

Legal Bases for the Interpretation of Contract Terms under the UNIDROIT Principles of International Commercial Contracts*

JKT 24(1)

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Received 18 December 2019

Revised 20 January 2020

Accepted 20 February 2020

Abstract

Purpose – This paper examines the legal standards for the interpretation of contract terms in the UNIDROIT Principles of International Commercial Contracts (PICC) and the cases thereunder in order to provide academic implication to promoting an appropriate understanding of this topic in practical business.

Design/methodology – This article uses the literature research and case study under the PICC.

Findings – the contract terms shall be interpreted according to the common intention of the parties. If such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances. The statements and other conduct of a party shall be interpreted according to that party's intention if the other party knew or could not have been unaware of that intention. If not, the reasonable person standard will apply. In applying above articles, all relevant circumstances including the conduct of the parties, practices and usages shall be considered. Terms and expressions shall be interpreted in the light of the whole contract or statement in which they appear and contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect. Where contract terms supplied by one party are unclear, *contra proferentem* rule applies. Where there is discrepancy between several equally authoritative versions of a contract, a preference is given to the interpretation according to the version originally drawn up. Where the parties to a contract have not agreed regarding an important term for their rights and duties, a term which is appropriate in the circumstances shall be supplied.

Originality/value – This article examines various cases regarding the topic that were determined under the PICC. By finding legal standards and rulings of relevant cases, this article will help readers in practical business to enhance the ability to apply the provisions to their contracts.

Keywords: Intention of the Parties, International Commercial Contracts, Interpretation of Contract Terms, PICC

JEL Classifications: K12, K22, K33

1. Introduction

'Interpretation of contract terms' is generally to determine whether there exists a declaration of an intention for a contract and if so, to conclude its terms clearly based on such

* This work was supported by the Daegu University Research Fund of 2020 and the Hankuk University of Foreign Studies Research Fund of 2020.

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declaration as the legal bases to secure 'formation of contract' and 'its validity'.

If the 'act of declaring an intention' contained in the contract terms agreed between the parties in the process of the 'international commercial contract' is consistent with the 'real intention' of the parties resulting therefrom, no obstacles or problems will arise due to the interpretation of a contract in the process of concluding or implementing it. However, if such act or the 'effective intention' between the parties is different, there will be unusual problems in interpreting contract terms. In this case, if the act is inevitably interpreted in various meanings, it is necessary to comprehensively consider relevant circumstances other than such act. Even if the act has a single meaning, where there is a dispute between the parties, there is a problem that contract terms must be interpreted from an appropriate and reasonable point of view considering all surrounding circumstances.

In fact, the view point on the interpretation of contract terms is divided into the 'expressionism' that the object of the interpretation should be external 'acts of declaring an intention' (majority view) and the 'intentionalism' that it should be internal 'effective intention' (minority view). This division was made academically. However, examples of actual legislation and the trend of judicial precedents have generally shown real intention of the 'expressing person' as legal interest according to methods such as 'natural interpretation', 'normative interpretation', and 'supplementary interpretation'.

In this case, however, a certain order of interpretation is applied, i.e., firstly in the event that the parties in fact agree on a certain indication, 'natural interpretation', by which the effect as its original meaning is recognized, is applied. Next, when the agreement between the parties is not confirmed, 'normative interpretation' which reveals the objective and normative meaning of the act of declaring an intention is applied, and finally in case of finding a gap in the juristic act as a result of its interpretation, 'supplementary interpretation' is applied.

The interpretation of contract terms in the 'international commercial contract' focuses on clarifying the intention of the parties, since the purpose of such interpretation is to generate juristic effects originally intended by respecting the intention of the contracting parties. However, this means that clarifying the parties' intentions does not focus on the real intentions of the parties but concentrates on revealing the meaning given to acts of declaring an intention.

Therefore, interpreting contract terms in the international commercial contract usually pursues to seek the objective and normative meaning that can be commonly applied to all parties. This is based on the fact that since one of the contracting parties understands the intention of the other party, the expressing person, in this case according to the act of declaring an intention of the person, if the interpretation of contract terms centers on that person, it will be against the legal equality.

For example, the interpretation of contract terms in the international commercial contract focuses on revealing the true intention based on the act of declaring an intention expressed outwardly of the expressing person. However, ultimately, it aims at defining and constructing the true meaning which is legally valid and valuable, as well as objectively determining the real intention of such person.

Based on such background, the purpose of this article is to infer legal bases for the interpretation of contract terms in conjunction with judicial precedent examples which can be referred to, centering on the 'UNIDROIT Principles of International Commercial Contracts (2016)(hereinafter referred to as the PICC)' promulgated by 'UNIDROIT', which stands out as a universal legal standard, in other words, general principles of international commercial contract. Therefore, this article is to provide some clues in promoting an appropriate understanding of this topic in practical business.

2. Interpretation of Contract Terms in Legal Systems

2.1. International Contract Law

2.1.1. CISG

The CISG (The United Nations Convention on Contracts for the International Sale of Goods) provides the provisions on the interpretation of 'statements' and 'conducts' of the parties as the basis for the interpretation of contract terms (Art. 8). Its gist is that at the application of the CISG, statements made by and other conduct of a party are to be interpreted according to its intention where the other party knew or could not have been unaware what that intention was [natural interpretation]. However, if it is not applicable, such statements or conduct are to be interpreted according to the understanding that a reasonable person of the same kind as the other would have had in the same circumstances [normative interpretation]. In this case, it is provided that in determining the intention of a party or the understanding that a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties [criteria for the interpretation of statements and conducts].

