wait for the actual delivery date in order to send a notice of termination.

If the contract had been governed by the UNIDROIT Principles, company A would have had the right to send a notice of termination on the basis of Article 7.3.3 for anticipatory non-performance, a solution which appears perfectly reasonable and in line with the current needs of the shipbuilding market.

## VII. Article 7.3.5: Effects of termination in general

### 1. *Switzerland / Arbitration / Voser, Ninković / Unilex 668 / 2000*

**Case:**<sup>678</sup> The worldwide organisation A is a network of member firms and is divided in two business units, A1 and A2. The cooperative entity B acts as the administrative organ of A. Every member firm and its practice partners enter into an agreement with entity B pursuant to which the member firm and/or its practice partners agree to adhere to the professional standards and principles coordinated by entity B. The relevant arbitration clause in the agreement stated that ‘[t]he arbitrator shall decide in accordance with the terms of this agreement and of the articles and bylaws of [entity B]. In interpreting the provisions of this Agreement, the arbitrator shall not be bound to apply the substantive law of any jurisdiction but shall be guided by the policies and considerations set forth in the preamble of this agreement and the articles and bylaws of [entity B], taking into account general principles of equity.’

As organisation A developed through the years, various difficulties began to strain the relationship between the business units A1 and A2. The member firm of the business unit A1 initiated arbitration

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<sup>677</sup> Case illustration based on writer’s experience of circumstances where the UNIDROIT Principles could be applied as the governing law of the contract.

<sup>678</sup> ICC, Case No 9797, Final Award, 28 July 2000.

proceedings against the member firms of the business unit A2 as well as entity B and asserted that both have breached their obligations under the agreement. Allegedly, A2 member firms unduly interfered with A1's own business practices and entity B failed to coordinate the activities of member firms of the two business units and to implement guidelines to ensure compatibility among them.

The arbitral tribunal seated in Switzerland held that '[t]he UNIDROIT Principles 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'.

The arbitral tribunal came to the conclusion that the members of the business unit A2 did not breach its obligations under the agreement. For this reason, it concluded that A1 member firms cannot claim any harm from the alleged breach and are not entitled to any compensation and referred in that regard to Article 7.4.2 of the UNIDROIT Principles. On the other hand, the arbitral tribunal held that entity B was in breach of its material obligations under the agreement, which amounted to a fundamental non-performance, and applied in that regard the criteria set out in Article 7.3.1(2) of the UNIDROIT Principles. It further held that such a fundamental non-performance, in accordance with Articles 7.3.1(1) and 7.3.5(1) of the UNIDROIT Principles, justified the termination of the agreement and release of A1 member firms from all their obligations towards entity B and A2 member firms under the agreement for the future.

With respect to the request for restitution of the transfer payments already made to A2 member firms, the arbitral tribunal made a reference to Article 7.3.6(1) of the UNIDROIT Principles 1994 (ie, now Article 7.3.6) and noted that upon termination of the contract either party may claim restitution of whatever it has supplied provided that such party concurrently makes restitution of whatever it has received. However, since A1 member firms were unable to return the benefits they had received under the agreement, the arbitral tribunal finally found that they were not entitled to the restitution of the transfer payments.

## 2. *Italy / Arbitration / Koh / Unilex 622 / 1996*

**Case:**<sup>679</sup> Company A from country X entered into a joint venture with company B from country Y. Mr Z became the export director of company A by a consultancy and brokerage contract concluded between company A and company B. The contract was entered into for two years and was tacitly renewable for the same period.

The contract was renewed twice, but prior to the third renewal, company A and Mr Z negotiated an exclusive agency contract. The agency contract was concluded for a period of three years and was to be tacitly renewed unless notice of non-renewal was given six months before expiry. Clause 18 of the agency contract also stipulated that '...In the case of termination by one of the parties, all the conditions of this contract shall be terminated as of the date of the notice, with the following exceptions: a) the agent shall leave all advertising and sales materials supplied by the principal at the principal's disposal on the agent's premises; b) the principal shall pay to the agent all commission

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679 *Company X v Company Y*, Final Award, CAM Case No 1795, 1 December 1996.

fees for orders received, independent of when the orders have been accepted or confirmed or when delivery takes place or the invoices are issued by the principal’.

Company A later terminated the agency contract with Mr Z. Company A later confirmed termination by a letter to company B.

With regard to the effect of termination, the tribunal made reference to Article 7.3.5 of the UNIDROIT Principles, highlighting the parties’ intentions to the contract that all conditions be terminated as of the date of notice, with the exceptions as stipulated above.

## **VIII. Article 7.3.6: Restitution with respect to contracts to be performed at one time**

### *1. Italy / National Court / Martinetti / Not Unilex / 2017*

**Case:**<sup>680</sup> Ms A sued Dr B, a dentist, in order to obtain the termination of the contract, the refund of the payments remitted and compensation for material and non material damages suffered because of the professional misconduct by Dr B.

The court found that Dr B did not prove that the breach of contract was determined by the impossibility of the performance due to a cause non-chargeable on her. Nevertheless, the court did not consider it a grave breach and therefore rejected the claim on the termination of the contract. Likewise, the court rejected the claim for the refund of the payments remitted to Dr B, on the same grounds provided in the case previously analysed. Indeed, the judge quoted the relevant paragraph of that case, also referring to Article 7.3.6 of the UNIDROIT Principles for the above mentioned reasons.

### *2. Italy / National Court / Martinetti / Not Unilex / 2004*

**Case:**<sup>681</sup> Mr A sued Dr B, a dentist, to obtain compensation for material (future medical expenses and refund of the payments) and non material damages suffered because of the professional misconduct of Dr B.

The court found the dental treatments performed by the dentist inadequate and decides, therefore, that Mr A is entitled to obtain compensation for non-material damages and for the future medical expenses that he will have to bear. Nevertheless, the court did not grant Mr A the refund of the payments remitted to Dr B. Indeed, the ‘secondary’ obligations were conditional on each other meaning that each party shall return what was received to the extent that the counterparty is able to fulfil its obligation. Therefore, if one of the performances cannot be returned because of its ontological nature (eg, a dental treatment), also the payment remitted by the other party cannot be returned unless it is found to be reasonable to assign a monetary value to the performance.

On this matter, the judgment quotes Article 7.3.6 of the UNIDROIT Principles that states: ‘On termination of a contract to be performed at one time either party may claim restitution of whatever it has supplied under the contract, provided that such party concurrently makes restitution of

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680 Tribunale of Milano, Case No 1850/2017.

681 Tribunale of Roma, Case No 197/2004.

whatever it has received under the contract. If restitution in kind is not possible or appropriate, an allowance has to be made in money whenever reasonable.’ The judge considered that such article extends to secondary obligations the rule according to which if a party’s performance becomes partially or completely impossible, the other party is accordingly free.

### 3. *Switzerland / Arbitration / Voser, Ninković / Unilex 668 / 2000*

**Case:**<sup>682</sup> The worldwide organisation A is a network of member firms and is divided in two business units, A1 and A2. The cooperative entity B acts as the administrative organ of A. Every member firm and its practice partners enter into an agreement with entity B pursuant to which the member firm and/or its practice partners agree to adhere to the professional standards and principles coordinated by entity B. The relevant arbitration clause in the agreement stated that ‘[t]he arbitrator shall decide in accordance with the terms of this agreement and of the articles and bylaws of [entity B]. In interpreting the provisions of this agreement, the arbitrator shall not be bound to apply the substantive law of any jurisdiction but shall be guided by the policies and considerations set forth in the preamble of this agreement and the articles and bylaws of [entity B], taking into account general principles of equity’.

As organisation A developed through the years, various difficulties began to strain the relationship between the business units A1 and A2. The member firm of the business unit A1 initiated arbitration proceedings against the member firms of the business unit A2 as well as entity B and asserted that both had breached their obligations under the agreement. Allegedly, A2 member firms unduly interfered with A1’s own business practices and entity B failed to coordinate the activities of member firms of the two business units and to implement guidelines to ensure compatibility among them.

The arbitral tribunal seated in Switzerland held that ‘[t]he UNIDROIT Principles 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’.

The arbitral tribunal came to the conclusion that the members of the business unit A2 did not breach their obligations under the agreement. For this reason, it concluded that A1 member firms cannot claim any harm from the alleged breach and are not entitled to any compensation and referred in that regard to Article 7.4.2 of the UNIDROIT Principles. On the other hand, the arbitral tribunal held that entity B was in breach of its material obligations under the agreement, which amounted to a fundamental non-performance, and applied in that regard the criteria set out in Article 7.3.1(2) of the UNIDROIT Principles. It further held that such a fundamental non-performance, in accordance with Articles 7.3.1(1) and 7.3.5(1) of the UNIDROIT Principles, justified the termination of the agreement and release of A1 member firms from all their obligations towards entity B and A2 member firms under the agreement for the future.

With respect to the request for restitution of the transfer payments already made to A2 member firms, the arbitral tribunal made a reference to Article 7.3.6(1) of the UNIDROIT Principles 1994 (ie, now Article 7.3.6) and noted that on termination of the contract either party may claim restitution

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682 ICC, Case No 9797, Final Award, 28 July 2000.

of whatever it has supplied provided that such party concurrently makes restitution of whatever it has received. However, since AI member firms were unable to return the benefits they had received under the agreement, the arbitral tribunal finally found that they were not entitled to the restitution of the transfer payments.

## **IX. Article 7.3.7: Restitution with respect to long-term contracts**

### **1. *Russia / Arbitration / Koh / Unilex 1733 / 2012***

**Case:**<sup>683</sup> The claimant, a company from country X, who was the buyer, entered into a purchase agreement with the respondent, a company from country Y, who was the seller, for technical equipment. The respondent alleged that the claimant had failed to pay for the goods in full and refused to supply a portion of the goods. The claimant countered that they had paid in full for the goods and initiated arbitral proceedings.

The tribunal found that the claimant had paid the price for the goods and that the respondent had no legal grounds to suspend its contractual obligations unilaterally. The tribunal found that the claimant was entitled to suspend the unperformed part of the contract, as the delivered parts were divisible from the undelivered parts. In making this decision the tribunal relied not only on the contracts for the International Sale of Goods, but also on Article 7.3.7(1) of the UNIDROIT Principles. The provisions state that if the performance of the contract is of a continuing nature and is divisible, restitution can only be demanded for the period after termination has taken effect. Thus, the tribunal found that the claimant was entitled to recover the price it had already paid to the respondent for the goods the respondent had not delivered.

## **X. Article 7.4.1: Right to damages**

### **1. *Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2012***

**Case:**<sup>684</sup> Company A and company B entered into a supply and joint venture agreement. In doing so, company A entrusted company B with the exclusive distribution of its products in the area defined in the agreement and company B undertook to acquire certain products exclusively from company A.

In the years that followed, multiple disagreements emerged between the parties. This ultimately led to company A terminating the supply and JVA and company B initiating arbitration proceedings claiming, among other things, damages from company A because the latter had failed to comply with its contractual obligation to take product liability insurance during the term of the contract and had therefore not paid any premiums.

In its award, the arbitral tribunal seated in Switzerland made reference to Article 7.4.1 of the UNIDROIT Principles (which states that any breach of a contractual obligation gives the other party a right to damages) and Article 7.4.2 of the UNIDROIT Principles (which states that for the other party

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683 ICAC, Case No 111/2011, Award, 3 February 2012.

684 Supreme Court of Switzerland, Case No 4A\_360/2011, Decision, 31 January 2012.

to have a right to damages it must actually have suffered damages and that there must be a causal link between the breach of the contractual obligation and those damages).

Company A appealed the award before the Swiss Supreme Court on the ground that the non-observance of its post-hearing brief by the arbitral tribunal constituted, inter alia, a violation of its right to be heard. The Supreme Court found that this indeed violated company A's right to be heard and annulled the award. Since it was only confronted with the question of the consequences of the non-observance, the Supreme Court did not address in its decision the arbitral tribunal's reference to the UNIDROIT Principles.

## **XI. Article 7.4.2: Full compensation**

### **1. France / Arbitration / Sierra / Not Unilex / 2016**

**Case:**<sup>685</sup> Company A, of country X and company B, of country Y, entered into JVA by which they agreed to create two joint companies (companies C and D), in which company B would provide the technology and company A the commercial know-how in order to produce and commercialise certain products in country X. The parties agreed that the JVA would be subject to the UNIDROIT Principles, supplemented if necessary by the laws of country X.

After several years, company B filed a claim against company A, with the ICC. Company B claimed that company A incurred in several breaches, which caused two types of damages as a result of the compound effect of the breaches: (1) yearly losses of earnings before interest, taxes, depreciation, and amortization (EBITDA) (profitability) in the joint venture; and (2) deterioration in the value of the joint venture as an ongoing business. Hence, company B filed a global claim against company A.

The arbitral tribunal held that a global claim does not necessarily fail for lack of causal link between the breaches and the alleged harm. Under the tribunal's award, 'the existence of the necessary causal link requires the evidence that the overall effect of the established breach has caused the harm for which compensation is sought. Otherwise, the harm cannot be found to be the result of the non-performance as required by article 7.4.2 of the UNIDROIT Principles'. Furthermore, the tribunal held that even if company A only breached certain obligations, if those specific breaches were found to be dominant cause of damages, the global claim could prevail.

The tribunal held that company A did incur in certain breaches. However, it said breaches did not play a dominant role in causing the damages argued by company B, and therefore were not the dominant cause of company B's alleged damages.

### **2. Spain / National Court / Doria / Not Unilex / 2014**

**Case:**<sup>686</sup> A Spanish individual claims, as buyer, against a real estate developer company, as seller, for termination of a sale and purchase agreement of a property for breach of the latter, and compensation for moral damages. The property was sold as free from liens and encumbrances and was, therefore, not delivered to the buyer. The Court of Appeal's ruling, by reference to Article 7.4.2

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685 ICC, Case No 18795/CA/ASM (C-19077/CA).

686 Court of Appeal of Granada (Spain), Ruling 196/2014, 21 July 2014.

of the UNIDROIT Principles, among other, declares the valid termination of the sale and the buyer's right to compensation not only for all amounts paid but also for moral damages due to the wilful misconduct of the seller and the anxiety disorder caused to the buyer, confirming the ruling handed down by the judge of first instance.

### 3. *Spain / National Court / Doria / Not Unilex / 2013*

**Case:**<sup>687</sup> A Spanish trade union claimed against a Spanish bank based on breach of fundamental rights and public freedom as a result of the bank not granting an employee the credit of working hours to be used for union representation purposes.

The interest of this ruling of the Fourth Chamber of the Spanish Supreme Court (the chamber which deals with social and employment or labour-related matters) is that, when determining the right to compensation for moral damages it refers to the more open criteria of the Supreme Court and, specifically to the application of such compensation to breach of contracts and not only to torts as provided for in the UNIDROIT Principles (although not mentioned specifically, in Article 7.4.2), as stated in the First Chamber of the Supreme Court Ruling 366/2010 of 15 June 15 June 2010 mentioned below (Compiled Summaries case XI, 7 under article 7.4.2 of the UNIDROIT Principles).

