Moving Toward a Construction Lex Mercatoria -

A Lex Constructionis

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Introduction

While construction work has historically been performed on a local or national basis, and by local or national contractors, it has now become not only international but heavily focused on infrastructure projects in developing countries. That focus on infrastructure, means, in the industry, civil works, i.e. roads, bridges, water supply, sewerage; these are the kinds of projects which by their very nature lead to contract disputes of some magnitude.

The substantive law referred to in construction contracts as applicable is often the law of the place of performance, the developing country. In the absence of a comprehensive body of national construction law in many countries of the developing world, and in view of the dearth of publicized arbitration awards, is it not appropriate for arbitrators to look to the principles of a sort of *lex mercatoria* for construction, a *lex constructionis* so to speak, for guidance in interpreting international construction contracts?

If there can be said to be a *lex mercatoria* for international traders, we should as well recognize that there are construction law principles which, by reason of the activities of the multinational engineering firms (which draft contracts) and of the development banks (which standardize contract terms), already receive *de facto* recognition for international construction.

To the extent that similar provisions are used in construction contracts in different countries, including their arbitration clauses, a consistent interpretation and application of such provisions would be valuable in establishing greater certainty, thereby promoting participation in construction internationally.

The forms of contract of the *Fédération Internationale des Ingénieurs-Conseils* (FIDIC) are widely used and their dissemination has already developed a degree of commonality or construction *lex mercatoria*. This is useful. Consistent interpretation of FIDIC clauses will reduce uncertainty as to the law, and therefore some of the contracting risk, when contractors tender on international projects. This will require, however, increased availability of the arbitration awards which construe clauses. The confidentiality feature, sometimes cited as an advantage of arbitration, is of minimal relevance in large construction projects because of their high visibility and the involvement of so many firms and individuals.
I. ANYONE FOR LEX MERCATORIA?

Once past the challenge to the very existence of a *lex mercatoria*, we can look for definitions and usage. The treatise of Craig, Park and Paulsson suggests three concepts. In declining order of importance, and capsulizing their categories, they are:

- *lex mercatoria*, maximally, as an autonomous legal order existing apart from national law,
- *lex mercatoria*, as a body of principles sufficient as an alternative to national law to decide a dispute;
- *lex mercatoria*, minimally, as a complement to otherwise applicable law, a consolidation of usage and expectation.

The focus of this brief article is on the modest third concept, expanded to contemplate the value of a construction *lex mercatoria* as a reference, and an aid, in deciding disputes when the applicable law, is thin or non-existent.

There are said to be core principles. A list assembled by Lord Mustill, and posed by him with reluctance as rules said to constitute *lex mercatoria*, includes the following (put very summarily):

1. *Pacta sunt servanda* (contracts to be enforced according to their terms).
2. *Rebus sic stantibus*.
3. *Abus de droit*.
4. *Culpa in contrahendo*.
5. Good faith.
6. Contract obtained dishonestly is void.
7. State entity cannot evade by denying capacity.
8. The controlling interest of a group contracts for all its members.
9. Negotiate to overcome unforeseen difficulties, even absent a revision clause.
10. "Gold clause" agreements are enforceable.
11. A party is discharged if the other breaches substantially.
12. No party can bring about non-performance of a condition precedent by its own act.
13. The characterization of a contract is not binding.
14. Damages are limited to the foreseeable.

II. APPLICABILITY IN CONSTRUCTION ARBITRATION

We might view construction disputes as being like ugly stepchildren in the jet-set world of international arbitration. After all, awards speaking of mud, subsurface excavation for rock elevations, soil mechanics and concrete strength do not ring with sophistication as in, for example, "intellectual property" disputes. Nevertheless, it must be noted that a solid percentage of complex arbitration cases arise from construction disputes. And for many years, the sensible approach, via the standard forms, has been to refer such disputes to arbitration—a forum where the parties can find expertise and speed, sometimes. Of late, particularly in the United States, growing impatience with the expense and slowness of arbitration has led to the rise of other forms of "alternative dispute resolution" (ADR) of or of dispute prevention devices (e.g. "partnering"—a cosy term of fuzzy definition and legal impact). There continues to be recognized, however, the reality that disputes are inevitable in construction: civil works involve the often unpredictable vagueness of nature, building works involve the co-ordination of multiple subcontractors, and industrial works involve changing technology.