Article 8 places the factual intention of the expressing person on the first consideration in interpreting a declaration of an intention and, if the intention is not specified, the objective interpretation is provided as an alternative. In this case, elements to be considered in determining the unspecified meaning objectively are provided.

This Article applies to all notices under the contract as well as the declarations of intentions of the parties, and the conduct of a party under this Article includes both action and omission, as long as it is related to the contract (Albán, 2012). However, there is a limited requirement that such statements and conducts must be related to those contained in the scope of the CISG (Lookofsky, 2008; Schlechtriem, 1998).

In short, the key to the interpretation of the subjective intention under this Article is that if one party's statements and other conducts cannot be interpreted, it must be interpreted according to the objective intention. For example, the statements and other conducts of one party shall be interpreted in accordance with the understanding of a reasonable third party in the same situation as the other party. This is usually called rational interpretation.

2.1.2. PECL

Compared with the CISG, the PECL (The Principles of European Contract Law) provides more detailed provisions on the principles of the interpretation of the contract (Arts. 5:101 to 5:107), and they are as follows in the order:

First of all, as the general rules of interpretation, a contract is to be interpreted according to the common intention of the parties. Even if the common intention differs from the literal meaning of the words, the contract is interpreted according to such common intention. Further, if it is established that one party intended the contract to have a particular meaning, and at the time of the conclusion of a contract the other party could not have been unaware of the first party's intention, the contract is to be interpreted in the way intended by the first party [natural interpretation]. If, nevertheless, the intention of the parties cannot be proved, the contract is to be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances [normative interpretation]. It can be seen that the above is in line with the provisions of the CISG.

On the other hand, the point that can be highlighted in the interpretation of the contract

under the PECL is that the criteria for natural interpretation and normative interpretation are more specific than those of the CISG. The more specific points in interpreting the contract are that relevant circumstances are considered such as the circumstances in which the contract was concluded, including the 'preliminary negotiations'; the conduct of the parties, even subsequent to the conclusion of the contract; the nature and purpose of the contract; the interpretation which has already been given to similar clauses by the parties and the practices they have established between themselves; the meaning commonly given to terms and expressions in the branch of activity concerned and the interpretation similar clauses may already have received; usages; and good faith and fair dealing.

The '*contra proferentem* rule' adopted by the PECL holds the same legal view as in the PICC. However, the terms which have been individually negotiated take preference over those which are not. Terms are interpreted in the light of the whole contract in which they appear. An interpretation which renders the terms of a contract lawful, or effective, is to be preferred to one which would not. Accordingly, the PECL has more concrete provisions than the CISG or the PICC (Huber and Mullis, 2007).

Another difference between the CISG and the PECL exists in case of linguistic discrepancies. In other words, where a contract is drawn up in two or more language versions none of which is stated to be authoritative, there is, in case of discrepancy between the versions, a preference for the interpretation according to the version in which the contract was originally drawn up.

2.1.3. PICC

The PICC adopts natural, normative and supplementary interpretations. First of all, regarding natural interpretation, a contract shall be interpreted according to the common intention of the parties (Art. 4.1(1)). Nevertheless, if such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances (Art. 4.1(2)). The PICC, like the CISG, adopts a combination of subjective and objective approaches in interpretation of contracts (Bonell, 2007).

Regarding the interpretation of statements and other conduct, the PICC provides that the statements and other conduct of a party shall be interpreted according to that party's intention if the other party knew or could not be unaware of that intention, and if it is not applicable, such statements and other conduct shall be interpreted according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances (Art. 4.2). In this case, in confirming the intention of the parties, elements to be considered for relevant circumstances are preliminary negotiations between the parties; practices which the parties have established between themselves; the conduct of the parties subsequent to the conclusions of the contract; the nature and purpose of the contract; and the meaning commonly given to terms and expressions in the trade concerned; and usages (Art. 4.3).

On the other hand, regarding the interpretation of contract, the PICC has more concrete provisions than the CISG. For example, terms and expressions shall be interpreted in the light of the whole contract or statement in which they appear (Art. 4.4). Contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect (Art. 4.5). In addition, the PICC has a characteristics of adopting '*contra proferentem* rule' clearly (Art. 4.6). The PICC has a very similar provision to that of the PECL regarding the case of linguistic discrepancies (Art. 4.7).

However, unlike the CISG and the PECL, the PICC has a provision for the supplementary interpretation of contract terms. The PICC provides that where the parties to a contract have not agreed with respect to a term which is important for a determination of their rights and

duties, a term which is appropriate in the circumstances shall be supplied. In this case, in determining appropriate terms, 'the intention of the parties', 'the nature and purpose of the contract', 'good faith and fair dealing' and 'reasonableness' shall be considered (Art. 4.8). This provision is more appropriate resort than other provisions such as Article 1.7 (Good Faith and Fair Dealing) when supplying an omitted term is at stake (Bonell, 2001).

2.1.4. Conclusion

The provisions of the international contract law standard mentioned above on the interpretation of a contract are those for the purpose of disciplining the contracting parties in cases where their intentions have not been incorporated into their contracts from the beginning or they have different intentions. When compared with legal standards for international contracts, the CISG and the PICC show the same position that by focusing on declaration of intention incorporated into statements and other conduct of a party, such statements and other conduct shall be interpreted according to that party's intention if the other party knew or could not have been unaware of that intention.

On the other hand, the PECL provides that if it is established that one party intended the contract to have a particular meaning, and at the time of the conclusion of the contract the other party could not have been unaware of the first party's intention, the contract is to be interpreted in the way intended by the first party, and therefore shows a difference in that it includes the case where the other party knew or had not been unaware of the intention of the expressing person and also another case where the expressing person knew or had not been unaware of that the other party understands the declaration of intention of the expressing person differently from its intention.

