

# **Enforceability of International Construction Contracts and the Arbitral Decision**

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International construction contracting offers many economic benefits, while similarly posing significant risk to the United States Multinational Construction Corporation. To better understand contractual enforcement risk, this paper discusses the relationship between treaty law, customary international law, and the commonly employed international construction contract dispute mechanism arbitration.

**Key Words:** International Construction Contracting, Treaty Law, New York Convention, Arbitration

## **Introduction**

There is a global trend towards less restrictive international trade barriers that is leading to an expansive global market place. This result is a function of both treaty and statutory reform between numerous countries including the United States. Owing to this global economic expansion, the growth and opportunity for the United States (U.S.) Multinational Construction Corporation (MCC) is immense. For example, reported international construction revenues for 1995-1996 equate to \$105 billion dollars. This dollar figure represents a 14 percent growth rate from the prior year. For the U.S. MCC, design build contracting offers tremendous emerging market opportunity (Altman, Trinka, 1997). The international construction market does however represent a higher degree of unpredictable, legal, and business risk (Stokes, 1980). This extraordinary increased business risk is a function of political risk, national custom, foreign legal requirement, and associated applicable municipal law. As with domesticated U.S. construction contracting, international construction contracting also maintains a high degree of contract related disputes and claims. When a construction contract claim does arise, a multitude of complicated legal questions are set-forth such as: a.) which nation's law is applicable as to governance of the contract, b.) which nation possesses jurisdiction to decide the legal question presented, and finally c.) whether the judgment can be enforced (Cushman, Jacobsen, Trimble, 1996). In general, the purpose of this paper is to examine the contracting paradigm for private international law. More specifically, discussion shall focus on the legal aspects of the construction contracting process in a foreign nation and enforcement of same. Furthermore, this discussion shall be two-part. This first part shall write to and discuss the relationship between international treaty law and the formation and enforcement of an international construction contract. The second part shall explain the international construction arbitration mechanism as a subset of the international construction contracting process, and subsequent enforcement of same.

## **International Law**

International law is divided into *public law*, and *private law*. The former relates to political relationships between nation states. The latter, focuses on policing international trade and commerce between national legal systems (Janis, 1999). As noted in the introduction, this paper shall focus and write to private law. Therefore, no further discussion relative public international law shall take place.

The rules of law applied to private international law can be divided into the following three areas: a.) *treaty law or convention*, b.) *customary international law*, and finally c.) *general principles of law*. The law of treaty is similar to private contract law. The reason for this conclusion is that such a document typically explicitly creates a set of legal rights and duties that are obligatory to the signatory nation state. Thus, a treaty serves as an international contract, thereby binding the consenting signatory sovereign states. The underlying fundamental underpinning of *pacta sunt servanda* is the normative rule of law binding nation states to honor a treaty (Mazzini, 1997). Thus, a treaty is considered to be either: a.) constitutional, b.) legislative, or c.) contractual (Janis, 1999).

The descriptive rubric customary international law is unwritten law meaning custom and usage. This law has historical relevance in terms of longitudinal acceptance of normative procedures between nations. Illustrative of this body of law is maritime law. Custom law is used as a supplement to fill gaps in treaty interpretation, or establish law when no law exist (Janis, 1999; Mazzini, 1997). The conjoining of treaty law with customary law thereby creates a complete body of international law.

The third international law construct is general principals of law. The notion here is that all nation states observe their own domestic law. The basic proposition advanced by this model is that a general principle of law is fundamentally common to every legal system. The legal construct *pacta sunt servanda* illustrates such a model. In the hierarchy of international internal rules of law, general principals of law are applied last when treaty and customary law cannot give guidance to the court (Setar, 1996).

## **International Commercial Law**

Prior to commencing with a discussion regarding international construction contracting, it is both informative and important to note that there exists a body of private international law termed *international commercial law* (also termed private international economic law). This term means *law of merchant* having derivation emanating from the medieval body of law known as *customary legal rules*. In short, this body of law currently provides governance of, and to the majority of international business transactions (D'Amato, 1971). In line with this area of private international law, the United Nations has created the United Nations commission on International Trade Law (UNCITRAL) to facilitate and coordinate the unification of such private international economic law (Gwyn, Taylor, 1999). Another international document of import currently employed in the private economic law arena is the United Nations Convention on Contracts for International Sale of Goods (UNC). The UNC is similar to the Uniform

Commercial Code presently employed in the U.S. A multitude of nations, including the U.S., have ratified and become signatory parties to this agreement regarding its application and governance over international sales transactions. Both UNCITRAL and UNC are applicable to international construction contracts, and the arbitral process for same (Altman, et al, 1997).