### 4. *Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2012*

**Case:**<sup>688</sup> Company A and company B entered into a supply and joint venture agreement. In doing so, company A entrusted company B with the exclusive distribution of its products in the area defined in the agreement and company B undertook to acquire certain products exclusively from company A.

In the years that followed, multiple disagreements emerged between the parties. This ultimately led to company A terminating the supply and joint venture agreement and company B initiating arbitration proceedings claiming, among other things, damages from company A because the latter had failed to comply with its contractual obligation to take product liability insurance during the term of the contract and had therefore not paid any premiums.

In its award, the arbitral tribunal seated in Switzerland made reference to Article 7.4.1 of the UNIDROIT Principles (which states that any breach of a contractual obligation gives the other party a right to damages) and Article 7.4.2 of the UNIDROIT Principles (which states that for the other party to have a right to damages it must actually have suffered damages and that there must be a causal link between the breach of the contractual obligation and those damages).

Company A appealed the award before the Swiss Supreme Court on the ground that the non-observance of its post-hearing brief by the arbitral tribunal constituted, *inter alia*, a violation of its right to be heard. The Supreme Court found that this indeed violated company A's right to be heard and annulled the award. Since it was only confronted with the question of the consequences of the non-observance, the Supreme Court did not address in its decision that the arbitral tribunal's reference to the UNIDROIT Principles.

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687 Supreme Court of Spain, Ruling 279/2013 (Fourth Chamber), 2 February 2013.

688 Supreme Court of Switzerland, Case No 4A\_360/2011, Decision, 31 January 2012.

## 5. *Spain / National Court / Doria / Not Unilex / 2011*

**Case:**<sup>689</sup> Two Spanish individuals claimed against a travel agency for damages and moral damages suffered for breach of the obligations of the agency as intermediary in the sale of airplane tickets for the Madrid to Sydney journey, for the lack of confirmation of the Bangkok to Sydney in business class, which determined that they had to travel in economy class and which also obliged them to confirm in Sydney the return flight in business.

This ruling of the Court of Appeal, based on the prior ruling of the Spanish Supreme Court 366/2010 of 15 June, which refers to Article 7.4.2 of the UNIDROIT Principles, overrules the previous decision of the judge of first instance and declares the right to compensation for moral damages in the case at hand.

## 6. *Poland / National Court / Wardynski, Przygoda / Not Unilex / 2010*

**Case:**<sup>690</sup> The claimants sought compensation from the organiser of their holiday for the non-pecuniary damage they suffered due to the improper performance of the travel contract (so-called ‘wasted holiday claim’).

The Supreme Court discussed whether the relevant Polish statute allowed the award of such damages. It ruled that it did. In its reasoning, the court made reference to UNIDROIT Principles indicating that pursuant to their Article 7.4.2, the aggrieved party was entitled to full compensation for harm suffered as a result of the non-performance. The court explained that such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain to the aggrieved party resulting from its avoidance of cost or harm. Such harm may be non-pecuniary and could include emotional distress or physical suffering, among other matters.

## 7. *Spain / National Court / Doria / Not Unilex / 2010*

**Case:**<sup>691</sup> In January 2002, a Spanish individual purchased from four other individuals all the quotas of the Spanish company Fast English SL, a franchisee of Open Master Spain SA. The price was paid part in cash and the rest by the assuming debt from a loan granted to the target company by the sellers. The sellers did not disclose to the buyer that since 2000 the franchisor was in a difficult situation. In February 2002, the franchisor’s critical situation was made public and on May 2002 the latter finally filed for bankruptcy proceedings.

The buyer started legal proceedings against the four sellers of the quotas claiming for indemnification, including the payment not only of the purchase price but also for the amounts invested in the franchisee company and moral and physical damages suffered during the course of the closure of the franchisee company, which resulted in psychological consequences and impairment in functioning.

The Spanish Supreme Court, considering the existence of wilful misconduct of the sellers which was already declared in the ruling of the court in first instance, granted the moral damages suffered

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689 Court of Appeal of Navarra (Spain), Ruling 283/2011, 16 December 2011.

690 Supreme Court of Poland, Case No III CZP 79/10, Resolution, 19 November 2010.

691 Supreme Court of Spain, Ruling 366/2010 (First Chamber), 15 June 2010.

by the claimant which were denied in the judgment of the Court of Appeal. The decision of the Supreme Court is based not only on Article 1107 of the Spanish Civil Code ('[...] In the event of wilful misconduct the debtor shall be liable for all damages which are known to have arisen from the failure to perform the obligation') but with express mention to the inclusion of moral damages (also in breach of contracts) in the compensation, referring also in its reasoning to such effect to Article 7.4.2 of the UNIDROIT Principles.

## 8. *Switzerland / Arbitration / Moses / Unilex 1061 / 2001*

**Case:**<sup>692</sup> Company A is in the business of manufacturing and supplying industrial equipment. Company A contracted with company B for the delivery of industrial equipment at company B's location. The agreement between company A and company B detailed the time and place of delivery for the manufacturing equipment. The agreement further emphasised that the equipment needed to be delivered at the specified time because time was of the essence.

Company A never delivered the equipment leading to company B's failure in operating its business. Company A was fully aware of the importance of the industrial equipment to company B's business. The tribunal decided, reasoning in part on Article 7.4.2 of the UNIDROIT Principles, that company B was entitled to full compensation based on company A's failure to meet contractual requirements.

## 9. *Switzerland / Arbitration / Voser, Ninković / Unilex 668 / 2000*

**Case:**<sup>693</sup> The worldwide organisation A is a network of member firms and is divided in two business units, A1 and A2. The cooperative entity B acts as the administrative body of A. Every member firm and its practice partners enter into an agreement with entity B pursuant to which the member firm and/or its practice partners agree to adhere to the professional standards and principles coordinated by entity B. The relevant arbitration clause in the agreement stated that '[t]he arbitrator shall decide in accordance with the terms of this agreement and of the articles and bylaws of [entity B]. In interpreting the provisions of this agreement, the arbitrator shall not be bound to apply the substantive law of any jurisdiction but shall be guided by the policies and considerations set forth in the preamble of this agreement and the articles and bylaws of [entity B], taking into account general principles of equity'.

As organisation A developed over the years, various difficulties began to strain the relationship between the business units A1 and A2. The member firm of the business unit A1 initiated arbitration proceedings against the member firms of the business unit A2 as well as entity B and asserted that both have breached their obligations under the agreement. Allegedly, A2 member firms unduly interfered with A1's own business practices and entity B failed to coordinate the activities of member firms of the two business units and to implement guidelines to ensure compatibility among them.

The arbitral tribunal seated in Switzerland held that '[t]he UNIDROIT Principles 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,

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692 ICC, Case No 9950 Award, June 2001.

693 ICC, Case No 9797, Final Award, 28 July 2000.

moreover, are at the heart of those most fundamental notions which have consistently been applied in arbitral practice’.

The arbitral tribunal came to the conclusion that the members of the business unit A2 did not breach its obligations under the agreement. For this reason, it concluded that A1 member firms cannot claim any harm from the alleged breach and are not entitled to any compensation and referred in that regard to Article 7.4.2 of the UNIDROIT Principles. On the other hand, the tribunal held that entity B was in breach of its material obligations under the agreement, which amounted to a fundamental non-performance, and applied in that regard the criteria set out in Article 7.3.1(2) of the UNIDROIT Principles. It further held that such a fundamental non-performance, in accordance with Articles 7.3.1(1) and 7.3.5(1) of the UNIDROIT Principles, justified the termination of the agreement and release of A1 member firms from all their obligations towards entity B and A2 member firms under the agreement for the future.

With respect to the request for restitution of the transfer payments already made to A2 member firms, the arbitral tribunal made a reference to Article 7.3.6(1) of the UNIDROIT Principles 1994 (ie, now Article 7.3.6) and noted that on termination of the contract either party may claim restitution of whatever it has supplied provided that such party concurrently makes restitution of whatever it has received. However, since A1 member firms were unable to return the benefits they had received under the agreement, the arbitral tribunal finally found that they were not entitled to the restitution of the transfer payments.

## 10. Italy / Arbitration / Rojas Elgueta / Unilex 622 / 1996

**Case:**<sup>694</sup> A dispute arose when A, the principal, terminated a commercial agency contract with B, the agent, due to B’s failure to perform. B claimed that the termination was unlawful and instituted arbitration proceedings to recover pecuniary loss and damages caused by emotional distress from the termination.

The arbitral tribunal applied Article 7.4.2 of the UNIDROIT Principles and clarified that a company is entitled to claim pecuniary losses. However, compensation for non-material harm, such as emotional distress, is only awarded when concerning natural persons (individuals). This is demonstrated by the fact that compensation for non-material harm is only awarded in cases that concern types of harm that can only happen to a natural person, such as of ‘loss of certain acts of life’ or of ‘aesthetic prejudice’ or of ‘health’, ‘aesthetic’ or ‘biological’ damage. Given that the agent is a company and not a natural person, the tribunal found that it could not be awarded compensation on grounds of emotional suffering or distress.

## XII. Article 7.4.3: Certainty of harm

### 1. Mexico / Arbitration / Rojas Elgueta / Unilex 1149 / 2006

**Case:**<sup>695</sup> B, a distributor from country Y, struck a one-year exclusive distribution agreement with A, a grower from country X. A agreed to supply a specific amount of squash and cucumbers exclusively to

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694 Camera Arbitrale Nazionale ed Internazionale di Milano, Case No A-1795/51, Award, 1 December 1996.

695 Centro de Arbitraje de México (CAM), Award, 30 November 2006.

B for distribution on country Y's market against a commission. B instituted arbitral proceedings after A failed to deliver the specified goods and violated the exclusivity agreement. B sought damages for the undelivered goods and the contractual penalty for breaching the exclusivity clause.

In the opinion of the arbitral tribunal, B was able to demonstrate, with a high degree of certainty, the amount, foreseeability, and connection of the harm suffered due to A's failure to perform. However, the contract did not contain any specifics that could help determine a precise amount and B failed to substantiate an amount for the penalty. Since the amount of the penalty could not be established with a sufficient degree of certainty, the tribunal determined it on a discretionary basis according to Article 7.4.3(3) of the UNIDROIT Principles.

## 2. *France / Arbitration / Moses / Unilex 658 / 1997*

**Case:**<sup>696</sup> Company A is a business manufacturing televisions. Company A engages company B in a contract for company B to supply company A with a hardware component for company A's televisions. Company A wishes to sell the new televisions it will produce after company B supplies the necessary component. Company B is fully aware of company A's intentions.

Company B never performs its contract with company A and meanwhile another company enters the market and sells the televisions that company A intended to sell. The dispute between A and B goes to arbitration.

Although company A could still have obtained the component from a third source and damages were possibly not fully calculable, the tribunal – relying in part on Article 7.4.3 of the UNIDROIT Principles – decided that the damages were still reasonably certain to ascertain. The tribunal further reasoned that company A was entitled to damages since company B's lack of performance caused company A a loss of opportunity to realise a profit in the market.

## 3. *Italy / Arbitration / Rojas Elgueta / Unilex 654 / 1996*

**Case:**<sup>697</sup> A, the main contractor and B, the subcontractor, entered into a contract for the supply, installation, and maintenance of electrical works. Despite completion of work by B, A withheld sums due and refused to release the performance bonds which had been issued. B, therefore, requested the release of those bonds and claimed damages. A counterclaimed damages which arose from the delayed completion of work, alleging that the 20-month delay was due to several failures to perform by B that amounted to gross mistakes.

According to the tribunal, the subcontractor's performance amounted to a 'gross mistake' under the generally accepted definition given by the UNIDROIT Principles, since its conduct violated fundamental rules of the article and it repeatedly and continuously failed to perform, in a timely manner, important parts of its obligation. The tribunal therefore found that A was entitled to obtain compensation for the damages it suffered as a result of B's failures.

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696 ICC, Paris 8264, Award, April 1997.

697 ICC, Rome 5835, Award, June 1996.

Nonetheless, the tribunal clarified that the damages claimed by A arose from A's manpower disruption caused by B's delay, hence falling outside the categories of damages which can be established in an arithmetically satisfactory manner.

The law of the contract did not provide for the factors to be taken into consideration by the court when assessing the amount of damages in case they cannot be numerically established. Therefore, the tribunal, in accordance with Article 7.4.3(3) of the UNIDROIT Principles, determined the damages on a discretionary basis.

### **XIII. Article 7.4.4: Foreseeability of harm**

#### *1. Colombia / Arbitration / Rojas Elgueta / Unilex 700 / 2000*

**Case:**<sup>698</sup> Company A, following a public tender, concluded an agreement with B pursuant to which A was to sell electrical energy to B so that the latter could ensure the public supply of electricity in a part of country X. The agreement, however, remained unperformed and A initiated arbitration proceedings seeking damages for B's illegitimate breach of the contract.

The arbitral tribunal clarified that, for compensation to be awarded, the loss suffered needs to be not only direct but also foreseeable, being included in the definition of 'foreseeable losses', according to Article 7.4.4 of the UNIDROIT Principles, all those which may fairly and reasonably be considered either arising naturally from the breach itself, according to the usual course of things, or that have been within the contemplation of the party as associated with its breach.

Following this reasoning, the tribunal held that it was clear to B that the essential objective of A, in taking part in the public tender and in entering into the contract, was to obtain a return on its investment, and hence B was, in any case, able to foresee the consequences of its breach.

### **XIV. Article 7.4.5: Proof of harm in case of replacement transaction**

#### *1. Russia / Arbitration / Petrachkov, Bekker / Unilex 623 / 1997*

**Case:**<sup>699</sup> The claimant, a Russian company, filed a lawsuit against a defendant, a Hong Kong company, for collection of an advance payment for the goods, which were not delivered, and incurred interests. The defendant alleged that due to the fact that the claimant did not perform its payment obligations in full, the defendant had to make replacement transactions with two contractors and the price which the defendant had to pay to two contractors was higher than the advance payment under the contract with the claimant. The arbitral tribunal accepted the position of the defendant.

The court's reasoning is explained below.

As the parties in the contract did not agree on the law applicable to the case, during the arbitration proceedings the parties agreed to resolve the dispute in accordance with the UNIDROIT Principles;

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698 ICC, Case No 10346, Award, Barranquilla, 2000.

699 ICAC, Case No 116/1996, Award, 20 January 1997.

in accordance with the article 1.4 of the UNIDROIT Principles they are subject to application as the law governing the contract.