2.2. Laws of Major Countries

2.2.1. Germany

Regarding the interpretation of contract terms, the civil law of Germany provides two articles: interpretation of a declaration of intention (Art. 133)¹ and interpretation of contract terms (Art. 157).² The former provides that in interpreting the declaration of intention of a party, it should be done focused on the real intention of that party and in this case, it should not be adhered to the literal meaning of the declaration [natural interpretation].

The latter, as a standard of natural interpretation and normative interpretation, states that in relation to the interpretation of contract terms, commercial practices should be properly considered and also in accordance with the principle of good faith it should be interpreted accordingly.

2.2.2. Italy

The Italian Civil Code provides the rules for natural interpretation (Arts. 1362-1365) and normative interpretation (Arts. 1367-1371) regarding the interpretation of a contract. The articles provide that for the interpretation of a contract, what the common intention of the parties is should be found out and in this case, the interpretation of individual words in contract terms should not be made arbitrarily and further, relevant circumstances of the

¹ BGB, §133: "When a declaration of intention is interpreted, it is necessary to ascertain the true intention rather than adhering to the literal meaning of the declaration."

² BGB, §157: "Contracts are to be interpreted as required by good faith, taking customary practice into consideration."

parties should be considered including the conduct of the parties subsequent to the conclusion of the contract in order to confirm the common intention of the parties (Art. 1362).³ On the other hand, 'in case of doubt,' the contract shall be interpreted in the sense in which it can have some effect (Art. 1367). 'Ambiguous clauses' are interpreted according to the general practice in the place where the contract was concluded (Art. 1368). 'In case of doubt,' expressions which can have more than one meaning shall be understood in the sense most suitable to the nature and object of the contract (Art. 1369). These three articles and Article 1370 (interpretation against the author of provision 'in case of doubt') and Article 1371 (When the contract still remains obscure after the application of the articles 1362-1370, it shall be understood in the sense least burdensome for the debtor or in the sense which equitably reconciles the interests of the parties.) are considered as the rules for normative interpretation since these articles may be applied only when the common intention of the parties cannot be ascertained by Article 1362.

In particular, this Code has a separate article regarding the interpretation of contractual terms according to good faith (Art. 1366).⁴ However, good faith of this article is not a general principle of good faith, rather a specific side of good faith as a criterion of fair dealing and reasonableness in declarations of intention, and therefore good faith shall be used only when the intentions of the parties cannot be determined (Yildirim, 2019).

2.2.3. *Swiss*

The Swiss Obligation Act, provides that in determining contract terms in accordance with the manner and terms of the contract, attention should be paid to the true intention agreed between the parties, and in such process, the true and common intention of the parties must be ascertained, not in conflict with any inexact expression or designation they may have used in error or by way of disguising the true nature of the contractual relation [Art. 18(1)].⁵

In addition, contract terms may be freely set within the limits of the law [Art. 19(1)]. In this case, the agreement that deviates from provisions prescribed by law is admissible only where the law does not prescribe mandatory forms of wording or where deviation from the legally prescribed terms would not contravene public order, morality or rights of personal privacy [Art. 19(2)].

2.2.4. *The U.S.*

The US Restatement of Contracts rest on the principles of language use, such as the 'plain meaning rule' and the 'social purpose rule', when interpreting the law. As for the interpretation of contract terms, in addition to the principle of the interpretation of general law, especially the 'parol or extrinsic evidence rule' is highlighted. In this case, the principle implies that the final written contract includes all promise made prior to the conclusion of a contract or the separate oral promises that exist at the same time, which means that only the final written contract exists between the contracting parties.

³ Italian Civil Code, Art. 1362 : "The common intention of the parties, not limited to the literal meaning of the words, shall be sought in interpreting the contract. In order to ascertain the common intention of the parties, the general course of their behavior, including that subsequent to the conclusion of the contract, shall be taken into account."

⁴ Italian Civil Code, Art. 1366 : "The contract shall be interpreted according to good faith."

⁵ Swiss Obligation Act, Art. 18(1) : "When assessing the form and terms of a contract, the true and common intention of the parties must be ascertained without dwelling on any inexact expressions or designations they may have used either in error or by way of disguising the true nature of the agreement."

Although the parol or extrinsic evidence rule is a principle created in the case law of the United States, it can be seen that it is now regarded as one of the most widely used contracting principles not only in the prestigious legal regulations but also in contract practice (Flechtner, 2007). In short, in the US Restatement of Contracts, the interpretation of a contract is a confirmation of contract terms, and at the same time, the terms added by the parties in the same meaning to the contract must be interpreted according to their meanings (Art. 201).⁶

2.2.5. Korea

At present, Korea does not have a clear definition of the interpretation base on contract terms. The reason is probably because it is difficult to make external judgments by law on an element of internal intention. However, in some cases, even though the actual interpretation to determine contract terms is the most important issue in the dispute, various opinions are currently being expressed because the direct regulations on this issue cannot be found.

In short, in Korea, although the interpretation of contract terms is the most important issue in the actual dispute, there is no direct rule thereon. However, in the case of the Civil Act, in relation to the interpretation of contract terms, the two provisions of the Civil Act, Art. 105 (Optional provisions)⁷ and Art. 106 (De Facto Customs)⁸ which are related to the interpretation of juristic act, are being applied.

3. Legal Base and Judicial Precedents Under the PICC

3.1. Intention of the Parties

3.1.1. Legal Base

a) *Prior Application of Common Intention of the Parties*

As seen above, the PICC provides that a contract should be interpreted in accordance with common intention of the parties [Art. 4.1(1)]. However, if such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances [Art. 4.1(2)].