### **International Construction Contracts**

There exists a legion of international contract forms and provisions. For the U.S. MCC, the American Institute of Architects (AIA), and the International Federation of Consulting Engineers (FDIC) are the most common construction contract forms currently being utilized in the international construction arena (Cushman, Myers, 1999; Altman, et al, 1997). Another commonly employed construction contract is the United States Army corps of Engineers (COE) contracts for work performed in foreign countries. The (COE) either parallels and falls under the auspices of the Federal Acquisition Regulation (FAR) of the U.S. government. Of those contractual types alluded to above, the FDIC contractual form is most commonly employed in the international construction arena (Stokes, 1980). Therefore, owing to the wide utilization of the FDIC document, further discussion shall directly focus to the FDIC contract format (Altman, et al, 1997; Grove, Hummel, 1994).

The FDIC document has three principal parts: a.) form of agreement, b.) conditions of contract for works of civil engineering construction, and c.) conditions of particular applications. The FDIC contractual form is commonly referred to as the *Red Book* (Cushman, et al, 1999; Molineaux, 1995; Altman, et al, 1997). Like the standard U.S. private construction contract, particularly the AIA version, similarly too the FDIC document is a tri-union constellation (owner, contractor, and designer) of contractual parties. Within this tri-union, the engineer has a significant and substantial discretionary authority regarding interpretation and administration of the construction contract documents (Molineaux, 1995). This discretionary authority creates what is referred to operationally and constructively as the *independent engineer*. In this role, the engineer function similarly to that of the architect role found in the standard AIA document (typically referred to as a quasi-adjudicator) regarding contractual disputes (Stokes, 1980). Here also, like the standard AIA documents (AIA 201 - General Conditions), the FDIC civil form provides for arbitration of disputes found at clause 67 of the document. Clause 53 of the FDIC document outlines the procedural aspects for presentment of a contractual claim, this clause conjoins with clause 67, whereby arbitral proceedings shall relate to claims relative to the work, completion of the work, satisfaction of the work, breach, termination, and abandonment (Molineaux, 1995; Cushman, et al, 1999). Thus, because the FDIC document, as well as many other international construction contracts documents provide for mandatory binding arbitration, the arbitral process is currently the most often preferred and utilized dispute resolution mechanism employed in the international construction arena (Hoellering, 1994; Stokes, 1980).

### **International Commercial Arbitration**

International *arbitration* is defined as a systematic methodology of dispute resolution privately agreed to by contractual parties. The system creates a process, whereby an appointed private

judge acting as a neutral having expertise in the disputed area, conducts a hearing without the normal formal civil court proceedings (Jones, 1994). Arbitration is a process and system of dispute resolution dating back to ancient Greece 500 B.C., and has developed internationally as a customary practice originating over the centuries primarily from international maritime trade (King, LeForestier, 1985). Although the proceedings are entirely private, arbitral decisions are rendered on the predicate of international law (treaty, and/or customary law) and enforced via treaty. In view of the above, however, international commercial arbitration is viewed as an alternative dispute resolution mechanism to that of municipal (law of one's own nation) litigation and the uncertainties relative domestic court rulings (Janis, 1999). Therefore, the fundamental purpose and objective of international commercial arbitration is to promote, harmonize, and facilitate the growth of international trade and commerce.

Essentially, commercial international arbitration finds governance and enforcement via pertinent multilateral or bilateral convention, treaty, or agreement (McDonnell, 1995, et al). Most notable are the United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention), and the United Nations Commission on International Trade Law Model Rules of Arbitration (UNCITRAL) (Davis, 1994; Hoellering, 1995). The effective and predictable enforcement of arbitral proceeding are greatly enhanced and facilitated by such treaty and convention law. With the above, and because: a.) international commercial arbitration leads to more predictable outcomes than international domestic municipal law decisions, b.) is also less expensive than litigation c.) provides faster resolution to disputes, and finally, d.) most international entities prefer private negotiation to resolving disputes rather than litigation. Therefore, arbitration is the preferred mechanism for resolving international commercial disputes (Hoellering, 1994).

### **International Construction Arbitration**

As with the U.S. construction industry, international construction contracting is fraught with contractual dispute. Similarly, as with U.S. construction contracting, the rapid increase in employing arbitration as a dispute resolution mechanism is a growing trend in the international construction arena (Stipanowich, 1998). This trend is a function of the complexity of the construction process, time constraints associated with same, and the significant cost associated with the litigation in a foreign jurisdiction (Mason, 1994; Molineaux, 1995). As a result, the standard international construction contract document (FDIC) typically includes a commercial arbitration clause (Wagoner, 1993). When an international construction contract has a commercial arbitration provision incorporated within the agreement, the enforceability of a foreign arbitral awards falls under the auspices and governance of the New York Convention (NYC), and UNCITRAL (Mason, 1994; Hoellering, 1994; et al). In short, the above alluded to treaty and convention requires all signatory countries to recognize and enforce the written arbitration agreements and the subsequent decisions rendered there from by the arbiter. Gwyn and Taylor (1999), list minimum requirements set-forth by the NYC necessary to enforce an arbitration as follows:

“The arbitration clause should meet the minimum requirements of the New York Convention, i.e. that: 1) the agreement is in writing; 2) the agreement deals with differences that have arisen or

that may arise between the parties; (3) the agreement is valid under the law to which the parties have subjected it; (4) the parties have legal capacity under that law to enter into such an agreement; (5) place of arbitration; (6) number of arbitrators; (7) language of the arbitration; (8) law to be applied in the arbitration; and (9) the international arbitration institution and/or arbitration rules that the parties intend to use, unless an ad hoc arrangement is intended. “Ad hoc” refers to arbitrations conducted without institutional assistance, established rules, or both. Ad hoc arbitrations can be very effective, if the appointed arbitrators are competent and the contract designates an authority, such as a chamber of commerce or court, to appoint the arbitrator or the chairman of the arbitration panel if the parties cannot agree. Provided these minimum requirements are met, then the NYC prescribe that signatory nations enforce the arbitral judgments as international law amongst the signatory nations.”

Now that the process and relationship between treaty, international contract law, the arbitration provision, and enforceability of same have been outlined, this discussion shall turn and next write to international arbitration organizations. Referring to the list of minimum requirements laid down by the NYC, note that item 9 refers to arbitration institution and/or rules. There presently exists a myriad of international arbitration systems to perform such a task, and most international contracts specify such a managing dispute resolution organization (Coulson, 1986). The international law community does not dictate which arbitral system to be employed because such agreements are private in nature. However, NYC, does recommend that the parties select of one such institution and incorporate the designated organization in the contract (Mason, 1994, Hoellering, 1994, 1995). There are several well-known institutions, these being: a.) the International Chamber of Commerce (ICC), b.) the American Arbitration Association, c.) London court of International Arbitration, d.) Inter-American Commercial Arbitration Commission, and e.) Institute for Dispute Resolution (Bresee, 1994). Thus, under the FDIC red book agreement, the parties would stipulate to the managing international commercial arbitration system to be implemented in the event a dispute arose (Stokes, 1980). Thus, for example, should the parties to an international construction contract elect the International Chamber of Commerce (ICC) as the managing arbitral system, then the parties are thereby bound to comply with promulgated ICC rules. Typical rules for managing arbitral systems relate to a.) rules regarding the appointment and number of arbitrators, b.) notice provisions, c.) discovery, d.) choice of language, e.) choice of law and f.) award (Gwyn; et el, 1999). Once the arbitral proceedings are concluded, the award is issued and the winning party looks to NYC and UNCITRAL for enforcement of the award under international law (Groves, et el, 1994).

Illustrative of the discussion above is *Biotronik Mess-und Therapiegeraete GmbH & Co., v. Medford Medical Instrument, Company*, 415 F. Supp. 133, (1976). Biotronik, a West German manufacturer/distributor, entered into a commercial agreement with a U.S. firm, Medford Instrument Co. (Medford). The agreement contained a provision for arbitration under the International Chamber of Commerce rules (ICC). The issue presented to arbitration was one of contractual breach, and in dispute was the amount owing and due regarding goods delivered to Medford. The dispute was submitted to the ICC for arbitral decision. The arbiters’ award was in favor of the German firm Biotronik. The U.S. firm Medford refused to honor the award, contending that Biotronik knowingly concealed evidence at the hearing that constituted fraud and, therefore, the arbitrators’ decision was not enforceable. Thereafter, Biotronik sought suit in federal court to confirm and enforce the award as provided for by the New York Convention,

pursuant to 9 U.S.C. section 201, 1976. Although the court examined the record presented by Medford, the court emphasized that there existed no fraud by narrowly construing the statutory fraud defense found at 9 U.S.C. 10 (a) (court noted that it may vacate an arbiters award on the basis of fraud). Because Medford was incapable of establishing fraud pursuant to section 10 (a), the court, after establishing subject matter jurisdiction via the Convention and subsequent pertinent U.S. code section (9 U.S.C.), enforced the international awards against Medford.