Is there a core of construction law principles like or unlike these suggested for *lex mercatoria*? In a superficial sense, construction law is simply a branch of contract law and in some contexts a branch of government procurement or administrative law. Various other law specialities intrude on the construction process: e.g. labour, tort and suretyship, and even copyright and patent law. It is comparable to *lex mercatoria* because several commercial transactions take place. But the commercial transaction...
contemplated by the *lex mercatoria* takes place relatively quickly and any one transaction is similar to thousands of others. As Lord Mustill has pointed out, the *lex mercatoria* is developed by and for the immediately involved merchants. The implication seems to be that since only self-interest is involved, the system is perhaps suspect. It is pragmatic: it serves the traders-nothing more.

If we take this purely mercantile approach a step too far, some transactions might be characterized as having as their sole end the transaction itself rather than, for example, the accomplishment of a useful step in the chain from producer to consumer. If the goal is merely to effect a middleman transaction, there is little "value-added", as our British friends would say. The delightfully droll arbitration award in the *Macao sardine* case, as recounted by Sir Michael Kerr, demonstrates this sterile thought. There, it will be recalled, the Tribunal found that the documented shipment of tins of sardines was solely intended to move forever in international trade (rather like Edward Everett Hale's "Man Without a Country"), never to reach a consumer who might eat the sardines; accordingly, the discovery that the tins contained only mud was simply irrelevant.  

Of course, when the self-interest of the merchants is alluded to, this is certainly not to say that some elevating principles are not involved-trust, good faith, etc. But international construction contracts have a far broader impact than routinized and repeated trading transactions of concern to the merchants involved. There are three considerations:

Every construction project is unique, it is one-of-a-kind by its very nature, including especially its physical *situs*, to which, in fact, it usually becomes permanently attached, and the basic construction contract is accompanied by various other related contracts concerning finance, engineering services, subcontracts, equipment rental, material purchase, suretyship, insurance, *et al.*

Secondly, the performance of the basic construction contract itself takes place over an extended period, sometimes years. With the onset lately of BOT-type (buildoperate-transfer) contracts, the extended period can become very extended indeed. This obviously expands the risk for all involved and gives rise to interesting questions as to the parties' expectations, implied conditions, the doctrines of frustration, *imprévision*, and *force majeure*, etc. In this context, some wags would say that the *pacta sunt servanda* concept should not be viewed as a principle at all, not for the reason that it is an almost self-evident expression but that, in the perception of some, the construction contract is but the announcement of the beginning of an extended negotiation.

Thirdly, and most significantly from the viewpoint of the question whether accepted international norms, by way of a *lex constructionis*, should be applied in construing contracts for international construction, there is the reality of the humanitarian interest. Beyond and distinct from the *lex mercatoria*, with its focus on an immediate mercantile transaction, it is important to consider that many of the large construction contracts are development-related: they are concerned with basic human needs for water supply, sewage treatment, transportation, energy, fertilizer. This facet means that we have a communitarian concern in seeing construction proceed with efficiency because human needs are being met by the process and public moneys are involved. Within the context of public construction contracting there is thus a strong public interest, since poor procurement practices, for whatever reason, mean that fewer projects can be funded.

### III. SOURCES OF LEX CONSTRUCTIONIS

For the *lex mercatoria* one obvious source of principles is to be found in the standard contracts universally accepted and used. The situation is similar for construction. In part, recent events can be said to confer even greater importance on certain forms of standardized contracts. The single most widely used form of international construction contract is that for civil works of the FIDIC. The FIDIC form of contract conditions (informally, the Red Book) has only been around since 1957, but it is actually based upon a much older, widely used British form—that of the Institution of Civil Engineers (ICE). The International Bank for Reconstruction and Development (the World Bank) had "recognized" the Red Book for years. Now, and importantly, with the issuance of new World Bank guidelines for procurement which are incorporated in the Bank's loan agreements with its borrowers, the Bank has mandated the use of what it terms "Standard Bidding Documents", the principal document of which is almost entirely based upon the FIDIC Red Book.

Thus, what was already the leading set of international construction contract conditions for civil works, has now become
the norm for the major construction projects supported by the world's leading development financing institution. Before presuming to advance some particular principles in this article, a few background observations might be made with regard to the World Bank document.