This Article declares that in determining the meaning to be attached to contract terms, preference is to be given to the intention common to the parties. In other words, a contract term may be given a meaning which differs both from the literal sense of the language used in a contract term in international commercial transactions and from the meaning which a reasonable person would attach to it, provided that such a different understanding was

⁶ Restatement of Contracts, §201 : “(1) Where the parties have attached the same meaning to a promise or agreement or a term thereof, it is interpreted in accordance with that meaning. (2) Where the parties have attached different meanings to a promise or agreement or a term thereof, it is interpreted in accordance with the meaning attached by one of them if at the time the agreement was made (a) that party did not know of any different meaning attached by the other, and the other knew the meaning attached by the first party; or (b) that party had no reason to know of any different meaning attached by the other, and the other had reason to know the meaning attached by the first party. (3) Except as stated in this Section, neither party is bound by the meaning attached by the other, even though the result may be a failure of mutual assent.”

⁷ Korean Civil Act, Art. 105 : “If the parties to a juristic act have declared an intention which different from any provisions of Acts or subordinate statues which are not concerned with good morals or other social order, such intention shall prevail.”

⁸ Korean Civil Act, Art. 106 : “If there is a custom which differs from any provisions of statutes which are not concerned with good morals or other social order, and if the intention of the parties to a juristic act is not clear, such custom shall prevail.”

common to the parties at the time of the conclusion of a contract.

For example, a contracting party will not use an entirely different meaning from commonly used terms, but if the matter is in such a case, once a dispute arises, it would be extremely difficult to prove that the specific meaning that one party claims to be a common intention was shared or understood by the other party at the time of the conclusion of the contract. Therefore, this provision should be applied carefully and universally (Vogenauer, 2009).

b) Base of Reasonable Person

If the parties cannot establish or deduce from the common intention of the parties, the understanding of the reasonable person involved is not a general and abstract standard, as is conventional, but a person who has the same language ability, technical skill or business experience as the parties. In this case, Article 4.1 (2) as in the relevant provisions of the CISG [Article 8(2)], shows that for example, when one of the parties bearing a contractual obligation decides on what level of conduct should be done as the performance of such obligation, as the reasonable person engaged in a same class of occupations, the method of acting of the average person is accepted as a standard. In other words, if it cannot find a specific clue that is consistent with the arrangement from the act of the party, it shall be judged on the basis of the normal average person in the same specific circumstances as the party under this Article.

c) Base of Natural and Normative Interpretations

If the intention of contracting parties is common, relevant circumstances should be considered in order to confirm such intention. In this case, consideration shall be given to the preliminary negotiations between the parties, the practices established between the parties, the conduct of the parties subsequent to the conclusion of the contract, the nature and purpose of the contract, the meaning commonly given to terms and expressions in the trade concerned and usages. If the common intention of the parties is not established, it will be interpreted as the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances.

d) Interpretation of Standard Terms

The so-called natural interpretation in Article 4.1(1) and the normative interpretation in the same Article 4.1(2) may not be appropriate in some cases for interpretation under the standard terms. Indeed, the standard terms incorporated into consideration, in terms of special characteristics and purposes, are often irrelevant to the normal level of understanding that one party to the contract or a reasonable person of the same kind as the business of the parties may have.

Nevertheless, it has been recognized that this provision of normative interpretation should be construed in accordance with the expectations of a reasonable person even in the interpretation of the standard terms. In this case, the standard terms are collectively referred to as the actual contract provisions that are prepared in advance by one party for the purpose of general and repetitive use and are not negotiated with the other party [Art. 2.1.19(2)].

3.1.2. Judicial Precedents

a) Issues and Judgments⁹

According to an *International Arbitration Court at the Chamber of Commerce and Industry*

⁹ In this paper, the term “judgment” is used for the sake of convenience in the meaning of the judgment of the court and the judgment of the arbitral tribunal.

of the *Russian Federation Arbitral Award* (2002a),¹⁰ under an agreement between A (claimant, Russia) and B (respondent, Germany), A undertook to render commercial services to B relating to the marketing of goods produced by B. In performing the agreement, A found a potential buyer for B's goods in Russia and assisted B in drafting the contract of sale, which was subsequently signed between B and C, the buyer of the goods.

In the process of the performance of the contract, C later terminated the contract and returned the goods to B. On that basis, B refused to pay to A the fee stipulated in their agreement, arguing that it was obliged to pay the fee only in the event of a successful sale and that, failing such a successful outcome, A had no right to remuneration for its commercial services. A insisted on payment, arguing that the agreement did not contain an express provision that the fee was payable only in the event of success, and that the fact that B was unable to meet the buyer's requirements should not affect the right to be paid for services rendered.

On the other hand, A mentioned that in the agreement, there is no explicit provision that the remuneration of the commission fee is paid only for an successful outcome, and that the goods B will provide to C could not meet the specifications of the particular goods of C due to grounds attributable to B's responsibility, and stating that such fact could not have any effect on the remuneration of the commercial service he had provided to B, A requested B to pay the compensation.

The Arbitral Tribunal decided to apply the PICC to resolve the dispute, in consideration of the reference to the legal system of both parties being the same as the case where no specific domestic law was selected in interpreting the terms of contract containing PICC as the governing law. Furthermore, it pointed out that the dispute arises from the different interpretations between the parties in the light of the contractual arrangements agreed between the parties, and applied Arts. 4.1 and 4.3 of the PICC.

The Arbitral Tribunal's decision as an order is that the agreement contains a detailed contractual description of the commercial service that A must provide and that because there is no explicit contractual agreement in relation to the performance of the contract between B and C, it was unclear whether the compensation for the service provided by A was subject to the successful implementation of the contract concluded through intermediation of A.