In *Parsons and Whittemore Overseas Inc. v. Socete Generale De Industrie Du Papier*, 508 F.2d 969 (2<sup>nd</sup> Cir. 1974), here Parsons (U.S. corporation) seeks relief from U.S. court arguing that an international award rendered by an arbitration tribunal is unenforceable as violative of U.S. public policy because the award was predicated on resolution of issues beyond the scope of the contractual agreement to submit to arbitration. The court held by agreeing to submit to arbitration, Parsons relinquished its right to judicial review by agreeing to arbitration. The court further wrote that the issue before the arbitral panel was not of national interest, but instead, a judicial resolution of contractual obligation. Thus, the court held the arbitral tribunal acted within subject matter jurisdiction promulgated by the Convention, and pursuant to the Federal Arbitration Act, 9 U.S.C. enforced the foreign award rendered by the foreign arbitral body against Parsons. SEE also, *Landers Company, Inc., v. MMP Investments, Inc.*, 107 F.3d 76 (7<sup>th</sup> Cir. 1997); arbitral award was enforceable against Polish national corporation. Plaintiffs (Landers) failure to plead diversity jurisdiction did not abrogate the applicability and enforceability of the arbitral award rendered under the Convention, and same did not deprive district court of jurisdiction under the Federal Arbitration Act. Also, Bergesen, supra note 50, domestic arbitration awards are enforceable in foreign jurisdiction subject to the Convention because the Convention is subsumed into the legal structure of such signatory countries. Refer to *In the Matter of the Arbitration Between: Trans Chemical Limited, and China National Machinery and Export Corporation*, 978 F. Supp. (S.D. Tex. 1997), mirroring, and standing for the same proposition as Bergesen supra.

### **Conclusion**

Significant economic opportunity avails itself in the international construction arena. There is however significant risk associated with international construction. This risk has to do with unpredictable legal outcomes rendered by international courts. As a solution to this problem, nations have joined together and signed an international treaty authorizing arbitration as an alternative mechanism to international litigation. The intent was to minimize and harmonize economic trade between nation states. As a result of this effort, 70 nations currently recognize the United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards. In short, this convention requires each signatory nation to recognize and enforce written arbitration agreements and awards of all other signatory countries.

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### End Notes

1. Ross J. Altman, timothy E. Trinkka, *International Law*, The National Law Journal, 1 (1997); (“trade agreements such as the North American Free Trade Agreement and the General Agreement on Tariffs and Trade, is having a vast impact on the design and construction industry.”).
2. SEE *Biotronic Mess-und Therapiegeraete GmbH & Co., v. Medford Medical Instrument Company*, 415 F. Supp. 133 (1976). Thomas Sanders, *International Commercial Arbitration-How to Improve its Functioning?* Arbitration 9, 1990, (there is greater uncertainty regarding rules that govern dispute in foreign venue, therefore procedural complexities of litigating in a foreign jurisdiction lead to increased time, expense, and less certainty as to enforceability of the judgment. Regarding arbitration enforcement, a foreign arbitral judgment is simpler and more certainable to enforce than enforcement of a foreign judgment. Therefore, arbitral clauses predominate international commercial contracts.
3. Pacta sunt servanda means agreements of parties must be observed. Black’s Law dictionary, 999, (1979).
4. Customary International law is also termed general international law.
5. Clause 67 provides a three tiered process for dispute resolution: step 1 – claim presentment to engineer for decision, step 2 – effort to reach an amicable settlement, and step 3 – final and binding arbitration. Article 50 states the decision of the engineer is subject to full (de novo) review; *De novo* meaning anew. Black’s Law Dictionary, 5<sup>th</sup> ed., 392 (1979).
6. Under United States Law – Codified at 9 U.S.C. and incorporated into the Federal Arbitration Act by legislative Enactment. See Janis, at Chapter 4, discusses legislative ratification of treaty’s in relation to the U.S. Constitution and the Supremacy Clause of Article VI, whereby a treaty is regarded by courts of the United States to be operative similar to an act by the U.S. congress, thus being considered codified law in the United States provided such treaty is not in contravention of the United States Constitution. Further New York convention was adopted in 1958, now ratified by 90 countries; the Convention supercedes two prior multilateral treaties adopted by the League of Nations, the Geneva Protocol on Arbitration Clause (1923), and the Geneva Convention on the Execution of Foreign Arbitral Awards (1927).
7. In *Biotronik*, citing to 9 U.S.C. sec. 203: An action falling under the convention shall be deemed to arise under the law and treaties of the United States district courts of the U.S. shall have original jurisdiction regardless of amount in controversy.
8. *Productos Mercantiles E Industriales, S.A. v. Faberge USA, Inc.*, 23 F.3d 44, 41 (2<sup>nd</sup> Cir. 1994). International commercial arbitration agreement, (New York convention) and the Federal Arbitration Act provide authority to signatory states, and to the district courts of the U.S. to recognize and execute an arbitration award.
9. *Bergesen v. Joseph Muller Corp.*, 710 F.2d 928 (2<sup>nd</sup> Cir. 1983), congress intended to provide subject matter jurisdiction via treaty convention and parallel legislation under the Federal Arbitration Act, thereby giving jurisdiction to courts to confirm arbitration awards both in the United States and those of foreign countries that are signatories to the Convention.