

**THE UNIVERSITY OF THE WESTERN CAPE**

**FACULTY OF LAW**

**Lex Mercatoria:  
Scope and Application of the  
Law Merchant in Arbitration**



**A thesis submitted in fulfilment of the requirements for the LL.M. Degree,  
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**ABSTRACT:****Lex Mercatoria: Scope and Application of the Law Merchant in Arbitration****(Frank Baddack)**

LL.M. (International Trade Law), Thesis, Faculty of Law, University of the Western Cape

Arbitration is the preferred method of dispute resolution in international trade. Naturally, a set of rules is necessary to govern the conflict's resolution. For cultural, political, economical or other reasons the parties' national laws may not serve the individual interests and needs of that particular contract well. If one wants to avoid the application of both parties' national laws, one can choose that the contract be governed by an a-national legal standard, e.g. general principles of International Trade Law or the general usages of a particular trade<sup>1</sup>. These internationally accepted principles of law governing contractual relations are called *lex mercatoria* (law merchant).

*Lex mercatoria* already existed in the Middle Ages and can even be dated back to antiquity. Later it disappeared through the nationalization of International Trade Law and was rediscovered in the 1950s, when international traders were again creating their own law and disputes were increasingly resolved outside of the national jurisdictions and applying a-national law. *Lex mercatoria* is being applied more and more by arbitrators and is therefore becoming increasingly important for dispute resolution in International Trade.

Numerous different concepts and theories of *lex mercatoria* have been developed. Its being an autonomous legal system is questioned by some authors<sup>2</sup> and the doctrine in favour of it called unfounded<sup>3</sup>. The critics also argue that the authority to apply *lex mercatoria* may be a recipe for amateurism and the substitution of the arbitrator's private preferences for the parties' intentions, for it

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<sup>1</sup> Lew, "Applicable Law in International Commercial Arbitration", New York (1978), 116.

<sup>2</sup> Delaume, "The myth of the Lex Mercatoria", Tulane Law Review (1989), 575.

<sup>3</sup> Mann, "England rejects delocalised contracts and arbitration", 33 ICLQ (1984), 193.

is easy to proclaim common principles on the basis of limited knowledge<sup>4</sup>. The *lex mercatoria* is said only to exist because scholars talk about it<sup>5</sup>. However, these and other allegations can be refuted by critically analyzing the arguments that are supposed to underline those assumptions.

Applying *lex mercatoria* to solve international trade disputes has many advantages. By choosing *lex mercatoria* the parties avoid rules which are unfit for international contracts, e.g. peculiar formalities, brief cut-off periods and special difficulties created by domestic laws. In addition to that, neither of the parties has the advantage of having the dispute governed by his own law<sup>6</sup>. Since one of the central rules is the principle of good faith and fair dealing, *lex mercatoria* neither leads to arbitrary results nor does it favour the rich.

Is it possible for the arbitrators to apply *lex mercatoria* if no law has been chosen by the parties? The failure of the parties to indicate a choice could well mean that they did not wish to have their contract governed by any of their national laws. In some awards arbitrators applied *lex mercatoria* as they considered the community of international merchants to be autonomous and to exist beyond national legislation<sup>7</sup>. However, it cannot be deduced from the absence of such a choice that the parties have impliedly chosen *lex mercatoria* to be the law governing the conflict. *Lex mercatoria* is applicable only as a subsidiary law in cases where no national law has been chosen and seems apt.

24 September 2005

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<sup>4</sup> Craig, Park, Paulsson, "ICC Arbitration", New York (2000), 632.

<sup>5</sup> Highet, "The enigma of the Lex Mercatoria", Tulane Law Review (1989), 616.

<sup>6</sup> Lando, "The lex mercatoria in International Commercial Arbitration", 34 ICLQ (1985), 747.

<sup>7</sup> ICC Award No. 2375/1975, Journal du Droit International (1976), 974; ICC Award No. 3131/1979, YCA vol. IX (1984), 110.

**DECLARATION:**

I declare that *Lex Mercatoria: Scope and Application of the Law Merchant in Arbitration* is my own work, that it has not been submitted for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged by complete references.