The Standard Bidding Documents volume for major works of the World Bank is, as indicated, based upon the FIDIC Red Book. The Bank does not accept the FIDIC conditions in toto but has changes which are labelled, in declining degrees of inexorability, as "mandatory", "recommended" or "optional". The process by which the Red Book has been developed and revised is of interest. It is now much more than a device developed over time by parties to construction contracts. Under the ICE-based FIDIC form, of Victorian vintage and prose, the engineer had a professional responsibility and a unique dual role in a construction contract to which he was not a party: he was both the agent of the owner and the decision-maker in disputes between owner and contractor. Without going into problem aspects (e.g. the principle nemo in propria causa judex esse debet) of that arrangement, which did actually work, a point to be noted here is that the conditions found in the standard form are very rarely negotiated between the parties. If anything, the contract conditions are imposed, not unlike a contract of adhesion. But, as the FIDIC engineers revised the form over three editions (most recently in 1987) for international usage, they did so in consultation not only with contractor organizations internationally, such as the European International Contractors, headquartered in Wiesbaden, and the Associated General Contractors of America, but also with the development banks (acting in effect on behalf of their borrowers, the borrower-owners not having an ongoing organization). This occasionally adversarial negotiating process led, as can be seen in the finished product, to a balanced document, perceived as fair and workable. In this context, of course, the contra proferentem principle would seem to be inapplicable. After all, one of the purposes of having standard forms is to foster international competitive bidding (ICB being a procurement principle of the World Bank). One indicator of the Red Book's delicate balance is that it is attacked by various commentators both as pro-owner and pro-contractor. The FIDIC/World Bank conditions of contract, as standards, thus merit attention as in establishing good practice and fairness.

The point has nevertheless been urged that standard form contracts generally cannot be considered a "codification" of lex mercatoria because "in the community of merchants there is no codifying authority." For the FIDIC forms, however, to the extent that they are mandated by the World Bank at least, there is a new authority-added to the long-existent usage of the standard construction form around the world. What had previously reinforced and spread that usage, of course, was the balanced structure of that contract, the engineer playing a unique and powerful role in the administration of a contract to which he was not a party, acting as agent and quasi-arbitrator, combined with the historic fact that the standard FIDIC form had developed from a British form and travelled easily wherever in the Empire the British engineers engineered. The Empire may be gone, but the accepted usage has now acquired new force by reason of the World Bank's virtual imposition of its conditions of contract.

For Americans it should be noted that many of the concerns addressed by contract clauses in this originally British form are familiar. These concerns receive treatment which is consistent with American construction contract practice. For example, when site conditions are encountered during construction which were unexpected by an experienced contractor, relief is afforded if the contractor has been damaged (FIDIC Red Book, Clause 12); this is similar to the U.S. government's "Differing Site Conditions" clause (mandated by the Federal Acquisition Regulation (FAR)). Whilst at common law this sort of relief would be unavailable without such a clause, and pacta sunt servanda applied, the reasonableness of allocating this risk to the owner (who often furnishes the site) is apparent. In the Model Procurement Code for State and Local Government published by the American Bar Association, the same principle is recommended.

As another example, the FIDIC-World Bank form calls for formal performance security to be furnished by a third party (Red Book, Clause 10); the U.S. counterpart, of course, is found in the federal Miller Act (40 U.S.C. § 270) and the "little Miller Acts" of the various states.

Another provision, mutually recognized, is that work must continue even while changes occur, as sometimes happens, which might otherwise amount to a substantial breach of contract (compare Red Book Clause 51 with the FAR); provision also is made for change pricing.
IV. APPLICATION OF LEX CONSTRUCTIONIS

With respect to *lex mercatoria*, it is clear that where the parties have denominated the national law to be applied to their contractual disputes, an arbitration tribunal must apply that law. The same observation would apply to *lex constructionis*. That having been duly said, the frequent problem for construction arbitrators is the dearth of precedent in most developing countries. What must be considered is that much in the way of construction dispute resolution focuses not only on neatly put legal propositions but on their consideration together with sometimes ambiguous specifications or drawings and uncertain, complicated, or even buried facts, after the fact.

The *lex constructionis* can perhaps be seen as a force for a valuable consistency in interpretation—valuable because consistency suggests a promise of predictability in contract clause interpretation. To further the World Bank’s sensible policy of international competitive bidding, contractors should be afforded as much certitude as can be made contractually available when they undertake the risks of tendering internationally. To leave the risk of uncertain contract interpretation lurking beneath the dark contractual waters, because the law of nation D (for developing) may have nothing relevant to say, inhibits tendering. If the risks are increased, the prudent will walk away and the tendering will devolve upon the few large contractors. This is neither good procurement policy nor good social policy. What now begins to facilitate the use of a body of *lex constructionis*, of course, is the relatively recent availability to a limited extent of arbitration awards for guidance as construction precedent. As Professor Berger puts it:

"...the widespread publication of international awards, which can be effected without violating the parties' right to keep the proceedings confidential from third parties not concerned and from the public in general, should be encouraged. Under these circumstances, reference to arbitral case-law may therefore lead to the progressive evolution of international economic law and, more specifically, of the *lex mercatoria.*"

For construction as well, with respect to standard forms, the sponsoring and distributing professional organizations can receive feedback via published awards as to problem provisions.