The plaintiff did not fulfil his obligations for the advance payment of goods within the terms established by the contract and in the additional terms provided by the defendant, which in accordance with Article 7.3.1 of the UNIDROIT Principles granted the defendant with the right to terminate the contract and, in order to reduce the damage, make a replacement transactions for the sale of goods, which were not paid for by the plaintiff, with other buyers under the terms of the contract. As a result of termination of the contract and making two replacement transactions by the respondent, both disputing parties suffered damages: the plaintiff – in the amount of the advanced payments, and the defendant – in the amount representing the difference between the contract price and the price of the replacement transactions. The damage suffered by both parties is proved. However, the plaintiff's claim to return to him an advance payments is not justified, while the plaintiff's reference to Article 7.3.6 of the UNIDROIT Principles cannot be taken into account, because the right of the defendant to receive compensation for damage is provided for in Article 7.4.5 of the UNIDROIT Principles.

Taking into account that the claim for compensation of damages suffered by the defendant is not formalised as a counterclaim, but rather presented in the form of statement of defence against the plaintiff's claims and, as it follows from the materials, the damage suffered by the defendant exceeded the damages suffered by the plaintiff, the ICAC does not find grounds for satisfaction of the claim.

## **XV. Article 7.4.6: Proof of harm by current price**

### **1. China / Arbitration / Moses, Rojas Elgueta / Unilex 1441 / 2004**

**Case:**<sup>700</sup> B, a trading company, entered into a contract with A, a steel importer, for the supply of rolled steel sheets. Shortly before the agreed time of delivery, B informed A that it would not be in a position to fulfil its contractual obligations since it had to deliver the goods to another customer under a contract it had previously concluded with the latter. Consequently, A commenced arbitral proceedings requesting compensation for the losses suffered as a result of B's failure to perform.

In the view of the tribunal, whenever a replacement transaction is not possible, compensation has to be calculated with regard to the price current at the time of termination of the contract, which, in light of Article 76 of the CISG and Article 7.4.6 of the UNIDROIT Principles, corresponds to the time of avoidance or to the time, in the words of the tribunal, 'when the repudiation of it by one of the parties is accepted by the other party', because until such time the contract might well not be avoided.

### **2. France / Arbitration / Rojas Elgueta / Unilex 655 / 1996**

**Case:**<sup>701</sup> A and B entered into a contract for the supply of a given quantity of rice. Even though all the required formalities had been carried out, B failed to provide the goods as agreed. A, therefore, commenced arbitral proceedings seeking damages.

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700 China International Economic and Trade Arbitration Commission, Case No 0291-1, Award, September 2004.

701 ICC, Case No 8502, Award, Paris, 1996.

The arbitral tribunal found that since B failed to comply with its obligations under the contract and its failure was not legally justified, A was entitled to compensation. In calculating the amount of the compensation the tribunal clarified, referring both to Article 76 of the CISG and Article 7.4.6 of the UNIDROIT Principles, that, when a replacement transaction is not possible, the damaged is entitled to recover the difference between the ‘contract price’ (the price determined by the contractual provisions agreed by the parties, which include the initial contract and all the subsequent amendments) and the relevant ‘market price’ (the price charged at the place where the contract should have been performed or the place that appears reasonable to take as a reference) at the time the contract was terminated.

## **XVI. Article 7.4.7: Harm due in part to aggrieved party**

### **1. *Switzerland / Arbitration / Moses / Unilex 1179 / 2007***

**Case:**<sup>702</sup> Person A entered into an agreement with person B. A and B are both scientists and engaged with each other to undertake a joint venture to produce a new pharmaceutical drug. The agreement detailed the various responsibilities each party owed to one another and was otherwise void of any fraud or inequitable terms.

After the agreement’s execution, disagreement arose between the parties. Person A accused person B of not fulfilling its obligations in obtaining the necessary licensing requirements to market, distribute, and patent the new drug. Meanwhile, before and during the dispute, person A neglected to provide person B with the required information for person B to fulfil their obligations under the agreement.

Person B’s actions, however, showed that they were unnecessarily withholding performance of certain contractual obligations that were within their powers to control. In light of this, the tribunal reasoned, under Article 7.4.7 of the UNIDROIT Principles, that person B should be required to pay damages to person A for those damages that could be attributed to person B’s failure to perform. With respect to the damages that person B sought – but was responsible in causing – the arbitral tribunal decided that they were not entitled to an award of those damages.

### **2. *Russia / Arbitration / Rojas Elgueta, Petrachkov, Bekker / Unilex 1041 / 2003***

**Case:**<sup>703</sup> Company B purchased components of ‘high sensitivity’ from company A, for incorporation into a final product. Company B discovered that the products company A delivered were not as specified in the contract. The products were defective and did not possess the specified characteristics for incorporation into its final products. Company B commenced arbitral proceedings claiming damages due to non-conformity. Company A did not contend that the goods were not defective. Instead, company A argued that company B did not thoroughly inspect the goods before they were delivered or notify company A of the non-conformity in a timely manner and was therefore not entitled to damages.

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702 World Intellectual Property Organization Arbitration and Mediation Center (Geneva), Award, 25 January 2007.

703 ICAC, Case No 97/2002, Award, 6 June 2003.

According to the tribunal, notwithstanding the ‘high sensitivity’ of the goods delivered, the parties did not set out the procedure and methods of inspection of said goods in the contract. Nor did the contract contain any reference to the technical documentation required by standards set by the international organisations.

The tribunal found that, even if company B was a professional participant in the market of such goods and was well aware of the requirements set for finished products in which the purchased goods were used, yet company B did not use due care either when making the contract or when performing it and acted with negligence. Therefore, the tribunal reasoned, partly under Article 7.4.7 of the UNIDROIT Principles, that B had also contributed to the harm and that the parties were to be considered jointly liable.

### 3. *France / Arbitration / Rojas Elgueta / Unilex 964 / 2003*

**Case:**<sup>704</sup> Company B contracted with company A, a manufacturer, for the sale of goods to be delivered directly to company B’s customers. Some customers of company B refused to pay for the goods delivered by company A due to non-conformity. Company B contacted company A, urging it to contact company B’s customers and find a solution for the non-conforming goods. Company A did no such thing. Company A requested company B to pay for the delivered goods and the cost of the raw materials used for manufacturing. Company B refused to make the payments, and company A responded by initiating arbitral proceedings.

With respect to the request for payment of the goods already delivered, the tribunal held that, despite the alleged defects of the goods, Company B’s customers were able to use the goods for other purposes and eventually paid company B the full price. Thus, B’s refusal was not justified, and A was entitled to obtain payment.

With respect to the request for payment of the raw materials, the tribunal invoked Article 7.4.7 of the UNIDROIT Principles. The tribunal found that company A and company B’s lack of cooperation in solving the claims made by B’s customers had significantly contributed to the harm. Thus, that uncooperative behaviour prevented each of them from requesting damages related to the cost of the raw materials.

### 4. *Russia / Arbitration / Rojas Elgueta / Unilex 670 / 1997*

**Case:**<sup>705</sup> The seller and the buyer entered into a contract for the sale of goods, which required the buyer to make a payment in advance. However, the seller was not able to deliver the promised goods in time due to a delay in the clearance of the goods in customs. As a consequence, the buyer initiated arbitral proceedings for payment of interest on the amount it had paid in advance.

According to the tribunal, the delay at customs was partially caused by the actions of the buyer. The buyer, in fact, had not provided the seller with the documentation required for customs clearance in a timely manner. Therefore, the tribunal only awarded part of the interest asked by the buyer. In doing so, the tribunal referred to the UNIDROIT Principles, Article 7.4.7, which states whenever the harm suffered by the aggrieved party is in part due to an act or an omission of that same party, that party has to bear concurrent liability.

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704 ICC, Case No 12111, Award, 3 October 2003.

705 ICAC, Case No 225/1996, Award, 2 September 1997.

## XVII. Article 7.4.8: Mitigation of harm

### 1. *Spain / National Court / Doria / Not Unilex / 2015*

**Case:**<sup>706</sup> From 2000–2003, company A expanded its distribution of energy into another market in Spain by entering into supply agreements with a number of customers in the new market. Once it had concluded all the works of the infrastructure and installations and obtained the necessary licences, company A requested company B to use of its distribution network to deliver the service to its customers, based on the regulations in force given that company B was the owner of the only existing network in the area. Company B denied access to company A, in spite of the resolutions of the National Energy Commission (and the later rulings of the administrative courts) acknowledging company A's right to do so. In order to not to incur penalties with its customers, the latter decided to provide the service by using diesel generator equipment rented from third parties, which implied a considerable over cost in respect of the access to company B's network. Company B offered to company A to render the services to the latter's customers through its network but using the infrastructure and installations constructed by company A, which was rejected by this company.

In 2003, company B sold its network to another company, which finally granted company A access to the network.

In 2010, company A filed a claim before the Spanish courts against company B for compensation of the over cost incurred in delivering the service to its customers. Company B opposed the claim alleging, among other grounds, the fact that the attitude of company A did not mitigate the harm, as the provisional solution offered by company B would have been less costly than the one company A adopted. The Spanish Supreme Court ruled that the amount claimed by the latter (which was a matter of dispute in the previous instances) should be paid by company B, rejecting the arguments of this company on the lack of mitigation, as it would have been illegitimate to prevent company A from servicing its customers and that the solution of renting diesel generators was reasonable. The Supreme Court in its ruling referred also to the obligation of the damaged party to mitigate the harm as contemplated in Article 17 of the Spanish Insure Contract Act, Article 77 of the Convention of Vienna of International Sale of Goods, Article 7.4.8 of the UNIDROIT Principles and Article 88 of the Uniform Law for the International Sales of Goods.

### 2. *France / Arbitration / Rojas Elgueta / Unilex 1661 / 2006*

**Case:**<sup>707</sup> A, the seller, entered into a sales contract with B, the buyer, for certain goods to be delivered to the port of country X. However, with the goods in transit, B sold them to a third company, C. Upon delivery of the goods, C received two conflicting bills of lading for the same shipment, a clean bill and a bill mentioning defects as per an independent surveyor's report. A dispute then arose between the parties in relation to the quality and conformity of the goods. Following the dispute the parties signed a settlement agreement, upon B's proposal.

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706 Supreme Court of Spain, Ruling 123/2015 (First Chamber), 4 March, 2015.

707 ICC, Case No 13009, Award, 2006.

After the settlement, A instituted arbitral proceedings claiming that it had been forced to settle due to economic duress. A claimed, among other things, that B had failed to mitigate its losses entitling A to damages.

Indeed, before commencing arbitration proceedings, A had initiated civil and criminal court proceedings against B and C, in which B had endorsed C's position. In light of these facts, the arbitral tribunal rejected all the claims made by A. The tribunal observed that, according to Article 7.4.8 of the UNIDROIT Principles, B had indeed exercised its duty to mitigate losses by endorsing C's position. It is common judicial practice that a defendant (B in the case at hand) joins its contractor (C in the case at hand) in court proceedings.

### 3. *France / Arbitration / Rojas Elgueta / Unilex 691 / 1999*

**Case:**<sup>708</sup> A dispute arose when A, the seller, delivered and installed certain defective machinery to B, the buyer. Upon notification of the problem, A made efforts to mitigate, however, B without exploring other options, halted payments to A. B also began using the defective machinery which produced defective final goods. These defective final goods were sold to customers who ended up filing cases against B for damages from the non-conformity of the final goods.

An arbitration proceeding was instituted wherein both parties A and B, accused the other of breach of contract. B also claimed consequential damages from the non-conformity of the final goods as a result of the malfunctioning of the machinery.

The tribunal referred to Article 7.4.8 of the UNIDROIT Principles and found that B could not be granted any recovery of losses due to A's alleged breach. This is because B did not take any reasonable steps to mitigate its damage, as was demonstrated by the fact that, even after the discovery of the defects, it continued using the machinery. B did not take any serious measures to repair those defects or entertain A's offer to accommodate matters over the defective machinery.

### 4. *Argentina / National Court / Moses / Unilex 1631 / 2001*

**Case:**<sup>709</sup> Party A engaged party B to do certain irrigation work on party A's property. Party A, a landowner with agricultural land, was relying on party B's irrigation work to conduct its farming business. The agreement detailed the responsibilities and the timeline by which party B was to complete its work.

Party B negligently installed a small part of the irrigation system which caused a section of party A's crops to be destroyed. However, a good portion of the crops in that section could have reasonably been saved had party A exercised reasonable care and irrigated those crops manually.

In this action, the court, referring to Article 7.4.8 of the UNIDROIT Principles, held that party A was not entitled to recover those damages that it could have reasonably avoided because a party has a duty to mitigate losses.

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708 ICC, Case No 9594, Award, March 1999.

709 *Nadal Nicolau, Carlos A v Departamento General de Irrigación*, Suprema Corte de Justicia de la Provincia de Mendoza, Judgment, 18 September 2001.

## 5. France / Arbitration / Rojas Elgueta / Unilex 659 / 1997

**Case:**<sup>710</sup> A, the seller of certain food products, stopped delivering goods to B, the buyer, and subsequently terminated an agreement with B, as B was unable to make the payments by the agreed upon deadlines. B instituted arbitral proceedings against A claiming that delays in payment originated from the dismissal of its general manager who had set up a competing commercial relationship with A.

According to the arbitrator, the sudden, unexpected interruption of deliveries from A to B caused B harm by forcing it to adapt its manufacturing to handle the lack of deliveries from A. The arbitrator noted, however, that B neither provided proof that these difficulties lasted for a long period of time nor specified what efforts were made during these adaptations.

In the absence of proof as to the efforts and attempts made by B during the alleged year of inactivity, the arbitrator, applying Article 7.4.8 of the UNIDROIT Principles, considered that B's commercial inactivity was at least partially due to B's own actions, and that B had not taken reasonable steps to reduce the harm it suffered.

### XVIII. Article 7.4.9: Interest for failure to pay money

#### 1. *Russia / Arbitration / Petrachkov, Bekker / Not Unilex / 2013*

**Case:**<sup>711</sup> A claimant, a Japanese company, filed a lawsuit with the ICAC against a defendant, a Russian company, for collection of an advance payment for the goods, which were delayed in delivery, contractual penalties and interests. The defendant objected, inter alia, against penalties and interests.

The court's reasoning is explained below.

On the question of applicable law, the ICAC stated that this issue is resolved by the parties in the contractual provision containing the arbitration clause. In both versions the parties have chosen the law of the Russian Federation as the applicable law.

Since the subject of the contract was the supply of goods by the Russian company to the Japanese company, the ICAC found that the relations of the parties to the contract, in terms of subject matter and involving parties, were covered by the CISG, to which the Russia is a party.

The ICAC stated that in the hearing the defendant acknowledged the claimant's right to claim interests, but at the same time defendant requested to reduce the amount of interests on the basis of Article 333 of the Civil Code of the Russian Federation.