Frank Baddack

24 September 2005



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## Chapter 1

### Introduction

Arbitration is defined as the “referral of a dispute by the voluntary agreement of the parties to one or more impartial arbitrators for a final and binding decision”<sup>8</sup>. The arbitrator is a private person and arbitration is the preferred method of resolving disputes in International Trade Law. Actually, most international trade contracts contain a clause choosing arbitration as the mode of dispute resolution. When referring to international commercial arbitration one cannot use the term alternative dispute resolution<sup>9</sup>. This would imply that a majority of international trade disputes are resolved by other methods, when, in fact, some 90 % of international trade contracts contain an arbitral clause<sup>10</sup>.

Naturally, a set of rules is necessary to solve a conflict. According to the traditional point of view a conflict in international trade should always be resolved by applying a national law<sup>11</sup>. The judge or arbitrator who is being called upon to decide the dispute has to apply the national law that is prescribed by the conflict of law rules of his seat. According to this approach, these rules should always designate a national law. After World War II and with the enormous growth in international trade that followed it, scholars began to contest that traditional point of view and proposed that a-national legal standards could be used for dispute resolution in international trade<sup>12</sup>. For cultural, political, economical or other reasons the parties’ national laws may not serve the individual interests and needs of that particular contract well. Should the parties wish to avoid the application of their national laws, they can opt for the contract being governed by an a-national legal standard, e.g. by the general principles of International Trade Law or the

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<sup>8</sup> Seide, “Dictionary of Arbitration and its terms”, New York (1970), 27.

<sup>9</sup> Booysen, “Principles of International Trade Law as a monistic system”, Pretoria (2003), 751.

<sup>10</sup> Berger, Formalisierte oder “schleichende” Kodifizierung des transnationalen Wirtschaftsrechts; Berlin, New York: de Gruyter (1996), 62.

<sup>11</sup> Mann, “Schiedsrichter und Recht”, in: Festschrift Flume (1978), 594; Smit, “A-national Arbitration”, 63 Tul. L. R. (1989), 631.

<sup>12</sup> Goldman, “Frontières du Droit et Lex Mercatoria”, Le droit subjectif en question., Archives de Philosophie du Droit (1964), 181; Schmitthoff, Helsinki Lectures (1957), cited in: Osman, Les Principes Généraux de la *Lex Mercatoria*, Paris (1992), p. 13, footnote 27.

general usages of a particular trade<sup>13</sup>. These internationally accepted principles of law governing contractual relations are called *lex mercatoria* (law merchant). With the growing acceptance of *lex mercatoria*, national laws and jurisdictions are becoming less important in International Trade Law: *In short, it is evident that those involved in international trade tend to adopt norms developed without the participation of national organizations and tend for the most part to prefer not to bring their disputes to national courts, relying exceptionally upon governmental assistance in the enforcement of arbitral tribunal decisions.*<sup>14</sup>

It is important to underline the detail that *lex mercatoria* exists almost exclusively in the area of arbitration, because national courts are often bound to apply their proper national laws and hence there is hardly any scope for a transnational set of rules in national courts. However, as the *lex mercatoria* reflects customs and usages of the merchant community, judges often take its rules into consideration when interpreting an international business contract or a clause<sup>15</sup>.

There is extensive literature on the subject and the character, scope and sources are very controversial. Nevertheless, the importance and the appeal of *lex mercatoria* as the law governing an arbitration are increasing<sup>16</sup>.

By choosing *lex mercatoria* the parties avoid rules which are unsuited for international contracts, e.g. peculiar formalities, brief cut-off periods and particular difficulties created by domestic laws. In addition to that, neither of the parties has the advantage of having the dispute governed by its own law<sup>17</sup>.

It must be determined whether or not the parties have the option of choosing *lex mercatoria* as the law governing the contract. Some authors question whether it is an autonomous legal system<sup>18</sup> and deem the doctrine in favour of it unfounded<sup>19</sup>. The *lex mercatoria* is said to exist only because scholars talk about

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<sup>13</sup> Lew, "Applicable Law in International Commercial Arbitration", New York (1978), 116.

<sup>14</sup> Blaurock, "The Law of Transnational Commerce", in: Ferrari (ed.), *The Unification of International Commercial Law*, (1998), 17.

<sup>15</sup> Lew, "Applicable Law in International Commercial Arbitration", New York (1978), 465.

<sup>16</sup> Rivkin, "Enforceability of Arbitral Awards Based on *Lex Mercatoria*", 9 *Arb. Int'l.* (1993), 67.