As a final judgment, the Arbitral Tribunal has ordered by applying the PICC 4.1(2) B to pay the interest thereon as well as the compensation.

b) Evaluation

The point of this case is whether there exists common intention of the parties to the contract. In this case, B did not clearly specify the scope of the commercial service of A but originally claimed compensation for A on condition that the successful contract with C was fulfilled, but the labor of A's commercial service had already been provided. Considering the fact that in the course of the proceedings, B failed to substantiate the consensus that would clearly support B's claim, the judgment is considered justified.

Even if the claim of B is accepted, A's burden to bear being unable to satisfy the requirement of the goods requested by C as the reason of termination of the contract is unfair and even harsh as the standard of the reasonable person of the same kind as A. Therefore, the judgment of the arbitral tribunal is deemed reasonable.

¹⁰ The below can be referred to as similar precedents. Supreme Court of New South Wales Court of Appeal (Australia), *Franklins Pty Ltd. v Metcash Trading Ltd.*, 2009.12.16., Tribunal Supremo (Spain), *74/2012*, 2012.02.28., High Court of Justice, Queen's Bench Division, Commercial Court (U.K.), *Great Hill Equity Partners II LP v Novator One LP & Ors*, 2007.05.22., Court of Appeal (New Zealand), *2000, NZCA 350; Hideo Yoshimoto v Canterbury Golf International Limited*, 2000.11.27.

3.2. Interpretation of Statements and Other Conducts

3.2.1. Legal Base

Article 4.2 of the PICC provides that the intention of the parties is applied in advance if, in interpreting the statements and other conducts of a party, the other party knew or could not have been unaware of that intention, and in all other cases, the statements or other conducts of a party may be interpreted according to the understanding that a reasonable person of the same kind as the other would give to it in the same circumstances.

As this Article corresponds literally to Art. 8(1) and (2) of the CISG, the formation of a contract is done through this Article by statements and conducts. Through this process, whether or not a contract is ultimately concluded can be determined (Vogenauer, 2009).

There are however also unilateral acts performed after the conclusion of a contract which may give rise to problems of interpretation: for example, a notification of defects in goods, notice of avoidance or of termination of the contract, etc.

3.2.2. Judicial Precedents

a) Issues and Judgments

According to an ICC *International Court of Arbitration Arbitral Award* (2000),¹¹ A (Claimant, Germany), concluded a contract with B (Defendant, India), for the delivery and installation of industrial equipment. A delivered an equipment which according to B was defective. When B declared its intention to return the equipment, A filed a request for arbitration. In such process, B argued first of all that the contract was null and void due to A's fraudulent 'misrepresentation' during negotiations and secondly that A had delayed delivery and delivered a defective equipment.

The governing law provision of this contract stipulates that the Swiss law shall apply and that all disputes arising out of or relating to this contract shall be arbitrated. A asserted that according to the provision, the governing law for this contract was Swiss law. However, B argued that the contractual terms by the Swiss law is limited to the contract, and that the issue of misrepresentation by fraud arising from the negotiation process for the conclusion of the contract should be settled by the law of India as a law of an act according to good faith and fair dealing. However, the Arbitral Tribunal rejected B's assertion and accepted A's assertion to determine Swiss law as the only applicable law.

In interpreting the choice of law clause contained in the contract, the Tribunal expressly referred to Articles 4.1 and 4.2 of the PICC, and stated that in the absence of a common intention between the parties, contract terms should be interpreted according to the meaning that reasonable persons as the same kind as the parties would give to them in the same circumstances. In this case, the Tribunal determined that the intention of the reasonable person should be understood and decided, covering circumstances involving all kinds of disputes arising in connection with the contract without distinguishing between issues related to the contract after its conclusion and issues related to the formation process.

b) Evaluation

The key point of this case is the base and scope of a reasonable person. The Arbitral Tribunal determined that the standards and scope shall be understood and applied to cover

¹¹ As similar precedents, ICC International Court of Arbitration, 「10335」, 2000.10., ICC International Court of Arbitration, 「9875」, 2000.03., International Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation, 「152/1998」, 1999.04.16.

all disputes arising in connection with the contract and the entire process of the contract.

In the light of the practice, individual cases of disputes may be treated as a typical case of an order to be governed by such provisions, provided that there is an explicit governing rule like this case, apart from an illegal act of the public law in domestic law.

3.3. Consideration of Relevant Circumstances

3.3.1. *Legal Base*

Some of the provisions listed in Article 4.3 of the PICC relate to certain issues existing between the parties [(a) to (c)], and others may be regarded as having a normal character [(d) to (f)]. In this case, as the other circumstances, the provisions of (e) and (f) shall be subdivided as follows.

First of all, in the case of (e), the meaning commonly given to terms and expressions in the trade concerned is that only one party to the contracting party is applicable where it is typical in the industrial sector in question, or it could be related even though it is peculiar in the industrial sector in question to which neither parties belong. In the case of (f), the usages are subject to satisfaction of the limitation provision of usages and practices (Art. 1.9) which provides: the parties are bound by any usage to which they have agreed and by any practices which they have established between themselves. Further, the parties are bound by a usage that is widely known to and regularly observed in international trade by parties in the particular trade concerned.

3.3.2. *Judicial Precedents*

a) Issues and Judgments

According to an *International Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation Arbitral Award* (2008),¹² A (Claimant, Germany), entered into a contract with B (Respondent, Russia), for D. The dispute arose when A 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 B, 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 Russia, according to which a modification of a written contract must be made in writing. A argued that this formal requirement was met by the exchange between the parties of messages and documents, some of which in 'electronic message', while B objected that the alleged modifications by A should have been laid down in a single document signed by both parties.