The tribunal considered such a petition of the defendant was satisfied on the following grounds.

First, the regulation of the collection of annual interests accrued on monetary obligations in Article 78 of the CISG and in Article 395 of the Civil Code of the Russian Federation has significant differences. The CISG provides for recovery of damages above the amount of interest, and not in part, exceeding the amount of interests, as it is specified in the Civil Code. The generally accepted

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<sup>710</sup> ICC, Case No 8817, Award, December 1997.

<sup>711</sup> ICAC, Case No 218/2012, Award, 1 July 2013.

approach in international commercial practice, reflected in Article 7.4.9(1) of the UNIDROIT Principles, is that a debtor who failed to pay a sum of money shall pay interest, regardless of whether he is released from responsibility for failure to perform a payment.

Considering the above and relying on clause 1 of Article 84 of the CISG and paragraph 1 of Article 395 of the Civil Code of the Russian Federation, the ICAC considered that the claimant's claim to recover interest from the defendant was reasonable and justifiable.

## 2. *Switzerland / Arbitration / Voser, Ninković / Not Unilex / 2011*

**Case:**<sup>712</sup> Company A from country X entered into a contract for the supply of a commodity with company B from country Y, which provided for several deliveries and a purchase price formula with fixed and variable parameters. The contract was governed by 'the substantive law of Switzerland'. A few days later, company B entered into a contract with a third company, C for the onward sale of the commodity. On the date the first shipment was to be loaded, the price of the commodity collapsed and consequently the purchase price was minimal and even negative in respect of certain deliveries. Since company A did not deliver the agreed quantities, company B could not fulfil its obligations towards company C. Company B initiated arbitration proceedings against company A claiming loss of profit, damage to its reputation, reimbursement of contractual penalties paid to company C and compensation for consultancy and legal fees and the time spent in connection with attempts to remedy the situation.<sup>713</sup>

The arbitral tribunal seated in Switzerland addressed the issue of hardship. It stated that under the CISG parties are free to include in their contracts hardship clauses, which 'address an unforeseen shift in the economic equilibrium, not unforeseen [factual, legal, etc] impediments' [emphasis omitted].<sup>714</sup> After pointing out that such a distinction is not always made in commercial practice, the arbitral tribunal stated that the distinction was introduced to transnational commercial law by the UNIDROIT Principles, which may be used, according to its preamble, as an interpretation help or as a supplement to international uniform law instruments. Consequently, the tribunal applied the requirements as set out in Article 6.2.2 of the UNIDROIT Principles. After it found that these requirements were met, the arbitral tribunal addressed the effects of hardship as set out in Article 6.2.3 of the UNIDROIT Principles and found that the requirements of Article 6.2.3 were met as well since the parties failed to reach an agreement during their negotiations. For this reason, according to Article 6.2.3(3) of the UNIDROIT Principles, it was up to the arbitral tribunal to take the adequate measure pursuant to subsection (4) of the same article. The tribunal held that it enjoys substantial discretion in this regard and decided that adaptation, rather than termination, was both 'reasonable' and 'fair'.

In the context of the loss of profit claim, the tribunal applied interest at the statutory rate provided for in Swiss law, as requested by company B, starting from the time when the loss occurred. Yet, the arbitral tribunal mentioned in an aside that it saw much merit in the uniform law approach taken by some arbitral tribunals which have applied, in light of CISG's silence on the issue of interest rates, the rate provided for in Article 7.4.9 of the UNIDROIT Principles.

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712 ICC, Case No 16369, Final Award, 2011.

713 Albert Jan van den Berg, *Yearbook Commercial Arbitration Vol XXXIX* (Kluwer 2014) 39, 170 et seq.

714 *Ibid* at 201.

### 3. *Serbia / Arbitration / Rojas Elgueta / Unilex 1442 / 2008*

**Case:**<sup>715</sup> Company A entered into a contract with company B for the purchase of white crystal sugar from country X's 2002 harvest. The contract required company B to provide a national certificate of origin, known as an 'EUR 1', for the sugar. The certificate is issued by the customs administration of country X and gives the sugar deliveries favoured treatment without import duties. A dispute arose when company B was unable to acquire the certificate for the last quarter of the sugar deliveries. As a consequence, company A paid import duties plus VAT at the border to import the sugar.

The arbitral tribunal found that company B was in breach of its contractual obligations by failing to deliver a portion of the sugar order with a certificate of origin. The tribunal awarded company A compensation for payment of the import duties plus interest. The tribunal based its calculation of interest on Article 9:508 of the Principles of European Contract Law, Article 7.4.9 of the UNIDROIT Principles and a Statistical Report of the European Central Bank from December 2007, which highlighted changes in the interest rate, EURIBOR, for the relevant period.

### 4. *Poland / National Court / Wardynski, Przygoda / Not Unilex / 2008*

**Case:**<sup>716</sup> Company A, a Germany entity, and company B, a Polish entity, were in dispute regarding an international sales of goods contract. A was seeking damages for breach of contract, together with interest. The Supreme Court had to decide which rate of interest applied. It ruled that this had to be determined according to the *lex contractii* stipulated by the conflict of laws rules for the seat of the court.

The justification of the judgment showed that B tried to rely on UNIDROIT principles (although the specific provision was not mentioned) to justify its position on the level of interest.

The court ruled that private codifications, such as the UNIDROIT Principles or the of European contract law, may not be used, even as a secondary source of law, that they are external to CISG, and that they are not relevant for a state court which must rule based on the law. Had the court applied the applicable Articles 7.4.9 and 7.4.10 of the UNIDROIT Principles, it would have assessed the rate of applicable interest differently.

### 5. *Russia / Arbitration / Rojas Elgueta / Unilex 1475 / 2008*

**Case:**<sup>717</sup> A dispute arose when a buyer, A, of certain goods received only a portion of their order, with some goods being defective, from a seller, B, after making the entire payment in advance as per the terms of the contract. A requested a portion of the total price to be reimbursed by B along with the payment of the contractual stipulated penalty for partial delivery. After B refused, A instituted arbitral proceedings asking for the reimbursement of the price, the contractual penalty, and an interest payment for the delay in payment. However, B countered that its failure to perform was excused by an exempting event.

The tribunal ruled that B faced an exempting event and was excused from paying the contractual stipulated penalty. However, the tribunal ruled that B did have to make the interest payment. This

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715 Foreign Trade Court of Arbitration attached to the Serbian Chamber of Commerce, Case No T-9/07, Award, 23 January 2008.

716 Poland Supreme Court, 9 October 2008, Case No V CSK 63/08. Published in OSNC 2009/10/143.

717 ICAC, Case No 13/2007, Award, 13 May 2008.

conclusion was based on the generally accepted international commercial practice of interest being due even if the delay in payment is the consequence of force majeure. Article 7.4.9 of the UNIDROIT Principles supports the tribunal's view.

## 6. *Russia / Arbitration / Petrachkov, Bekker / Unilex 1077 / 2004*

**Case:**<sup>718</sup> A claimant, a Russian company, filed a lawsuit with the ICAC against a defendant, an Indian company, for collection of indebtedness for the goods, which were not delivered, and incurred interest. The arbitral tribunal ruled in favour of the claimant.

The court's reasoning is explained below.

With regard to the amount of interests, the ICAC stated that in the 1980 CISG (Article 78) the interest rate and the procedure for calculating them were not expressly determined. In Article 395 of the Civil Code of the Russian Federation stipulates that the amount of interest shall be determined as the current interest rate at the place of location of the creditor in the amount of the banking interest rate on the day of fulfilment of the monetary obligation. In case of recovering of debt in court, a court may satisfy the creditor's claim based on the banking interest rate on the day of the submission of claim or on the date of the judgment. The claimant's representatives insisted on applying of the interest rate on the day of filing the claim, on 5 July 2002, the arbitral tribunal found it possible to satisfy such request.

Since there is no interest rate in Indian rupees in Russia, that is, at the location of the creditor (the claimant), the arbitral tribunal took into account the international practice applied in similar cases, reflected in Article 7.4.9(2) of the UNIDROIT Principles (1994), according to which 'the rate of interest shall be the average bank short-term lending rate to prime borrowers prevailing for the currency of payment at the place for payment, or where no such rate exists at that place, then the same rate in the state of the currency of payment'.

Considering this, the arbitral tribunal applied the interest rate as established by the Reserve Bank of India as used for short-term lendings to prime borrowers, according to the publications of the Reserve Bank of India as of date of filing the claim – 12.8 per cent per annum (2001 Report of the Reserve Bank of India for 2001–2002, official website of the Reserve Bank of India, [www.rbi.org.in](http://www.rbi.org.in)).

Based on the foregoing, the ICAC concluded that the defendant is obliged to pay interest to the claimant.

## 7. *France / Arbitration / Rojas Elgueta / Unilex 1068 / 2001*

**Case:**<sup>719</sup> Company A, a manufacturer, contracted companies B and C to promote A's products and assist in the collection of payments from A's customers. It came to A's attention that B and C had withheld part of the amount due to A. In response, A initiated arbitral proceedings against B and C, claiming the withheld amounts and accrued interest.

The arbitral tribunal awarded A the amounts due and the accrued interest. The tribunal based its calculation of interest on Article 1282 of the Italian Civil Code, and Article 7.4.9 of the UNIDROIT

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718 ICAC, Case No 100/2002, Award, 19 May 2004.

719 ICC, Case No 11051, Award, July 2001.

Principles, which states that ‘[i]f a party does not pay a sum of money when it falls due, the aggrieved party is entitled to interest upon that sum from the time when payment is due [...]’. In this case, the time when payment is due was from when the amounts were paid by A’s customers to B and C.

#### 8. *Switzerland / Arbitration / Voser, Ninković / Unilex 665 / 1998*

**Case:**<sup>720</sup> Company A entered into an agreement with company B for the provision of certain services to help company B win and perform a construction contract. The agreement contained a choice of law clause in favour of Swiss domestic law. Company B paid 40 per cent of the commissions, but afterwards refused to pay the balance to company A, based on allegations of bribery. Company A initiated arbitration proceedings to recover the outstanding commission, plus damages and interest.

The arbitral tribunal seated in Switzerland dismissed the allegations of corruption and ordered company B to pay the commission plus interest. In particular, in order to confirm that the claim for interest was part of the general claim for damages, the arbitral tribunal cited the author Klaus Peter Berger, according to whom ‘[f]rom a functional perspective, the interest claim in article 78 CISG, just as the one in article 7.4.9 of the Principles, and any statutory interest claim constitutes the minimum lump sum compensation for damages in areas where the creditor need not prove the actual damages incurred. It is a long-standing practice of international arbitrators, as well as of the Iran-US Claims Tribunal, to consider the interest claim as part of the general claim for damages’.<sup>721</sup>

The arbitral tribunal held that nothing in the agreement suggested that the parties intended to exclude the right to payment of interest in the event of default, and awarded company A the interest rate of five per cent provided for under Swiss law. In reaching this conclusion, it pointed out that such an exclusion of interest would have been difficult to reconcile with ‘[...] the usages of international trade which are echoed by, among others, the [CISG] or again the UNIDROIT Principles [...]’.

#### 9. *Switzerland / Arbitration / Voser, Ninković / Unilex 637 / 1995*

**Case:**<sup>722</sup> In order to perform a contract with a third party, company A from country X entered into a contract with company B from country Y for the supply of chemical fertilizer. Company B in turn applied to the supplier company C from country Z in order to obtain part of the fertilizer. Company A sent company C the packaging (bags) to be used for delivery of the fertilizer, which were manufactured by company A under company B’s instructions. As the bags did not conform to the technical rules of country Z’s chemical industry, company C could not use them and, consequently, the fertilizer were not delivered within the contractual time limit.

Company A asked company B in writing when the goods would be delivered and expressly stated that, in the absence of a clear commitment by company B, it would avoid the contract with respect to the part of the fertilizer not yet delivered. Because of company B’s generic reply, company A had to make a substitute purchase at a higher price to be able to perform under the contract with the third party. Company A commenced arbitration proceedings demanding damages, including the cost of the bags

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720 ICC, Case No 9333, Final Award, October 1998.

721 ICC International Court of Arbitration Bulletin (1999) 10(2), 102 et seq.

722 ICC, Case No 8128, Final Award, 1995.

it had supplied to company C as well as the loss deriving from the substitute purchase. It also asked for interest at the London International Bank Offered Rate (LIBOR) plus two per cent.

The arbitral tribunal seated in Switzerland decided that company A was entitled to recover damages, including both the costs for the bags as well as the substitute purchase. Since CISG does not determine the rate of interest, the arbitral tribunal applied the average bank shortterm lending rate to prime borrowers, as provided for in Article 7.4.9 of the UNIDROIT Principles and Article 4.507 of the Principles of European Contract Law, which must be considered applicable because they constitute general principles on which CISG is based. As the rate required by company A corresponded to the bank short-term lending rate to prime borrowers, the arbitral tribunal awarded interests at the required rate.

#### 10. *Austria / Arbitration / Rojas Elgueta / Unilex 635 / 1994*

**Case:**<sup>723</sup> The seller, A, sold rolled metal sheets through a contract to the buyer, B. After receiving the first two deliveries, B sold the metal to C who then sold the sheets to a manufacturer, D. Upon arrival, D found the metal to be defective and would not accept the rest of the shipment. Prior to instituting arbitral proceedings, B sent notice to A seeking damages for the defective products. However, A claimed this notice was untimely and refused to pay damages. After A's refusal, B instituted arbitral proceedings seeking the requested damages and the accrued interest.

The tribunal ruled in favour of B and awarded damages. To decide on the payment of interest the tribunal referred to Article 7.4.9 of the UNIDROIT Principles. The article states that, in the event of failure by the debtor to pay a monetary debt, the creditor – who, as a business person, must be expected to resort to bank credit as a result of the delay in payment – should be entitled to interest at the rate commonly practiced in the creditor's country and with respect to that country's currency. The tribunal awarded interest based on the average prime rate in B's country and with respect to B's country's currency of payment.

## XIX. Article 7.4.10: Interest on damages

#### 1. *France / Arbitration / Rojas Elgueta / Unilex 1060 / 2001*

**Case:**<sup>724</sup> A entered into a contract with B and C for the delivery of certain goods. The contract provided for an advance payment from A which the latter promptly made. B and C, on the contrary, delivered goods not in conformity with the characteristic specified in the contract. A, therefore, sued companies B and C for damages related to their failure to perform, asking also for interest to be calculated, alternatively, from the time of the breach of the contract, or from the time of the advance payment originally made, or from the termination of the contract, or, lastly, from the date of A's request for reimbursement.

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723 Internationales Schiedsgericht der Bundeskammer der gewerblichen Wirtschaft, Wien, Case No SCH-4318, 15 June 1994.