<sup>17</sup> Lando, "The *lex mercatoria* in International Commercial Arbitration", 34 *ICLQ* (1985), 747.

<sup>18</sup> Delaume, "The myth of the *Lex Mercatoria*", *Tul. L. R.* (1989), 575.

<sup>19</sup> Mann, "England rejects delocalised contracts and arbitration", 33 *ICLQ* (1984), 193.

it<sup>20</sup>. Due to this controversy, courts may feel uncertain in enforcing an award based on a law that is not generally recognized<sup>21</sup>. Critics argue that the authority to apply *lex mercatoria* may be a recipe for amateurism and the substitution of the arbitrator's private preferences for the parties' intentions, for it is easy to proclaim common principles on the basis of limited knowledge<sup>22</sup>.

What is the relationship (if any) with the national laws? National attitudes are divided on whether or not to allow the application of *lex mercatoria*. Indeed, French law explicitly permits the subjection of an international dispute to norms other than those provided by a single national legal system<sup>23</sup>. When no choice has been made, the arbitrator must apply the rules that he considers appropriate to govern the contract and to resolve the dispute, including usages of international trade. On the other hand, some authors do not accept awards based on *lex mercatoria* and courts do not consider it a genuine system of law<sup>24</sup>.

Is it possible for the arbitrators to apply *lex mercatoria* if no law has been chosen by the parties? The failure of the parties to indicate a choice could well mean that they did not wish to have their contract governed by any of their national laws. As one arbitrator put it: "The contract was to be performed in three different countries ... it was clear that the parties intended to refer to the general principles and practices of international trade."<sup>25</sup> Others call a state-free contract a logical impossibility: "If a contract is stateless it is not a contract and cannot be enforced."<sup>26</sup>

The thesis will outline the emergence and acceptance of *lex mercatoria* as a viable and effective system of law and attempt to answer the aforementioned questions. It is intended to demonstrate that this system constitutes a

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<sup>20</sup> Hight, "The enigma of the Lex Mercatoria", Tul. L. R. (1989), 616.

<sup>21</sup> Booysen, "Principles of International Trade Law as a monistic system", Pretoria (2003), 755.

<sup>22</sup> Craig, Park, Paulsson, "ICC Arbitration", New York (2000), 632.

<sup>23</sup> Article 1496 (1) of the French Code of Civil Procedure: "*L'arbitre tranche le litige conformément aux règles de droit que les parties ont choisies; à défaut d'un tel choix, conformément à celles qu'il estime appropriées.*" (The arbitrator shall settle the dispute in accordance with the rules of law which the parties have chosen, and in the absence of such a choice, in accordance with those rules of law which he considers appropriate.)

<sup>24</sup> Mustill and Boyd, "The Law and Practice of Commercial Arbitration in England", (1982), 612.

<sup>25</sup> ICC Award No. 1859/1973, *Revue Arbitrale* (1972), 133.

<sup>26</sup> Hight, "The enigma of the Lex Mercatoria", Tul. L. R. (1989), 615.

comprehensive set of rules sufficient for resolving disputes arising out of international trade relations. This a-national order is being applied more and more by arbitrators and is therefore becoming increasingly important for dispute resolution in International Trade.



## Chapter 2

### Historical Background

The *lex mercatoria* is not a 20<sup>th</sup> century invention or phenomenon. It was developed with the earliest beginnings of international trade to meet the needs of the international merchant community. The *lex mercatoria* never ceased to exist, but was adapted to the special needs of each forum<sup>27</sup>.

#### A. *The ancient lex mercatoria*

The frequently used term new law merchant implies that there is an “old” law merchant. The emergence of this *lex mercatoria* can be dated back to antiquity. With the emergence of the earliest forms of international trade there was an instant need to find a set of rules to govern these trade activities. The local laws were not harmonized and unsuitable to reign over these complex international trade activities. Therefore, the merchant community developed its own set of rules according to its needs and customs. As Trakman put it: “Custom, not law, has been the fulcrum of commerce since the origins of exchange.”<sup>28</sup> As early as 300 BC the merchants in the Mediterranean used a comprehensive body of maritime law that consisted of merchant customs. This *Lex Rhodia*, the Sea Law of Rhodes, was used by Greeks and Romans<sup>29</sup>.