The Arbitral Tribunal decided in favor of A. In so doing it first of all relied on a specific provision contained in the contract itself stating that any appendices, addenda and alterations to it were valid and constituted an integral part of it only if made in writing and signed by both parties, and that the said appendices, addenda and alterations communicated by means of electronic interchange were considered as originals.

Moreover, it referred to the usages established effectively in international trade in light of Arts. 2.1.1, 4.1, 4.2, 4.3 of the PICC. Further, the Tribunal made a final determination that a contract in this case may be concluded by the acceptance of an offer or by conduct of the parties that is sufficient to show agreement and the agreement shall be interpreted according to the common intention of the parties.

¹² As similar precedents, ICC International Court of Arbitration, Milano, 「8908」, 1998.09., ICC International Court of Arbitration, Zürich, 「9117」, 1998.03.

b) Evaluation

The issue of this case is about the validity of the electronic document. To determine the validity of the electronic document, the Arbitral Tribunal applied Article 4.3 of the PICC. The Arbitral Tribunal rejected B's argument by associating the usages of international trade and the agreement of the intention of both parties. In general, electronic documents are guaranteed the 'functional equivalent' of 'paper-based document' under the domestic and foreign Acts, and their validity has been recognized. In addition, in international trade, the juristic effect of electronic documents is recognized without exception.

Russia reserves Article 11 (form of contract) and Article 29 (change of contract and written requirement) of the CISG, so the addition of the contract terms in writing form and other changes must be in writing. In this case, the determination of the Tribunal deems reasonable, considering there is no specific limit to the occurrence of legal effects in the traditional writing of an electronic document, and there is no limitation or problem in the affirmation of the agreement of the parties in light of the contract terms.

This may, in practice, be considered as a decision which requires special attention in the form of contracts or in transactions with countries that have unusual restrictions on the written requirements and changes of contracts like Russia in international trade.

3.4. Reference to Contract or Statement as a Whole and Its Rule

3.4.1. Legal Base

Article 4.4 of the PICC declares that the terms or expressions used by one or both of the parties to the contract should not be considered separately and should be treated as a whole in the general context. Accordingly, the contract shall be construed in accordance with this Article in the context of the entire contract or statement appearing outwardly.

Regardless of the order in which the contract is made, there is no precedence, in principle, between contract terms or between Articles, since the importance of each is the same in interpretation. However, in the course of the implementation of a contract, a series of additional notices or declarations may relate to the interpretation of contract terms in question. In the event of a dispute, it is a common practice for a contract of a particular nature to take precedence over the general terms of a contract (Net, 2002). Therefore, it is important to consider that, in practice, explicitly specifying the priority of contract terms in advance according to the necessity in the field may be very important in view of the prerequisites for securing the legal understanding of the parties in the light of this Article.

Article 4.5 stipulates that a contracting party initially interprets the terms of an unclear contract in order to give effect to all the provisions of the contract, instead of excluding some of contract terms in clarifying the original contract terms. It should be noted, however, that this Article applies only to the case where the contract terms are unclear, despite the application of the basic rules under the interpretation of contract terms stipulated in Articles 4.1 to 4.3.

3.4.2. Judicial Precedents

a) Issues and Judgments

According to an *Indian High Court of Delhi Decision (2006)*,¹³ A (Plaintiff, India[Ⓐ]) and B (Defendant, India[Ⓑ]) entered into an agreement for the sale by B of an apartment. Under the

¹³ As a similar precedent, ICC International Court of Arbitration, 「15956」, 2010.06.

Agreement A had to pay 20% of the purchase price immediately and the balance after receiving from B the clearance of the Income Tax Department. If A failed to pay the balance within twenty days of receipt of the clearance, the money paid in advance would be forfeited.

The Agreement also provided that a series of other documents had to be produced by B, one of which was an irrevocable and registered general power of attorney, with respect to which it was expressly stated that failure to execute it within five months would lead to the cancellation of the Agreement and the refund to A of the advance payment.

After A had paid the required 20% in advance and B had delivered the clearance A asked for the execution not only of the power of attorney but also of a sale deed. When B failed to provide the sale deed within five months A claimed the refund of the payment made in advance. On its part B insisted on the payment of the balance claiming that otherwise it would forfeit the A's advance payment.

The Court decided in favor of A, in other words, it found that according to the Agreement only the failure to execute the power of attorney led to the cancellation of the Agreement and the refund of the advance payment, while the failure to execute the sale deed was insufficient to justify the same result. In reaching this conclusion, the Court cited Article 4.4 of the PICC that in order to ascertain the meaning of its individual articles the Agreement had to be read as a whole and Article 4.5 of the PICC that the individual clauses had to be interpreted so as to give effect to all of them rather than to deprive some of them of effect.

b) Evaluation

This case shall be interpreted in such a way that the terms and expressions under the contract shall be construed in light of the contract or the statement in its entirety and that the terms of the agreement shall be construed so as to give effect to all of them. This can be treated as a typical precedent which the Articles of the PICC apply.

3.5. Contra Proferentem Rule

3.5.1. Legal Base

One party shall bear the responsibility for the completion of the specific contract. This is because either party has written it or has incorporated it into the contract. Therefore, one party should take a considerable risk if the contract terms adopted and incorporated by the other party are not clear.

Article 4.6 of the PICC stipulates that if a contract term provided by either party is unclear, it must be construed as disadvantageous to the party providing it. The level to which this Article applies shall depend on the nature of the contract in question.