724 ICC, Case No 9771, Award, January 2001.

The tribunal held that, according to Article 7.4.10 of the UNIDROIT Principles, A was only entitled to obtain interest from the time of the breach of the contract, and that, in any case, A was not even able to offer any reason on why interest should have been calculated from a different starting point.

## **XX. Article 7.4.13: Agreed payment for non-performance**

### *1. United Kingdom / National Court / Cowan / Not Unilex / 2015*

**Case:**<sup>725</sup> The court was determining appeals in two separate cases but which raised similar issues of law in relation to the English law ‘rule against penalties’ for breach of contract.

In the first case, A agreed to sell to B a controlling share in the holding company of a large advertising and marketing group. Under the agreement, in the event of breach of certain restrictive covenants, A would not be entitled to receive the final instalments of the sale price, and could be obliged to sell his remaining shares to B at a price that excluded the value of the goodwill of the business. A breached the restrictive covenants but argued that the two clauses were unenforceable penalties under English law.

In the second appeal, the case concerned A, who operated a private car park at which notices were displayed stating that failure to comply with a two-hour parking time limit would ‘result in a parking charge of £85’. B over-stayed for an hour beyond the two-hour limit, and argued that the £85 charge was an unenforceable penalty under English law.

Prior to the UK Supreme Court’s ruling in this case, the long-established principle in English law was that clauses would be held as unenforceable penalties where they imposed an obligation to pay a sum which was not a ‘reasonable pre-estimate’ at the time the contract was entered into of the loss that the other party would suffer in the event of breach of the obligation in question.

The UK Supreme Court criticised that pre-existing statement of the rule against penalties, and took the opportunity to restate the principle and its basis. In doing so, the court made several references to the UNIDROIT Principles, Article 7.4.13 (together with UNCITRAL texts) as influential attempts to codify the law of contracts internationally and which recognised the utility and desirability of judicial control over ‘grossly excessive’ or ‘manifestly excessive’ or ‘substantially disproportionate’ penalty clauses. With such sources described as ‘soft law’ by the court, this was characterised as consistent with civil law approaches in many jurisdictions that ‘all provide for the modification of contractual penalties using tests such as “manifestly excessive”, “disproportionately high”, or “excessive”’.

In respect of English law, the court distinguished between primary and secondary obligations: the former being the primary obligations to be performed, the latter being obligations that are conditional on the performance or non-performance of the former – for example, an obligation to pay a sum of money in the event of a breach of a primary obligation. The rule against penalties in English law only applies to the latter, not to the former.

In relation to secondary obligations, they would be unenforceable penalties where: ‘...the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary

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<sup>725</sup> *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Ltd v Beavis* (2015) UKSC 67.

obligation'. Elsewhere in the judgment, other judges expressed the test using language such as 'disproportionate' and 'extravagant, exorbitant or unconscionable', similar to the language used in Article 7.4.13 of the UNIDROIT Principles.

In considering a contractual provision against these tests, the court held that the legitimate interests of the innocent party could include wider concepts such as deterring the other party from breaching the contract, and thus could extend to amounts greater than 'pre-estimates of loss' viewed in purely compensatory terms.

## 2. *Poland / National Court / Wardynski, Przygoda / Unilex 1054 / 2003*

**Case:**<sup>726</sup> Party A and party B agree that in the event of non-performance or improper performance of the contract, party A will be entitled to contractual damages. A disagreement arose as to whether party B was obliged to pay contractual damages even if it was demonstrated that party A did not suffer any damage as a result of non-performance or improper performance of the contract by party B.

The Supreme Court discussed Polish case law and legal regulations in the legal systems of France, Germany and Switzerland, which it considered to have legal systems similar to that of Poland. The Court ruled that the debtor is obliged to pay the contractual penalty, even if he shows that the creditor did not suffer any damage. The Supreme Court made reference to the UNIDROIT Principles by pointing out that its resolution is in line with the Article 7.4.13 of the UNIDROIT Principles of 1994. According to the latter, if a contract specifies that the party that fails to perform the contract must pay the other party a certain amount in the event of non-performance, then the other party is entitled to claim this amount, regardless of the actual damage suffered. Unless otherwise stipulated, that amount might be reduced to a reasonable amount when it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances. The Supreme Court also pointed out that a similar regulation is included in Article 9.509 of the Principles of European Contract Law of 1998. Thus, the UNIDROIT Principles were referred to as one of the international bodies of legal rules supporting a view on a particular legal provision advocated by the Supreme Court. The principles were not used as an applicable law, but as a body of rules on which the Supreme Court drew and which it used to reinforce its reasoning process.

## 3. *Russia / Arbitration / Rojas Elgueta / Unilex 1196 / 2003*

**Case:**<sup>727</sup> This dispute arose from delayed payments from B, the buyer, to A, the seller. A and B's contract contained a clause providing a penalty of 0.5 per cent of the price of goods for every day payment was delayed.

When this dispute was initially brought before an arbitral tribunal, B was ordered to pay A 42 per cent of the original price of the goods as a penalty. A, however, did not receive this payment for two-and-a-half years. A instituted arbitral proceedings again against B, seeking an additional penalty for the delay in B complying with the first award. B acknowledged the payment was late, but argued that the new penalty amount that A was seeking was excessive and needed to be decreased.

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<sup>726</sup> Supreme Court of Poland, Case No III CZP 61/03, 6 November 2003.

<sup>727</sup> ICAC, Case No 134/2002, Award, 4 April 2003.

The tribunal noted that the penalty claimed by A came up to about 487 per cent of the original contract price. In the tribunal invoked Article 7.4.13 of the UNIDROIT Principles along with the general principles proportionality and conformability in deciding that A's requested penalty was excessive and needed to be reduced.

#### 4. *Russia / Arbitration / Petrachkov, Bekker, Rojas Elgueta / Unilex 673 / 2001*

**Case:**<sup>728</sup> A claimant, an English company, filed a lawsuit against a defendant, a Russian company, for collection of a purchase price of goods as delivered to the defendant, incurred penalties and annual interests. The arbitral tribunal ruled that only principal debt and annual interest shall be collected from the defendant.

The court's reasoning is explained below.

Regarding the claims of the plaintiff on the payment of penalties and interests, the ICAC arbitral tribunal found that the defendant had committed a breach entitling the claimant to demand them in accordance with the terms of the contract. However, considering this issue the arbitral tribunal took into account a number of circumstances. First, the contract of the parties provides for two negative consequences to the buyer for one breach of contract (delay in payment). Second, the plaintiff's claim for payment of annual interest is based on the Article 78 of the CISG, and their amount corresponds to the LIBOR rate for short-term foreign currency loans in US dollars, which is the average rate applied by the leading banks in the UK (which is the location of the creditor). Third, according to Article 333 of the Civil Code of the Russian Federation, if the penalty is clearly disproportionate to the consequences of a breach of an obligation, the Court is entitled to reduce the penalty. The same rule is established in Article 7.4.13(2) the UNIDROIT Principles, according to which regardless of any agreements the sum for non-performance may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances. Fourth, Resolution No 13/14 of the Plenum of the Supreme Court of the Russian Federation and the Plenum of the Supreme Arbitrazh Court of the Russian Federation 'On the Application of the Provisions of the Civil Code of the Russian Federation on the Interest for the Use of Monetary Funds' (No 6) dated 8 October 1998 (clause 6) states that in cases where the creditor has the right claim the penalty and the interest due to failure to fulfil a monetary obligation, the creditor is generally entitled to apply only one of these remedies.

In view of the foregoing, the arbitral tribunal concluded that only the annual interests specified in the contract in the amount calculated in the statement of claim is to be awarded to the plaintiff.

#### 5. *Finland / Arbitration / Taivalkoski / Unilex 645 / 1998*

**Case:**<sup>729</sup> The dispute in this case arose between the shareholders of company X and of company Y. Company X and company Y concluded an agreement that granted company Y the option of purchasing 51 per cent of company X's shares for a fixed price during a specified time period. The details of the agreement entailed that company X (the grantor of the option) be bound to pay a penalty corresponding

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728 ICAC, Case No 88/2000, Award, 25 January 2001.

729 Ad hoc Arbitration case, Helsinki, 28 January 1998.

to the purchase price of the shares should company X breach the agreement. Company X breached, and company Y instituted arbitral proceedings seeking payment of the penalty by company X.

The tribunal found that company X had indeed breached some of its obligations under the contract. However, the tribunal found that the amount company X had to pay was excessively high given that company X's breaches differed from its main obligation to sell the shares. The tribunal awarded only part of the requested penalty. It justified the mitigation of the penalty on the basis of Article 36 of the Nordic Contract Law, and Article 7.4.13(2) of the UNIDROIT Principles, which states that '[...] the specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances'.

## 6. *Russia / Arbitration / Petrachkov, Bekker, Rojas Elgueta / Unilex 669 / 1997*

**Case:**<sup>730</sup> A claimant, an English company, filed a lawsuit against a defendant, a Russian company, for collection of a purchase price of goods as delivered to the defendant, incurred penalties and annual interests. The arbitral ruled that only principal debt and annual interest shall be collected from the defendant.

The court's reasoning is explained below.

According to paragraph 2, Article 9 of 1980 CISG unless otherwise agreed, the parties are considered to have impliedly made applicable to their contract or its formation a use of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned.

Article 7.4.13(2) of the UNIDROIT Principles states that the sum for non-performance may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances.

In such situation, the arbitral tribunal considered it reasonable and fair to take into account the defendant's request for a reduction of the sum payable for the delay in payment as claimed by the plaintiff.

## 7. *Russia / Arbitration / Rojas Elgueta / Unilex 669 / 1997*

**Case:**<sup>731</sup> The dispute arose from a sales contract between A and B containing a penalty of 0.5 per cent of the purchase price per day in the case of a delay in payment by the buyer. When the buyer failed to pay on time, the seller claimed the penalty according to the agreement and the buyer refused as it thought the penalty was excessive.

The arbitral tribunal applied Article 7.4.13(2) of the UNIDROIT Principles in deciding this case. This article enables a tribunal to reduce a penalty when the penalty is 'grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances.' The tribunal found that the penalty indeed was excessive and reduced it.

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730 ICAC, Case No 229/1996, Award, 5 June 1997.

731 *Ibid.*

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\* These cases do not refer to the UNIDROIT Principles.

# Chapter 8: Set-off

## I. Article 8: Set-off

### *Introduction*

Because the Working Group was unable to identify any cases that refer to chapter 8 (Set-off), the group instead studied English cases on set-off. These cases are of interest because of the many similarities to the UNIDROIT Principles. These summaries have been marked with an asterisk because they do not refer to the UNIDROIT Principles.

Set-off is a concept familiar to English law and there are similarities between the positions under English law and the UNIDROIT Principles. Indeed, it would seem that similar conclusions would be reached in the example cases had the fact set been analysed under English law or under the UNIDROIT Principles.

Set-off under English law has some differences to set-off under the UNIDROIT Principles. By way of example, English law allows for indirect obligations to be set-off against one another, taking advantage of the wider commercial context of a transaction where subsidiaries and other affiliates of the primary obligor are involved.<sup>732</sup> By contrast, the UNIDROIT Principles only allow set-off when two parties directly owe each other an obligation. Therefore, setting off obligations of affiliates and subsidiaries would not appear to be possible under the UNIDROIT Principles.

There are, however, many similarities between the two regimes both in terms of allowing for the exclusion of rights of set-off, even if English law requires a greater level of explicitness in excluding the right<sup>733</sup> than the UNIDROIT Principles, where it can be impliedly excluded (see Article 1.5), and in requiring ascertainment of the obligations owed by each party and some form of link between such obligations.<sup>734</sup> Further similarities arise in that both regimes treat liabilities as being extinguished when set-off occurs.

There is large body of English case law dealing with the right of set-off in insolvency situations. Whereas English case law continues to apply to the right to exercise set-off within the insolvency context, the UNIDROIT Principles do not deal with the impact of insolvency proceedings on such right, which is left to be determined by the applicable law.

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<sup>732</sup> *Sinochem International Oil (London) Co Ltd v Mobil Sales and Supply Corp (No.1)* (2000) C.L.C. 878.

<sup>733</sup> *BOC Group Plc v Centeon Llc and Centeon Bio-Services Inc* (1999) 1 All ER (Comm) 970; *Hong Kong and Shanghai Banking Corp v Kloeckner & Co AG* (1990) 2 QB 514; *Coca-Cola Financial Corp v Finsat International Ltd* (1998) QB 43; *ABN AMRO Bank NV v Totisa Holdings SA* (2017) EWHC 3260 (Comm).

<sup>734</sup> *Geldof Metaalconstructie NV v Simon Carves Ltd* (2010) EWHC 1023 (Ch); *Secret Hotels2 Ltd v EA Traveller Ltd* (2010) EWHC 1023 (Ch).

## II. Article 8.1: Conditions of set-off

### 1. *United Kingdom / Court / Gibb / Not Unilex / 2001 \**

**Case:**<sup>735</sup> Company A sold the entire issued share capital of company B to company C. The purchase price was £30m, £20m of which was paid on completion. Payment of the final £10m was due to be paid in four further instalments. Company C received immediate enjoyment of the benefits of the contract.

The deadline for the first instalment passed without payment. Company C's solicitors sent a letter to company A's solicitors stating that payment was being withheld for the time being, as payment under a separate contract between company C and a third party was under contention, allegedly as a result of action taken by company A.

After 14 days had passed, company A issued proceedings for payment of the full £10m. Company C contended that it was entitled to set off this claim due to company A's alleged breach of three warranties under the share purchase agreement (SPA).

However, the SPA stated that no counterclaim could be brought unless notice in writing was given 'not later than the second anniversary of completion'. The Court of Appeal drew attention to the fact that the letter sent to company A's solicitors did not mention a counterclaim against company A, the right of set-off, or indeed any contention that the first instalment was not payable. As valid notice of a counterclaim had not been provided, the Court of Appeal ruled that the right of set-off was not available and company A was therefore entitled to repayment of the entire £10m.

### 2. *United Kingdom / Court / Gibb / Not Unilex / 2010 \**

**Case:**<sup>736</sup> Company A brought a claim against company B for overdue payment under a contract for supply of pressure vessels (supply contract). Company B argued that it was entitled to use the right of set-off in light of its counterclaim against company A under a contract for installation of storage tanks (installation contract). The court examined whether company B was entitled to set off its counterclaim under the doctrine of equitable set-off. The court found that the correct test consisted of two elements:

- formal element – there must be a close connection between the claim and the counterclaim; and
- functional element – it would be unjust to enforce one claim without taking the counterclaim into account.

The court acknowledged the difficulty in applying this test in cases involving two separate contracts, but allowed the appeal in these circumstances. The court ruled that a close connection between the claim and the counterclaim existed due to the fact that company A had insisted on payment of the supply contract as a pre-condition of returning to work on the installation contract. This close connection meant that it was manifestly unjust to enforce one claim without taking the other into account.