The Roman *ius gentium* is cited as a precedent in many texts about *lex mercatoria*<sup>30</sup>. The Roman *ius civile* was applied only to cases involving Roman citizens, regardless of the location of the contract. A Roman trading with a foreigner was not protected by the law. These relations were therefore marked by

<sup>27</sup> Trakman, “The evolution of The Law Merchant: Our Commercial Heritage“ (Part II), 12 J. Marit. L. & Com. (1981), 153.

<sup>28</sup> Trakman, “The evolution of The Law Merchant: Our Commercial Heritage“ (Part I), 12 J. Marit. L. & Com. (1980), 4.

<sup>29</sup> Berman/Kaufman, “The Law of International Transactions (Lex Mercatoria)”, 19 Harv. Int’l. L. J. (1978), 224; Trakman, “The evolution of The Law Merchant: Our Commercial Heritage“ (Part I), 12 J. Marit. L. & Com. (1980), 4.

<sup>30</sup> Berman/Kaufman, “The Law of International Transactions (Lex Mercatoria)”, 19 Harv. Int’l. L. J. (1978), 224; Goldman, “La lex mercatoria dans les contrats d’arbitrage internationaux: réalités et perspectives”, Journal du Droit International (1979), 475; Meyer, “Bona fides und lex mercatoria in der europäischen Rechtstradition”, Göttingen (1993), 51.

mutual trust and good faith<sup>31</sup>. With a growing commerce and the rise of Rome to a leading power and trading nation, the limitation of *ius civile* to Roman citizens no longer met the needs of the merchant community. *Ius gentium* was developed to remedy this detriment. This law was originally only applied to settle disputes between two non-citizens or between a Roman citizen and a foreigner. As noted above, *ius civile* was applied among Romans. The Romans assumed that it would not be fair to apply their own law to cases involving a foreigner. From the middle of the third century BC on there were special courts under the authority of the *praetor inter peregrinus* or *praetor peregrinus*<sup>32</sup>. For such cases he produced a *ius gentium* case law by rendering his sentences. Some authors support the view that there is an analogy with today's arbitral tribunals as they also begin to create a case law and base their decisions on other arbitral awards<sup>33</sup>.

Thus, Romans made a distinction between their civil law, *ius civile*, and *ius gentium*. The components of this *ius gentium* were the principles of law common to all states and general principles of natural justice<sup>34</sup>. In addition to that, customs and usages of international trade were taken into consideration<sup>35</sup>. The rules of *ius gentium* were less rigid than those of *ius civile* and thus better suited to govern international trade relations. Strict procedural rules, in particular, were opted out and the good faith and fair dealing principle played a central role again.

To the Romans, *ius gentium* was not created but discovered, much like the general principles of law that are part of the *lex mercatoria*<sup>36</sup>. Nevertheless, *ius civile* gradually became more important and *ius gentium* started to lose its influence. This development is due to two factors. First, *ius civile* became less formal and strict and some of its institutes were applied to foreigners as well. Second, Roman citizenship was granted to all the inhabitants of the Roman Empire in 212 AD with the *Constitutio Antoniana*. Thus, the importance of the

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<sup>31</sup> Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 9.

<sup>32</sup> Kunkel, *Römische Rechtsgeschichte*, 11<sup>th</sup> ed., Köln (1985), 73, 74.

<sup>33</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 14.

<sup>34</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 13; Ewart, "What is the Law Merchant?", 3 *Col. L. R.* (1903), 145, 146.

<sup>35</sup> Goldman, "La *lex mercatoria* dans les contrats et l'arbitrage internationaux: réalité et perspectives", *Journal du Droit International* (1979), 475.

<sup>36</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zürich (1989), 33.

*praetor peregrinus* and the *ius gentium* waned simply because there were fewer trading activities with foreigners<sup>37</sup>.

Therefore, one can find a predecessor of the *lex mercatoria* in the Roman law.

### **B. The medieval *lex mercatoria***

Beginning in the 11<sup>th</sup> century, there was a revitalization of trade in Europe. This was due to many factors, including the crusades, the conquest of Sicily, Sardinia and Corsica, as well as the foundation of cities as trading bases by the merchants and the development of the Hanseatic League<sup>38</sup>. The ancient Greek and Roman trade laws had become antiquated by then<sup>39</sup>. Medieval society was very isolated and the laws and customs differed from town to town. Some rules of Canon law, such as the interdiction to charging interest were even hostile to the development of trade. The local laws were designed for local needs, meaning very simple trading activities<sup>40</sup>. Roman law thus changed into *ius vulgare*, because a practical need for that highly developed law had ceased to exist. *Ius civile* and *ius gentium* merged into this unsophisticated law and the distinction between the two came to an end.