International commercial contracts are often written in more than one language that can be interpreted differently with respect to particular contractual arrangements. In this case, it is common for the contracting parties to indicate which language is preferred. Nevertheless, if all the languages have the same effect, the problem is how to deal with inconsistent parts of the contract. Article 4.7 does not provide a clear legal basis for this issue, but if the contract terms are merely originals which are equally authoritative, or if more than one copy of the written language are written, it stated that there is a preference for the interpretation according to a version in which the contract was originally drawn up.

As a matter of Comment to this article, a situation where a different solution may be preferable could arise where the parties have contracted on the basis of internationally and widely known instruments such as 'INCOTERMS' or the 'UCP 600' ('Uniform Customs and Practices on Documentary Credits'). In such a case, if the discrepancy between the different language versions available to the parties to the contract is found, the language version in

question which is much more obvious than the rest may prevail.

3.5.2. *Judicial Precedents*

a) *Issues and Judgments*

According to an *International Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation Arbitral Award* (2002b), A (Claimant, Russia) and B (Respondent, Canada) concluded a sales contract drafted in both Russian and English, providing that both language versions were equally authoritative for the interpretation of its provisions. However, the Russian and English texts of the arbitration clause which constituted an integral part of the contract were contradictory in their wording. In the English version, the official title of the arbitration court which was to deal with any disputes arising from the contract was not given in full. In particular, it did not include any reference to the organization to which the arbitration court was attached. When A brought an action before the arbitration court claiming breach of contract by B in accordance with A's understanding of the text of the arbitration clause, B contested the court's jurisdiction, referring to its own interpretation of which court had jurisdiction.

The Tribunal, in accordance with the parties' agreement, applied the law of Russia, in particular Article 431 of the Civil Law¹⁴ which provides the rules for the interpretation of contracts and states that in determining the common intention of the parties, the Tribunal must take into account the literal meaning of the words and expressions used in the text; if, in this way, it were to prove impossible to determine the parties' intention, the Tribunal must apply, in particular, trade usages. The Tribunal referred to this provision in its reasons for applying the PICC. It held that it would be justifiable to take advantage of the rules expressed in the PICC, which are becoming widely used in international practice for the interpretation of commercial contracts.

As to the problem of linguistic discrepancies in the present contract, the Tribunal found that the text had originally been drafted in Russian and afterwards translated into English. It referred to Article 4.7 of the PICC which stipulates that where a contract is drawn up in two or more languages which are equally authoritative there is, in case of discrepancy between the versions, a preference for the interpretation according to a version in which the contract was originally drawn up. The Tribunal ruled in favor of the interpretation that followed from the Russian language version of the contract.

b) *Evaluation*

Where the parties to a contract have written contracts in different language versions, how to deal with them in the event of an interpretation dispute in accordance with the contract terms is a key element. By citing the provisions of the PICC that the interpretation under the first written contract shall prevail in the event that there is a plurality of contracts in which the contracts are written in different languages in one contract and have equivalent originals,

¹⁴ Civil Law, Art. 431 : "The Interpretation of the Contract While interpreting the terms of the contract, the court shall take into account the literal meaning of the words and expressions, contained in it. The literal meaning of the terms of the contract in case of its being vague shall be identified by way of comparison with the other terms and with the meaning of the contract as a whole. If the rules, contained in the first part of the present Article, do not make it possible to identify the terms of the contract, the actual common will of the parties shall be found out with account for the purpose of the contract. All the corresponding circumstances, including the negotiations and the correspondence, preceding the conclusion of the contract, the habitual practices in the relationships between the parties, the customs of the business turnover and the subsequent behaviour of the parties shall be taken into account."

the judgment of the Tribunal is considered to be a very appropriate judgment in the light of the provisions.

3.6. Supplying an Omitted Term

3.6.1. *Legal Base*

Articles 4.1 to 4.7 of the PICC deal with the interpretation of contracts. In other words, a key point is on the meaning of unclear contract terms or conditions, such as the determination of the parties' real intentions.

On the other hand, Article 4.8 deals with other unusual issue, namely 'supplying an omitted term' of contracts. This means that if either party raises an issue that is not stipulated in its contract at all after the conclusion of the contract, the difference between the two parties may occur when the contract terms or provisions are missing because they either want the problem not to be dealt with or did not simply foresee it.

In most cases where contractual omissions or differences arise, several articles are provided to solve the issues. For example, 'determination of quality of performance' (Art. 5.1.6), 'price determination' (Art. 5.1.7), 'time of performance' (Art. 6.1.1), 'order of performance' (Art. 6.1.4), 'place of performance' (Art. 6.1.6), 'currency not expressed' in relation to the payment for the goods in question (Art. 6.1.10) are used to solve contractual omissions or differences.¹⁵ The contents of the Articles are listed below in order.

First, where the quality of the performance is neither fixed by, nor determinable, from the contract, a party is bound to render a performance of a quality that is reasonable and not less than the average in the circumstances.

Second, where a contract does not fix or make provision for determining the price, the parties are considered, in the absence of any indication to the contrary, to have made reference to the price generally charged at the time of the conclusion of the contract for such performance in comparable circumstances in the trade concerned or, if no such price is available, to a reasonable price. On the other hand, where the price is to be determined by one party and that determination is manifestly unreasonable, a reasonable price shall be substituted notwithstanding any contract term to the contrary. Further, where the price is to be fixed by one party or a third person, and that party or third person does not do so, the price shall be a reasonable price. In any other case, where the price is to be fixed by reference to factors which do not exist or have ceased to exist or to be accessible, the nearest 'equivalent factor' shall be treated as a substitute.

Third, a party must perform its obligations at the time stated below: if a time is fixed by or determinable from the contract, at that time; if a period of time is fixed by or determinable from the contract, at any time within that period unless circumstances indicate that the other party is to choose a time; in any other case, within a reasonable time after the conclusion of the contract.