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<sup>735</sup> *Fortman Holdings Ltd v Modem Holdings Ltd* (2001) EWCA Civ 1235.

<sup>736</sup> *Geldof Metaalconstructie NV v Simon Carves Ltd* [2010] EWCA Civ 667.

3. *United Kingdom / Court / Gibb / Not Unilex / 2010 \**

**Case:**<sup>737</sup> The court found the right of set-off to be available in situations in which the claim and counterclaim involve the same issues and are sufficiently connected.

4. *United Kingdom / Court / Gibb / Not Unilex / 1798 \**

**Case:**<sup>738</sup> Where mutual subsisting demands exist at the time at which the action is brought, the statutes of set-off will enable the defendant to set off their debt against the claim of the plaintiff.

5. *United Kingdom / Court / Gibb / Not Unilex / 1879 \**

**Case:**<sup>739</sup> The court found that a bank may only invoke banker's set-off in situations in which the two relevant accounts are current or running accounts. The balance on account must be payable on demand or at relatively short notice.

6. *United Kingdom / Court / Gibb / Not Unilex / 1993 \**

**Case:**<sup>740</sup> Director A (acting as director of company B) guaranteed the repayment of advances made by bank C to company B. The court found that director A could, upon the insolvency of company B, rely on the right of set-off under rule 4.90 of the Insolvency Rules 1986 to reduce the debt owed to bank C by company B by the amount standing to his credit in his own personal account with bank C. The court held that rule 4.90 operates to bring about a set-off in situations in which there are mutual dealings resulting in cross-claims which arise before commencement of winding-up.

7. *United Kingdom / Court / Gibb / Not Unilex / 1972 \**

**Case:**<sup>741</sup> Company A held an overdrawn account with bank B. Company A and bank B agreed to freeze the overdrawn account and open a second account. This second account would be kept in credit, and would be used for the business purposes of company A.

Shortly afterwards, the creditors of company A passed a resolution approving the voluntary winding up of the company. Bank B argued that it was entitled to use the money in the second account to set off the debt within the first account. The Court of Appeal held that the mandatory rules of insolvency set-off are triggered as soon as a company enters bankruptcy. The rules of insolvency set-off cannot be varied by contract, and are superior to any contractual rights of set-off. As such, bank B was able to exercise the right of set-off to reclaim a portion of the funds owed to it by company A. The court noted that, although these rules could not be varied by contract, the parties could agree between them not to claim should the other party become insolvent.

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737 *Secret Hotels2 Ltd v EA Traveller Ltd* (2010) EWHC 1023 (Ch).

738 *Lechmere, Esq v Hawkins, Gent* [1798] 170 ER 477.

739 *Re Willis, Percival & Co ex parte Morier* [1879] 12 Ch D 491.

740 *MS Fashions Ltd v Bank of Credit and Commerce International SA* [1993] Ch 425.

741 *National Westminster Bank Ltd v Halesowen Presswork & Assemblies Ltd* [1972] AC 785.

### 8. *United Kingdom / Court / Gibb / Not Unilex / 2016 \**

**Case:**<sup>742</sup> Company A, acting through its liquidators, brought a claim against director B for a sum owed in relation to a share subscription. Director B brought a counterclaim for an alleged debt owed to him by company A.

The court held that an individual could not exercise the right of set-off in relation to monies owed by him for a subscription of shares in the context of liquidation. The court ruled that director B must first pay the subscription moneys owed to company A before issuing a claim for the sum allegedly owed to him.

### 9. *United Kingdom / Court / Gibb / Not Unilex / 2000 \**

**Case:**<sup>743</sup> Company A was indebted to company B under a contract containing an ambiguous clause relating to set-off. Company A argued that it could set-off this debt against debts owed by affiliates of company B to affiliates of company A under separate contracts. Company B was granted summary judgment at first hearing, on the basis that the wording of the set-off clause did not permit set-off of this kind unless there had been a double default by both the contracting party and their affiliates.

The Court of Appeal affirmed the obligation of the court to interpret an ambiguous clause in such a way so as to reflect its commercial purpose. In doing so, the court must determine the meaning that the clause would convey to a reasonable businessperson, rather than the meaning of the actual words used. The Court of Appeal found that a reasonable businessperson would have adopted a wider interpretation of the set-off clause, and therefore allowed the appeal in this case.

## III. Article 8.2: Foreign currency set-off

### 1. *United Kingdom / Court / Gibb / Not Unilex / 2010 \**

**Case:**<sup>744</sup> Claimant A was awarded £438,569 in damages as compensation for the infringement of a trademark by defendant B. The court assessed the debt owed by claimant A to defendant B as €594,696. Both parties agreed that each debt should be set off against the other; however, they disagreed over the date on which the currency conversion should take place. This was important as the rate of exchange had altered significantly over the relevant period. At the date of the infringement, the exchange rate was approximately £1:€1.45, while at the time of the judgment it was approximately £1:€1.20. If the currency was to be converted at the rate prevailing at the date of judgment, the damages received by claimant A would amount to €26,283, which was significantly less than the debt owed to defendant B.

Defendant B argued that the currency rate at the date of judgment should be used, relying on a number of Admiralty cases as precedents for this course of action. Defendant B submitted that the total amount of each liability, including interest at a rate appropriate to the relevant currency, should be calculated as at the date on which judgment was given. The lesser sum should be converted into

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<sup>742</sup> *Oakdene Homes plc (In Liquidation) v Turpin* [2016] (Unreported).

<sup>743</sup> *Sinochem International Oil (London) Co Ltd v Mobil Sales and Supply Corp (No 1)* (2000) C L C 878.

<sup>744</sup> *Gary Fearn v Anglo-Dutch Paint & ors* (2010) EWHC 2366 (Ch).

the currency of the greater sum at the exchange rate prevailing on the date of judgment and then deducted from the greater sum, thereby providing the final balance.

The High Court ruled in defendant B's favour, finding there to be no 'justification for back-dating the set-off to any earlier date than the earliest date at which a set-off would have been possible, that is when the existence and amount of the two liabilities was finally determined by judgment or agreement'.

The High Court noted that this approach may mean that, due to currency fluctuation, the amount owed to defendant B exceeds that owed to claimant A. It could be argued that it is manifestly unfair that claimant A should pay a higher quantity of damages merely as a result of the time taken to resolve the issue. To combat this apparent defect in the law, the High Court advised that the movement in the exchange rate could result in a corresponding increase in the amount of claimant A's claim if it could be argued that claimant A would have used the profits of which he was deprived by the trademark infringement to pay off the debt owed to defendant B. However, there was no suggestion here that claimant A would have used the money owed by defendant B for this purpose.

## 2. *United Kingdom / Court / Gibb / Not Unilex / 2016 \**

**Case:**<sup>745</sup> under the Insolvency Rules 1986, debts owed in foreign currencies are required to be converted into sterling at the exchange rate prevailing at the date on which the company enters administration. There were substantial currency fluctuations between the date on which company A went into administration and the date on which its creditors were paid, meaning that many foreign currency creditors received less than they would have done if they had received payment in sterling. These foreign currency creditors sought to recover this shortfall as a non-provable debt.

The court held that the Insolvency Rules 1986 do not contain any provisions which enable creditors to bring a currency conversion claim.

## IV. Article 8.3: Set-off by notice; and Article 8.4: Content of notice

### 1. *United Kingdom / Court / Gibb / Not Unilex / 2017 \**

**Case:**<sup>746</sup> The claimants and the defendants entered into a SPA pursuant to which the defendants acquired the entire issued share capital of company A. At the time of the sale, the claimants were guarantors under a facility agreement provided to company A (the guarantee). Under the terms of the SPA, the claimants agreed to continue as guarantors in return for an indemnity from the defendants.

In the years that followed the sale, the business of company A failed. The claimants paid the shortfall due under the guarantee, before seeking reimbursement from the defendants. The defendants lodged a defence and counterclaim arising from alleged breaches of contractual warranties and misrepresentations. The claimants applied to strike out the defence and the counterclaim, citing the defendants' failure to notify them of any claim within two years of the sale, as required under the SPA.

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<sup>745</sup> *Lehman Brothers International (Europe) (In Administration), Re* (2016) EWHC 2131 (Ch).

<sup>746</sup> *Philip v Cook* (2017) EWHC 3023 (QB).

The High Court found that the words ‘the sellers are not liable for a claim [for breach of warranty] unless’ in the SPA operated to extinguish the underlying claim altogether. As such, the failure of the defendants to notify the claimants of a warranty breach meant that they could not bring a counterclaim for breach of warranty or rely on that breach to allow equitable set-off. The High Court placed emphasis on the fact that this clause required the claimants to simply notify the defendants within this period, rather than issue a full claim. The High Court also emphasised the fact that both sides had instructed solicitors so must be deemed to have fully comprehended the implications of the SPA.

## V. Article 8.5: Effect of set-off

### 1. *United Kingdom / Court / Gibb / Not Unilex / 2014 \**

**Case:**<sup>747</sup> Company A brought a claim against company B for monies due under a sale agreement. Company B brought a counterclaim by way of set-off for breach of warranty. The court found that the correct approach in determining the amount of damages payable was to assess the difference between the actual value of the business, and the estimated value had the warranties been factually correct.

## VI. Additional Article 8.6: No set-off

### 1. *United Kingdom / Court / Gibb / Not Unilex / 1999 \**

**Case:**<sup>748</sup> Company A brought a claim against company B for overdue payment under a SPA. Company B brought a crossclaim against company A for the following claims: (1) breach of agreement; (2) breach of indemnity; and (3) misrepresentation. Company A agreed that these claims would usually give rise to the right of set-off, but argued that that right had been expressly precluded by a clause in the SPA which stated that payment ‘shall be absolute and unconditional and shall not be affected by... any other matter whatsoever’.

The Court of Appeal ruled that the right of set-off had not been excluded. The Court of Appeal noted that, in order to correctly interpret a contract, it must determine the meaning which would be conveyed to a reasonable person having all the background knowledge which would reasonably have been available to the parties at the time of the contract. As such, sufficiently clear wording is required to exclude the right of set-off. The court noted the lack of express language (‘deduction’, ‘withholding’ or ‘payment in full’) in the relevant clause which would operate to exclude this right.

In addition, the language of the wider SPA suggested that the parties had intended that the full purchase price should not be affected by any potential crossclaims. The Court of Appeal placed emphasis on the fact that legal advice had been sought in the negotiation of the SPA, meaning that both parties should be deemed to have been aware of their legal rights.

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747 *Bir Holdings Ltd v Mehta* (2014) EWHC 3903 (Ch).

748 *BOC Group Plc v Centeon LLC and Centeon Bio-Services Inc* (1999) 1 All E R (Comm) 970.

## 2. *United Kingdom / Court / Gibb / Not Unilex / 1990 \**

**Case:**<sup>749</sup> Bank A provided facilities to company B to finance the purchase of oil. The facilities were made available on the basis of an undertaking provided by company B to repay the instalments in full without any right of set-off.

Bank A filed for summary judgment after company B suffered a number of losses. Company B filed a counterclaim for US\$10m payable under a standby letter of credit, and argued that it could set off this sum against the facilities owed to bank A.

The court found that it was possible to contract out of the right of set-off, and that bank A could therefore rely on the undertakings provided by company B that all amounts due would be paid in full. As such, the right of set-off was successfully precluded under this agreement.

## 3. *United Kingdom / Court / Gibb / Not Unilex / 1998 \**

**Case:**<sup>750</sup> Company A argued that a clause under a loan agreement waiving the right of set-off was not enforceable as, under the Insolvent Debtors Relief Act 1729, a debtor could not be prevented from setting off a mutual debt with a lender. Company A also argued that the waiver of a right of set-off was contrary to public policy.

The court held that the right of set-off could be excluded through agreement, and that such exclusion was not contrary to public policy. The court found that Company A had no arguable counterclaim and that, even if it did, the clause excluding set-off would function to prevent it from exercising this right.

## 4. *United Kingdom / Court / Gibb / Not Unilex / 2017 \**

**Case:**<sup>751</sup> The court found that the presence of a no set-off clause in the facility agreement indicated the existence of an agreement between the parties that any counterclaim should be pursued as a separate matter. The court placed great emphasis on this clause as reflective of the commercial intention of the parties. The High Court also noted the equality in bargaining strength between these two commercial parties.

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749 *Hong Kong and Shanghai Banking Corp v Kloeckner & Co AG* (1990) 2 Q B 514.

750 *Coca-Cola Financial Corp v Finsat International Ltd* (1998) Q B 43.

751 *ABN AMRO Bank NV v Totisa Holdings SA* (2017) EWHC 3260 (Comm).

## Compiled summaries of selected cases

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#### II. Article 9.2.1: Modes of transfer

1. Russia / Arbitration / Petrachkov, Bekker / Unilex / 2008 310

# Chapter 9: Assignment of rights, transfers of obligations, assignment of contracts

## I. Article 9.1.13: Defences and right of set-off

### 1. *Poland / National Court / Wardynski, Przygoda / Not Unilex / 2007*

**Case:**<sup>752</sup> Party A and party B are parties to a sale of goods contract. Party A and party C are parties to a factoring agreement. A fails to deliver the goods ordered by B but issues an invoice. B disputes the invoice and defaults on its payment. Within the scope of the factoring contract A (assignor) assigns to C (assignee) its right to payment due from party B in line with the disputed invoice. After the assignment, A corrects the invoice concerning the payment due from B. According to the corrected invoice, B's liability to A now equals zero. C requests payment from party B notwithstanding the latter's defence (correction of the invoice) against the assignor.

The court stated that under the UNIDROIT Convention on international factoring, an agreement (here 'correction of the invoice') between the factor and the debtor is ineffective for the assignee if this agreement was made without the assignee's consent and after the debtor was informed of the assignment. The court mentioned that the same follows from the UNIDROIT Principles (2004), although it did not indicate a specific principle. The court also pointed out that a similar solution is found in the Principles of European Contract Law (Articles 11.204 and 11.308). However, the court stated that in the circumstances of the case, on the basis of Polish law, the assigned liability might have retroactively expired in the light of failure to deliver the order. In such case, the assignment contract would be invalid. On these grounds, the Supreme Court returned the case to the Court of Appeal.

## II. Article 9.2.1: Modes of transfer

### 1. *Russia / Arbitration / Petrachkov, Bekker / Unilex 1476 / 2008*

**Case:**<sup>753</sup> A claimant, a Russian company, filed a lawsuit against a defendant, a Swiss company, for collection of purchase price under delivered goods and contractual penalties. The contract was concluded with the Italian branch of the defendant. However, in the course of performance of the contract, the Swiss company made several payments of goods as delivered by the claimant. The arbitral tribunal qualified such actions represent transferring of payment obligations from the initial contractor to the company, which actually performed the payments.

The court's reasoning is explained below.