For arbitrators, the distinction, of course, must be kept in mind among the quite different concepts of gap-filling, adaptation and deciding *ex aequo et bono*. In this regard, it is interesting to recall the provisions with respect to ICSID arbitration as to applicable law. Article 42 states:

"(1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.
(2) The Tribunal may not bring in a finding of *non liquet* on the ground of silence or obscurity of the law.
(3) The provisions of paragraphs (1) and (2) shall not prejudice the power of the Tribunal to decide a dispute *ex aequo et bono* if the parties so agree." (emphasis added).

It is reasonable that in the *non liquet* situation the tribunal should look to *lex mercatoria* to fill in gaps or clear up obscurity in the applicable law.

Construction contracts set forth the law for the parties and, in a particular way, are concerned with the allocation of risk (in addition to the obvious concerns of scope and price). Toward the goal of consistent interpretation of the same contract clauses, there needs to be candid utilization of the law of various jurisdictions in a unified way. This is rather more than merely "harmonizing" the law-to harmonize is not to play the same note. This is the predictability of legal result sought by jittery inside counsel of construction companies. If contract clauses are identical, via the use of standard forms such as those of the FIDIC, their interpretation ought to be more than harmonious.

A goal is the providing of greater certainty as to the applicable law and the consistent interpretation of construction contract provisions in the uncertain construction market. The UNCITRAL guide for industrial works contracts makes the point that uncertainty in this respect arises in connection with applicable law with and without a choice-of-law clause in two respects.
First, when a dispute arises concerning a contract or its performance to be settled in judicial proceedings, the court will apply the rules of private international law of its own country; in fact, the courts of several countries may be competent to decide disputes. On the other hand, when disputes are to be settled in arbitration, the tribunal will determine the applicable law. It may be difficult indeed to predict what law will be applied; the UNCITRAL guide makes the point as to arbitration, but it could equally be said to refer to judicial application of private international law (or conflict of laws), in view of the perceived uncertainty.29

Second, and more relevant to the recognition of a transnational lex constructionis, is UNCITRAL'S further observation on the choice-of-law question:

"The second factor producing uncertainty as to the law applicable to the contract is that even if it is known which system of private international law will determine the law applicable to the contract, the rules of that system may be too general or vague to enable the law applicable to a works contract to be determined with reasonable certainty."30

It is evident that a contract reference to a construction lex mercatoria would fill in for the generality or vagueness to which UNCITRAL here refers, it being apparent enough that the reference is to the law of the less-developed countries. This is, incidentally, a larger role than contractual gap-filling which, of course, is arguably another function of lex mercatoria.

V. LEX CONSTRUCTIONIS PRINCIPLES

Rather than venture to pose as many common principles as the twenty, listed above in Section I, a more modest, Mosaic ten are suggested. There are overlaps, of course, and the construction context needs to be considered.

1. Pacta sunt servanda. The obvious norm that contracts are to be observed is particularly significant in public construction where the integrity of the bidding process is at stake. Fairness, to both the taxpayer citizen and the losing bidders, demands that a winning low bidder be required to fully perform the contract for which he has competed.31

2. Rebus sic stantibus. This principle is considered by some commentators to be a sort of contrariety to pacta sunt servanda but is really in healthy tension, an attenuation, covering all of the substantial varieties among different national systems of excuse concepts or varieties of relief from an unjust application of pacta sunt servanda. Lumping together related but not identical concepts, this includes imprévision, frustration, Wegfall der Geschäftsgrundlage and force majeure.32 For construction, this principle is not to be applied casually but only in extreme situations, since the foreseeable risks are presumably anticipated by contractor pricing.

3. The good-faith principle is embodied in the common law and explicit in the French and German civil codes. For construction, facilitation of contract performance by the other party is implicit and seriously important, as is the duty to disclose relevant information. Owners usually furnish the work site, for example, and are better positioned to conduct subsurface investigations and to co-ordinate-contractually with other main contractors and politically with government agencies to obtain permits, etc.

4. Directed changes (or "variations") do not amount to contract breach, and are expectable. They should be priced prospectively, and preferably with reference to criteria and procedures set forth in the contract, to be consistent with the desirable fixed-price contracting approach.

5. Referring Principles:
   - I.1.1 - Good faith and fair dealing in international trade
   - IV.1.2 - Sanctity of contracts
   - VII.4 - Duty to mitigate
   - VIII.1 - Definition