Fourth, regarding the order of performance, to the extent that the performances of the parties can be rendered simultaneously, the parties are bound to render them simultaneously unless the circumstances indicate otherwise, and to the extent that the performance of only one party requires a period of time, that party is bound to render its performance first, unless the circumstances indicate otherwise.

Fifth, if the place of performance is neither fixed by, nor determinable from, the contract,

¹⁵ In these cases, implied obligations of the contracting parties on the issues above stem from 'the nature and purpose of the contract', 'practices established between the parties and usages', 'good faith and fair dealing', and 'reasonableness' (PICC, Art. 5.1.2).

a party is to perform: a monetary obligation at the obligee's place of business; any other obligation, at its own place of business. Also, a party must bear any increase in the expenses incidental to performance which is caused by a change in its place of business subsequent to the conclusion of the contract.

Sixth, where a monetary obligation is not expressed in a particular currency, payment must be made in the currency of the place where payment is to be made.

However, if the Articles above cannot provide appropriate solutions, Article 4.8 will apply. The standard which this Article provides is that the circumstances of the matter at issue shall be considered appropriately. In order to determine whether the circumstances are appropriate, the parties should consider, *inter alia*, the provision specified in the contract, preliminary negotiations between the parties, or a series of conducts of the parties subsequent to the conclusion of the contract as the intention of the parties. If the intention of the parties cannot be uncovered, the rules to be applied should be determined according to the nature and purpose of the contract; good faith and fair dealing; and reasonableness.

3.6.2. Judicial Precedents

a) Issues and Judgments

According to an ICC *International Court of Arbitration Arbitral Award* (2001), A (Claimant, Swiss), had been granted by B (Defendant, Poland) certain exclusive rights which A later transferred to one of its subsidiaries. When A initiated arbitration proceedings on the grounds of an alleged violation of these rights by B, the question arose as to whether A, when transferring these exclusive rights to its subsidiary, had transferred them alone or had transferred the whole contract it had concluded with B including the duties.

The Arbitral Tribunal held that, since the applicable Polish law did not provide any specific solution to this issue, it could subsidiarily apply international law instruments such as the PICC. However, in this case, the Tribunal found that the question as to whether A is entitled to transfer to its subsidiary the detailed parts of the contract obligation while withholding the main parts with B was not specifically addressed by the PICC.

Thus, the Arbitral Tribunal concluded that the solution could only be found by the provisions of the PICC which interpret contract terms. In this respect the Arbitral Tribunal referred to the provisions of interpretation laid down in Article 65¹⁶ of the Polish Civil Law as well as Articles 1.1, 4.1(1) and 4.8(2) of the PICC. Under such provisions, a contract is to be interpreted and supplemented having regard to the common intention of the parties, the nature and purpose of the contract, good faith and fair dealing, and reasonableness. Accordingly, the Tribunal determined that the status of A and its subsidiary is same and rejected B's assertion.

b) Evaluation

As noted above, in connection with supplying an omitted term, the PICC provides that: where the contracting parties have not agreed with respect to a term of the contracts which is important for a determination of their rights and duties, a term which is appropriate in the circumstances shall be supplied; and in determining what is an appropriate term, regard shall be had, among other factors, to the intention of the parties, the nature and purpose of the contract, good faith and fair dealing, and reasonableness.

¹⁶ Civil Law, Art. 65: "1. A declaration of will shall be interpreted as may be required by the principles of social co-operation or by established customs, having regard to the circumstances in which it has been made. 2. In contracts it is necessary to determine the common intention of the parties and the purpose of the contract instead of relying on its literal text."

The Arbitral Tribunal ruled this case considering those factors, but it seems that there is a defect in judgment in that it did not refer to the *contra preferentem* rule which means that if contract terms supplied by one party are unclear, an interpretation against that party is preferred. However, the judgment can be regarded as reasonable since the same result can be deduced in any case.

4. Concluding Remarks

This paper, by linking the legal standards for the interpretation of contract terms with related judicial precedents focusing on the PICC, which is recognized as a general principle in international commercial contracts, is to draw their implications. The provisions regarding the interpretation of contract under the PICC are composed of eight Articles which are summarized as below:

First, under the intention of the parties, a contract shall be interpreted according to the common intention of the parties. However, if such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances.

Second, the statements or other conducts of the parties shall be interpreted according to that party's intention if the other party knew or could not have been unaware of that intention and if not so, such statements and other conducts shall be interpreted according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances.

Third, in applying the above criteria, regard shall be had to all the circumstances, including preliminary negotiations between the parties; practices which the parties have established between themselves; the conduct of the parties subsequent to the conclusion of the contract; the nature and purpose of the contract; the meaning commonly given to terms and expressions in the trade concerned; and usages.

Fourth, terms and expressions shall be interpreted in the light of the whole contract or statement in which they appear. Also, in this case, as the principle of interpretation, contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect.

Fifth, if the contract terms provided by one party are unclear, an interpretation against that party is preferred. Where a contract is drawn up in two or more language versions which are equally authoritative there is, in case of discrepancy between the versions, a preference for the interpretation according to a version in which the contract was originally drawn up.

Sixth, in supplying an omitted term, where the parties have not agreed with respect to a term which is important for a determination of their rights and duties, a term which is appropriate in the circumstances shall be supplied. In this case, in determining what is an appropriate term regard shall be had, among other factors, to the intention of the parties, the nature and purpose of the contract, good faith and fair dealing, and reasonableness.

As the PICC is considered as an important and authoritative standard of international commercial contracts, the contracting parties shall improve the ability to understand the relevant provisions of the PICC, as well as shall put special consideration on the development of case law.

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