The claimant and the branch of the defendant located in Italy entered into a contract, according to which the seller undertook the obligation to supply to the buyer the goods produced by him on

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<sup>752</sup> Poland Supreme Court, 3 October 2007, Case No IV CSK 160/07. Published in OSNC 2008/12/141.

<sup>753</sup> ICAC, Case No 14/2008, Award, 19 December 2008.

the FCA terms (Incoterms 2000) in quantities, prices and within the time periods specified in the specifications and annexes to the contract.

The ICAC found that although the buyer in the person of Italian company was obliged to make payment of the goods as a signatory of the contract and the amendments to it, payments to the plaintiff under the contract were carried out by the company located in Switzerland.

Evaluating the relations established between the parties, the ICAC considers that in this case there was a transfer of contractual obligations relating to the payment of the goods from the company located in Italy (the buyer) to the company located in Switzerland, which the claimant had agreed. This is in particular confirmed by the claimant's acceptance of payments made by the Swiss company (defendant), correspondence between the parties, as well as the by the claim brought by the claimant against it and by the demand for recovery of the debt under the contract.

This method of transferring obligations, which is widely used in international trade practices, is reflected in the UNIDROIT Principles. According to Article 9.2.1 'Modes of transfer', an obligation to pay money or render other performance may be transferred from one person (the 'original obligor') to another person (the 'new obligor') either: (1) by an agreement between the original obligor and the new obligor subject to Article 9.2.3; or (2) by an agreement between the obligee and the new obligor, by which the new obligor assumes the obligation.

Having considered the above, the ICAC considers that the Swiss company (the new debtor), to which the obligation of the buyer (the original debtor) under the contract to pay for the delivered goods was transferred, is the proper despondent and that the sum recoverable from the said company (defendant) in favour of the claimant is subject to satisfaction.

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\* These cases do not refer to the UNIDROIT Principles.

# Chapter 10: Limitation periods

## *Introduction*

Because the Working Group was only able to identify a handful of cases that refer to chapter 10 (Limitation periods), the group studied English cases dealing with limitation periods. The summaries for these UK cases have been marked with an asterisk because they do not refer to the UNIDROIT Principles.

At the end of this chapter, the Working Group has included a discussion about the similarities and differences between the approach taken by the UK courts and the UNIDROIT Principles.

## **I. Article 10.2: Limitation periods**

### *1. France / Arbitration / Sierra / Not Unilex / 2016*

**Case:**<sup>754</sup> Company A, of country X and company B, of country Y, entered into a JVA by which they agreed to create two joint companies (companies C and D), in which company B would provide the technology and company A the commercial know-how in order to produce and commercialise certain products in country X. The parties agreed that the JVA would be subject to the UNIDROIT Principles, supplemented if necessary by the laws of country X.

Company A filed a claim against company B, with the ICC, arguing certain contractual breaches of company B, regarding different obligations to supply equipment according with the standards set out in the JVA. Company B responded arguing that said claims were time-barred under the general limitation period of three years of Article 10.2.1 of the UNIDROIT Principles.

Company A further contested the time limitation provided under Article 10.2.1 of the UNIDROIT Principles, arguing that even though the UNIDROIT Principles were the governing law of the JVA, they were not relevant to this case, since country X's mandatory rules, providing for a ten-year statute of limitations, were applicable.

Furthermore, company A argued that if the UNIDROIT Principles were applicable, the time limitation would be of ten years as provided by Article 10.2.2, which provides that the limitation starts to run when the right can be exercised, regardless of the obligee's actual or constructive knowledge as in Article 10.2.1.

The arbitral tribunal held that the parties submitted their contract to the UNIDROIT Principles and its statute of limitations should apply. Furthermore, the tribunal ruled that company A did not demonstrate that country X's rules on time limitation were mandatory rules and that company A did not offer a justification nor evidence providing that the parties cannot depart from such rules. On the other hand, the tribunal held that the alleged non-performance by company B was fully identifiable and identified by company A more than three years before the controversy started. Hence, the tribunal confirmed the three-year statute of limitations.

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<sup>754</sup> ICC Case No 18795/CA/ASM (C-19077/CA).

## 2. *The Netherlands / National Court / Meijer / Unilex 1924 / 2015*

**Case:**<sup>755</sup> The claimant, a company, and the respondent, the government of a country, entered into nine related contracts for the supply of anti-missile systems. Pursuant to the end of an internal conflict within the country, the respondent terminated the contract. The claimant initiated arbitral proceedings claiming damage. The respondent on the other hand claimed restitution of the advance payments it had made.

The contracts did not contain a choice of law provision but did contain references to ‘natural justice’ and ‘laws of natural justice’ or ‘rules of natural justice’.

Arbitral proceedings were initiated by the claimant and several awards were rendered by the tribunal. In its first partial award the tribunal found that the UNIDROIT Principles were applicable. It stated that ‘[...] the contracts are governed by, and should be interpreted in accordance with, the UNIDROIT Principles with respect to all matters falling within the scope of such Principles and that for all other matters, by such other general legal rules and principles applicable to international contractual obligations enjoying wide international consensus which would be found relevant for deciding controverted issues falling under the present arbitration’.

In another partial award, the tribunal dealt with the issue of whether the claims of the claimant were time-barred. This is an issue that was not dealt with in the UNIDROIT Principles at the time. However, the tribunal found that it might be a general principal of law that a claim is time-barred if it is pursued with unreasonable delay. This duty stems from the duty of parties to act in accordance with good faith and fair dealing, also affirmed in Article 1.7 of the UNIDROIT Principles. However, the tribunal found that the passing of 11 years did not prevent the claimant from pursuing its claim, and the claim was not made with unreasonable delay.

The claimant pursued a setting-aside action and made arguments for the annulment of all four partial final awards issued by the tribunal. The claimant argued that the UNIDROIT Principles, namely articles 10.2.2 and 10.9, as they were written in 2004 and which contained a chapter on limitation periods, contradicted the tribunal’s conclusion that the respondent’s claims were not time-barred. The respondent, in opposition, asserted that such retroactive application of the UNIDROIT Principles was not to be permitted and that the 2004 edition of the principles had not yet achieved general consensus.

The claimant’s arguments did not prevail, and the District Court confirmed all four partial final awards, a decision upheld by both the Court of Appeal and the Supreme Court. The Supreme Court ruled that the tribunal’s decision, being on the merits, could not be reviewed in setting aside proceedings before the courts. It also held that the fact that the tribunal’s decision regarding the application of the UNIDROIT Principles was at least partly procedural in nature did not affect the court’s finding in this respect.

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<sup>755</sup> *BAE Systems PLC, UK v Ministry of Defence and Support for Armed Forces of the Islamic Republic of Iran*, Supreme Court of the Netherlands, May 2015.

### 3. *Spain / National Court / Meijer / Unilex 1907 / 2015*

**Case:**<sup>756</sup> This dispute concerned a sale of goods contract between A, the buyer (in country X) and B, the seller (in country Y). A brought proceedings against B seeking the termination of the contract for non-performance. Alternatively, A sought the specific performance of the contract (ie, the delivery of goods). A brought its action based on the CISG, while B counter-argued that such application by A was time-barred due to the limitation period for the delivery of the goods.

The first instance court ruled in favour of B. In the appellate proceedings, the court upheld this decision. During the proceedings, however, A changed its stance and stated that the CISG was not applicable to the present case as the contract was not an international sales contract since it was concluded in country X, where B had its own sales offices, and the consideration was paid with a cheque from that country. This argument was rejected by the appellate court which upheld the application of the CISG owing to the fact that the parties had their seats in two different countries, both of which were also contracting states to the CISG.

However, as there was no mention of a limitation period in the CISG, the court indicated that it had to refer to Article 10.2 of the UNIDROIT Principles and held that the action brought by A was indeed time-barred.

### 4. *France / Arbitration / Meijer / Unilex 1662 / date unavailable*

**Case:**<sup>757</sup> A joint venture (X) and a state (Y) entered into a production sharing agreement (PSA) to explore and develop the geological resources of a specific area. The PSA was concluded for 20 years and provided for the law of Y to be the applicable law. However, the arbitral tribunal was also authorised to take into account ‘principles of law common to [the country of X and to country Y] and, in the absence of such common principles, [...] principles of law normally recognised by civilised nations in general, including those which have been applied by international tribunals.’

Shortly before the expiry of the PSA, the parties concluded and signed an agreement providing for the contract’s extension for five years. After the signing of the extension agreement, Y assured X that the extension had been granted, based on which X started a new exploration programme. However, X was soon evicted from the area as Y’s parliament actually refused to ratify the extension.

X commenced arbitral proceedings before the ICC, arguing that the PSA had been validly extended and sought damages for the breach of said extension. The tribunal, in finding that it was entitled to rely on the UNIDROIT Principles, indicated that such principles ‘offer reasonable solutions to respond to the needs of the modern economy in light of the experience of some of the major legal systems.’

One of the counterclaims submitted by Y in the arbitration related to X’s alleged failure to withhold and pay certain taxes. While referring to country Y’s law, which was the law governing the contract, the tribunal held that such a counterclaim was time-barred as a period of five years had passed. The tribunal noted that it did not apply the three-year limitation period as laid down in the UNIDROIT

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<sup>756</sup> *Castellana Inmuebles y Locales SA v Brunello Cucinelli SPA*, Audiencia Provincial Madrid, Case No 66/2015, February 2015.

<sup>757</sup> ICC, Case No 14108, undated.

Principles since the applicable law already provided for a specific time limit, finding that the UNIDROIT Principles could not be applied when the agreed-upon applicable law already contained specific provisions in this respect. However, the tribunal did refer to Article 10.2 of the UNIDROIT Principles while deciding at what exact moment the limitation period started to run since that was not clearly provided for in the laws of country Y.

#### 5. *United Kingdom / Court / Gibb / Not Unilex / 2007 \**

**Case:**<sup>758</sup> Council A appealed against a ruling that the respondent B had brought a claim for personal injury within the limitation period. B had delivered the claim form to the county court on the day before the limitation period was due to expire, along with a request that the claim be issued. However, the county court did not issue the claim until four days later.

The court examined the difference between bringing and issuing a claim, and found that a claim is brought on the day on which the court receives the claim form. It is the responsibility of the claimant to bring the claim form to court within the limitation period; however, it is outside the control of the claimant to influence the date on which the court issues the form. As such, a claim is brought when the claimant's request for the issue of a claim form is delivered to the correct court office during opening hours, and B had therefore brought the claim within the statutory limitation period.

## II. **Article 10.3: Modification of limitation periods by the parties**

#### 1. *United Kingdom / Court / Gibb / Not Unilex / 2007 \**

**Case:**<sup>759</sup> A and B entered into an agreement stating that no proceedings could be brought later than six years from practical completion (which occurred on 25 November 1998). B instigated arbitration just within the six-year limitation period. A argued that the claim was statute-barred, as the Limitation Act 1980 provides that claims must be brought within six years of the actual breach (which occurred before practical completion).

The Court of Appeal found that the inclusion of a provision which contractually lengthens the statutory limitation period does not operate to preclude a party from utilising the statutory limitation defence. Rather, it operates as a parallel contractual limitation on the ability of the other party to bring a claim. As such, express wording excluding the right to rely on the statutory limitation defence is required to provide that proceedings may be brought under an agreement if they would otherwise be statute barred under the Limitation Act 1980. Such wording was missing in this context (however, it is present in our standard precedent in Compiled Summaries Case II, 2 under Article 10.3 of the UNIDROIT Principles).

#### 2. *United Kingdom / Court / Gibb / Not Unilex / 2012 \**

**Case:**<sup>760</sup> A contractual limitation clause containing a one-year limitation period was upheld as valid by the Court of Appeal. The court acknowledged the brevity of this limitation period, but confirmed that this was acceptable when viewed in conjunction with the allocated time period of eight weeks for the entire project.

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<sup>758</sup> *Barnes v St Helens Metropolitan Borough Council* (2007) 1 WLR 879.

<sup>759</sup> *Ford Architects Partnership v Cheltenham Ladies College* (2007) PNLR 18.

<sup>760</sup> *Inframatrix Investments Ltd v Dean Construction Ltd* (2012) 28 Const L.J 438.

### 3. *United Kingdom / Court / Gibb / Not Unilex / 2003 \**

**Case:**<sup>761</sup> Company A appealed against a ruling that the time bar of nine months in the standard trading conditions of association B failed to satisfy the requirement for reasonableness under the Unfair Contract Terms Act 1977. The Court of Appeal allowed the appeal, emphasising the fact that both parties were commercial entities with equal bargaining power. The court also ruled that it was reasonable to expect company A to have been aware of this limitation period, and that compliance with said limitation period was reasonably practicable within the allocated timeframe.

### 4. *United Kingdom / Court / Gibb / Not Unilex / 2017 \**

**Case:**<sup>762</sup> Company A sought an order striking out part of a claim brought against them by company B arguing that it was time-barred. Company B had engaged company A to manage a construction project, but terminated company A's appointment in 2012 and sent a letter of claim.

On 5 November 2015, the parties entered into the first of three standstill agreements, the third of which expired on 30 November 2016. Company B issued proceedings seeking damages on 1 December 2016. Company A argued that three of these claims should be struck out on the basis that they were statute-barred. Company A argued that the causes of action in respect of the first three claims had accrued before mid-2010, and company B had issued the proceedings more than six years later, and therefore outside the statutory limitation period.

The court refused the application to strike out the claims, stating that company B had been correct in not issuing the claims on or before 30 November 2016. The court examined the wording of the standstill agreements, and found that these stated that the parties could not issue proceedings while the standstill agreements were effective. If company B had issued proceedings on or before 30 November 2016, then they would have been in breach of these very same agreements.

The court examined the nature and function of standstill agreements, and found that in this case the standstill agreements operated to suspend time rather than extend it. This meant that the parties' position on 30 November 2016 was the same as that when they signed the first standstill agreement (ie, they still had three weeks left to issue the claims). The court examined the wording used in the standstill agreements, and found that while the word 'suspend' was used multiple times in the operative provisions of the document, the word 'extend' was not used anywhere aside from the recitals. This is an important distinction, as if the document had operated to extend the time period then this would have expired on the date on which the standstill agreement expired (ie, 30 November 2016), meaning that the claims were in fact time-barred on 1 December 2016 when they were issued.

The court noted that, in general, it may be easier to issue a claim and then seek a stay rather than enter into multiple standstill agreements.

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<sup>761</sup> *Granville Oil & Chemicals Ltd v Davis Turner & Co* (2003) 2 CLC 418.

<sup>762</sup> *Russell v Stone* (2017) EWHC 1555 (TCC).

## 5. *United Kingdom / Court / Gibb / Not Unilex / 2006 \**

**Case:**<sup>763</sup> The appellants subscribed for shares in company A, which was owned by C and D. Shortly afterwards, company A entered into creditors' voluntary liquidation and was wound up. C and D had entered into a number of warranties as part of the sale of the shares. On 24 November 2003, the appellants' solicitors wrote to each of C and D giving notice of their intention to make a claim for breach of warranty.

C and D denied that they were in breach of warranty, and alleged that the claim was time-barred under the subscription agreement as they had not been notified adequately within the required three-year period.

The initial judge found that the letters to C and D did not constitute adequate notice of a claim, and that the appellants' claims were therefore deemed to have been waived. However, the Court of Appeal allowed the appeal, ruling that the letters sent to C and D from the appellants' solicitors gave notice of the intention to make a claim, and any reasonable recipient would have understood this letter to be notification of an existing claim for breach of warranty as a result of alleged inaccuracies in the management accounts. The wording of the subscription agreement did not require details of the claim to be provided within the limitation period along with the notice. Even if details of the claim were required, the Court of Appeal found that correspondence discussing the breach of warranty sufficiently supplemented the notice so as to ensure that any reasonable recipient would have understood that this was a notification of claim.

### III. **Article 10.4: New limitation period by acknowledgement**

#### 1. *United Kingdom / Court / Gibb / Not Unilex / 2010 \**

**Case:**<sup>764</sup> A had borrowed money from B to purchase a property. When A failed to make any repayments, B sold the property and set off the proceeds against the outstanding debt. A eventually began to make small monthly repayments, and B brought a claim to recover the rest of the debt. The recorder held that, although the claim had been brought outside of the statutory 12-year period under section 20 of the Limitation Act 1980, the monthly repayments (which had occurred within the 12-year period) had served to restart the limitation period from the first repayment. As such, the claim was within the statutory limitation period.

The Court of Appeal upheld this decision, emphasising the fact that there was only one outstanding debt between the parties and so the monthly repayments could only be in relation to that debt (rather than another).

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<sup>763</sup> *Forrest v Glasser* (2006) EWCA Civ 1086.

<sup>764</sup> *John Howard Ashcroft v Bradford & Bingley plc* (2010) EWCA Civ 223.

## IV. Article 10.5: Suspension by judicial proceedings

### 1. *The Netherlands / Arbitration / Meijer / Unilex 1967 / 2014*

**Case:**<sup>765</sup> This dispute arose in relation to a new law passed by the government of country X, which stated that all private companies in the health insurance sector were required to reinvest their profits back into the healthcare system and were prevented from paying dividends to their shareholders. This legislative change took place after a two-year period of liberalisation in the health insurance sector and following a change of government in country X. A, a foreign company which owned a 51 per cent shareholding in a health insurance company in country X, commenced arbitration proceedings against country X and claimed that the new law had wiped out the value of its investment in said health insurance company in that country.

A year after the commencement of the arbitration, A also brought court proceedings against country X before X's own courts. The basis of this action, the subject matter, and the amount claimed as damages were the same as the ones which had been submitted to arbitration. During the court proceedings, country X argued that the institution of a case before the courts by A constituted a waiver of the right to arbitrate. A made a reference to an alleged conservatory purpose as a justification for beginning the court proceedings. However, country X argued that, based on Article 10.6(1) of the UNIDROIT Principles, this justification held no water as the claim was not in danger of being prescribed.

The arbitral tribunal then, in a (second) award on jurisdiction, affirmed that A's conduct amounted to a waiver of the right to arbitrate. The tribunal noted that the only method of dispute resolution agreed to by the parties was arbitration. Thus, A's actions before the courts of country X were in excess of what was required to protect its position while the arbitration proceedings were still pending. Thus, the arbitral tribunal ruled that it lacked jurisdiction. The arbitral tribunal did not make a reference to the UNIDROIT Principles.

### 2. *United Kingdom / Court / Gibb / Not Unilex / 2014 \**

**Case:**<sup>766</sup> The High Court examined the correct interpretation of a contractual provision which required legal proceedings for a breach of warranty under the SPA to be 'served' within a specific time period. Company A argued that the deemed service provisions of the Civil Procedure Rules CPR 6.14 should be applied as the SPA referred to company B 'validly issuing and serving legal process'. However, the court held that, in the absence of any express wording stating otherwise, the word 'serving' should be given a non-legal interpretation (ie, the business meaning of being delivered and received). The court also held, obiter, that if the CPR were to be imported into the SPA, the relevant provision in this situation would be CPR 7.5 (which is concerned with when the claim form is despatched) rather than CPR 6.14 (which is concerned with the date of deemed service).

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<sup>765</sup> *European American Investment Bank AG (EURAM) v Slovak Republic*, PCA Case No 2010-17, June 2014.

<sup>766</sup> *Ageas (UK) Ltd v Kwik-Fit (GB) Ltd* (2014) EWHC 2178 (QB).

3. *United Kingdom / Court / Gibb / Not Unilex / 2015 \**

**Case:**<sup>767</sup> The court disagreed with the ruling above [2. *United Kingdom / Court / Gibb / Not Unilex / 2014*], and held that the words ‘served’ within a contract did in fact mean service within the context of the Civil Procedure Rules.

4. *United Kingdom / Court / Gibb / Not Unilex / 2017 \**

**Case:**<sup>768</sup> The court disagreed with the rulings in both cases above [2. *United Kingdom / Court / Gibb / Not Unilex / 2014* and 3. *United Kingdom / Court / Gibb / Not Unilex / 2015*]. The court held that service of the claim form occurs on the date on which it is deemed to have occurred under Civil Procedure Rules CPR 6.14, and not the date on which it is despatched under CPR 7.5.

5. *United Kingdom / Court / Gibb / Not Unilex / 2015 \**

**Case:**<sup>769</sup> Company A argued that the discovery of a fact which had been deliberately concealed by company B and others extended the limitation period under section 31(1)(b) of the Limitation Act 1980. The court dismissed this argument, stating that company A had submitted a detailed claim for which the concealed facts were not essential. The court held that the trigger for the initiation of the limitation period is not necessarily the discovery of every fact potentially relevant to the claim, and therefore the discovery of these facts did not justify an extension of the limitation period.

## V. **Article 10.8: Suspension in case of force majeure, death or incapacity**

1. *United Kingdom / Court / Gibb / Not Unilex / 1992 \**

**Case:**<sup>770</sup> The court found that a limitation period ceases to run when a company enters compulsory liquidation.

2. *United Kingdom / Court / Gibb / Not Unilex / 2010 \**

**Case:**<sup>771</sup> The court found that an administrator was required to obtain the consent of the shareholders of a company before accepting any statute-barred claims from creditors. The administrator submitted that these statute-barred claims should be accepted as there had been no objection from the shareholders of the company. The court ruled that a failure to submit a negative response did not constitute an agreement to the admission to proof of statute-barred claims.

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767 *T & L Sugars Ltd v Tate & Lyle Industries Ltd* (2015) EWHC 2696 (Comm).

768 *Brightside Group Ltd and others v RSM UK Audit LLP and another* (2017) EWHC 6 (Comm).

769 *Arcadia Group Brands Ltd and others v Visa Inc and others* (2015) EWCA Civ 883.

770 *Re Cases of Taf's Well Ltd* (1992) Ch 179.

771 *Re Leyland Printing Company Ltd and Leyprint Ltd* (2010) EWHC 2015 (Ch).

### 3. *United Kingdom / Court / Gibb / Not Unilex / 2011 \**

**Case:**<sup>772</sup> The applicant liquidators brought a claim against three directors of a company (a husband, wife and son) seeking an order that they pay a sum in respect of the loans made by the company to two of them shortly before the company entered into voluntary liquidation.

The proceedings were brought outside of the usual statutory limitation period of six years for breach of fiduciary duty. However, the court found that this claim was in fact a claim to recover trust property where it had been obtained in breach of trust, for which there is no applicable limitation period. As such, the two directors who had received the loans were unable to rely on the limitation defence.

## VI. Article 10.9: Effects of expiration of limitation period

### 1. *The Netherlands / Arbitration / Meijer / Unilex 1640 / 2010*

**Case:**<sup>773</sup> The government of Country X, via a contract, had agreed to reimburse B, an international organisation, for its expenses regarding the rent B had to pay for its office space in country X. In turn, B entered into a lease agreement with A, a real estate company in country X, where it leased out a building to be used as the organisation's headquarters. A dispute arose when A demanded the full payment of the rent amount under the lease agreement. However, B argued that only 80 per cent of the amount was due since that was the amount provided to B under the contract between B and country X, due to the fact that such amount was considered by country X to be a fair amount for the rent. A commenced arbitration proceedings under the lease agreement.

According to its choice of law clause, the lease agreement was to be applied and interpreted in light of the terms of the contract between B and country X and the 'the recognised principles of international commercial law' (to the exclusion of country X's law).

While the tribunal relied mostly on the lease agreement, it stated that 'the UNIDROIT Principles may indeed be regarded as indicative of recognised principles in the field of international commercial law.' It should be noted that, during the submissions, references were made to the UNIDROIT Principles by both parties. The tribunal also specifically referred to Article 10.9 of the UNIDROIT Principles with regard to the argument by A that B was time-barred from making a counterclaim, since three years, the time limit under the UNIDROIT Principles, had already passed. In this respect, the tribunal found that: (1) time-barred rights do not cease to exist; (2) for the expiry of the limitation period to have effect, it must be asserted; and (3) a time-barred right may still be relied upon as a defence.

### 2. *United Kingdom / Court / Gibb / Not Unilex / 2004 \**

**Case:**<sup>774</sup> When considering whether to extend the time limit for service of a claim, the court must give special consideration to whether such an extension would deprive a defendant of a limitation defence.

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<sup>772</sup> *Brown and another v Bulton and others* (2011) EWHC 1034 (Ch).

<sup>773</sup> *Polis Fondi Immobiliari di Banche Popolare SGRpA v International Fund for Agricultural Development (IFAD)*, PCA Case No PCA-45863, December 2010.

<sup>774</sup> *Hashtroodi v Hancock* (2004) 1 WLR 3206.

### 3. *United Kingdom / Court / Gibb / Not Unilex / 2011 \**

**Case:**<sup>775</sup> The Court of Appeal determined that, when considering whether an extension of time for serving the claim form under Civil Procedure Rules CPR 7.6(2) should be granted, the primary consideration for the court was whether the defendant would be deprived of a limitation defence. The court held that a valid reason for extension must directly impact on the limitation aspect of the situation. For example, if the service was delayed because the claimant was unaware of the breach until towards the expiration of the limitation period. Here, the claimants' decision to delay service of the claim form so that they could ensure that they had monies in place to finance the proceedings was rejected as an invalid reason.

### 4. *United Kingdom / Court / Gibb / Not Unilex / 2013 \**

**Case:**<sup>776</sup> The claimant was unable to provide any exceptional circumstances to justify an extension of time where he had failed to serve the claim form in time. The court held that a more suitable approach would have been to serve the claim form within four months and then apply for an extension of time to serve the particulars of claim. The court emphasised the importance of determining whether the claim would be time-barred by the time it was reissued, arguing that a defendant should not generally be deprived of the limitation defence.

### 5. *United Kingdom / Court / Gibb / Not Unilex / 2011 \**

**Case:**<sup>777</sup> A had issued claim forms against B just before the expiry of the three-year limitation period, but the claim had not been issued in time. B had accepted responsibility for the failure to issue the claim. When A attempted to issue a second claim, it was struck out as abuse of process. The question for the court was whether a claim which had been issued towards the end of the limitation period and struck out for not being issued in time could then be reissued in a second action commencing after the expiry of that limitation period.

The court emphasised the importance of ensuring that courts strictly regulate the time periods granted for service, and acknowledged the public interest inherent in this. However, a negligent failure to serve a claim form in time does not constitute abuse of process. The Court of Appeal ruled that the appeal should not be allowed.

### *English law perspectives*

The case summaries in this area reflect English cases that consider limitation periods as included within chapter 10 of the UNIDROIT Principles. However, the decisions that have been identified under English law have been made without reference to the UNIDROIT Principles. The cases are therefore intended to assist the reader with how the English courts consider the concept of limitation periods in areas that the UNIDROIT Principles cover.

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<sup>775</sup> *Bayat Telephone Systems International Inc v Lord Michael Cecil* (2011) EWCA Civ 523.

<sup>776</sup> *Malcom-Green v And So To Bed* (2013) EWHC 4016 (IPEC).

<sup>777</sup> *Aktas v Adepta* (2011) QB 894.

The approaches to limitation periods taken under English law and the UNIDROIT Principles differ. Although there is some common ground, this seems to simply reflect the fact that legal systems typically contain a concept of a limitation period as a way of encouraging claims to be brought swiftly and providing for a cut-off when the defendant party is able to close its files. Indeed, there is such a difference between the two regimes that it would seem unlikely that a similar result would have been reached if the facts set out in these English law case summaries were considered under the UNIDROIT Principles.

The two major differences between the regimes are in the length of the limitation periods and the use of a two-stage process under the UNIDROIT Principles, compared to the single-stage approach under the Limitation Act 1980.

The time limits under both regimes are fundamentally different with the UNIDROIT Principles adopting a three years from actual/constructive knowledge of the breach of obligation limit coupled with an absolute stop of ten years from when the ability to exercise the right arose. English law generally takes the position that an appropriate limitation period is six years from when the loss occurs. In addition, the court has discretion within the statute to extend certain limitation periods (including where there is fraud) where it is felt that public policy demands greater flexibility.

The other key difference between the regimes is on the ability of two parties to set shorter or longer limitation periods than standard. While the UNIDROIT Principles allow for some flexibility in the parties to a contract, there are absolute limits on the modification of the limitation periods that cannot be contracted out of; in fact, the maximum and minimum lengths of the period are some of the few mandatory provision within the UNIDROIT Principles. By comparison, under English law any limitation period can be contracted out of although this is subject to the terms of the reasonableness test under the Unfair Contract Terms Act and case law that requires an explicit contracting out of the statutory limits. In several cases, a short limitation period has been held to be valid under English law, but it would seem that such a provision would have breached Article 10.3 of the UNIDROIT Principles.

The difference in approach is also illustrated by the exceptions that can allow for additional extensions of the period regardless of whether the limitation period is still running. One key example is in the case of fraud, where under the Limitation Act if a defendant deliberately conceals a relevant fact then a limitation period does not begin to run until the fact has been discovered. By comparison under the UNIDROIT Principles, while the general limitation will not run until the claimant has actual or constructive knowledge of the fact, the concealment of the fact will not appear to affect the maximum ten-year period from running.

However, there are some similarities in the approach to limitation periods between English law and the UNIDROIT Principles. In both systems the expiry of the limitation period does not automatically bring an end to the rights of the claimant: expiry must be asserted as a defence at which point it is absolute. Additionally, once judicial proceedings have been started, the running of the limitation period is frozen and under both systems the running of the limitation period can be frozen or started again by the agreement of the parties.