Merchants, however, were mobile and began to trade across boundaries. In doing so, the travelling merchants also transported their trade customs and laws. Thus, the laws of important cities or trade centres were applied more often and accepted to a higher degree – they became dominant<sup>41</sup>. Thus the Rolls of Oléron, a collection of maritime judgements of the court of Oléron, from around 1150, became widely accepted by the maritime traders and adopted by a large number of

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<sup>37</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 13.

<sup>38</sup> Kappus, *Lex mercatoria in Europa und Wiener UN-Kaufrechtskonvention 1980*, Frankfurt am Main (1990), 31, 32; Lorenz, “Die Lex Mercatoria: Eine internationale Rechtsquelle?”, in: *Festschrift Neumayer*, Baden-Baden, Nomos (1985), 407.

<sup>39</sup> Berman/Kaufman, “The Law of International Transactions (Lex Mercatoria)”, 19 *Harv. Int’l. L. J.* (1978), 224.

<sup>40</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zürich (1989), 33.

<sup>41</sup> Trakman, “The evolution of The Law Merchant: Our Commercial Heritage“ (Part I), 12 *J. Marit. L. & Com.* (1980), 4.

seaport towns on the North Sea and the Atlantic Ocean<sup>42</sup>. Likewise, the Laws of Wisby, from around 1350, which were possibly derived from the Oleron compilation, became widely accepted in the Baltic Sea, as did the law of Westcapelle in the Netherlands. Another example of an internationally accepted code of customs is the *Consulato del Mare* (approximately 1340), which is presumed to be based on the maritime customs of Barcelona. It is a very detailed compilation covering most of the situations and reflecting the general principles and trade usages of maritime transport at the time and was accepted throughout the Mediterranean Sea<sup>43</sup>.

The term *lex mercatoria* was first used in the *Fleta*, or “*Fleta, seu Commentarius juris anglicani*”, an English law manual or collection of customs that was written in Latin during the reign of King Edward I around 1290<sup>44</sup>. This law merchant was almost as universal in medieval times as canon law, the law of the Catholic Church<sup>45</sup>. The rules were spread all over the civilised world by the travelling merchants. There are numerous reasons for this universality of the medieval law merchant<sup>46</sup>. First of all, a uniform trade law was spread through the great trade fairs that were visited by merchants from many countries. Customs and usages concerning international maritime transport were harmonized and a special jurisdiction existed.

In the introduction to his book, Gerard Malynes, an English businessman, points out: *I have intituled the Booke, according to the ancient name of the Lex Mercatoria, and not Ius Mercatorum; because it is a Customary Law approved by the autoritie of all Kingdomes and Common Weales and not a law established by the Souveraigntie of any Prince, either in the first foundation or by continuence*

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<sup>42</sup> Berman/Kaufman, “The Law of International Commercial Transactions (Lex Mercatoria)”, 19 Harv. Int’l. L. J. (1978), 224.

<sup>43</sup> Goode, “Usage and its Reception in Transnational Commercial Law”, in: Ziegel (ed.), “New Developments in International Commercial and Consumer Law”, Oxford (1998), 18; Trakman, “The evolution of The Law Merchant: Our Commercial Heritage” (Part I), 12 J. Marit. L. & Com. (1980), 4. Translation by Jados, University of Alabama Press (1975).

<sup>44</sup> Kappus, “Lex mercatoria in Europa und Wiener UN-Kaufrechtskonvention 1980“, Frankfurt am Main (1990), 34.

<sup>45</sup> Seide, A Dictionary of Arbitration and its terms, Oceana Publications, New York (1970), 139, 140.

<sup>46</sup> Schmitthoff, “Das neue Recht des Welthandels”, 28 Rabels Zeitschrift für ausländisches und internationales Privatrecht (1964), 49.

*of time. ... because the same doth properly consist of the Costome of Merchants in the course of Trafficke, and is approved by all Nations, according to the definition of Cicero, Vera Lex est recta Ratio, Natura concruens, diffusa in Omnes, Constans, Sempiterna*<sup>47</sup>.

The sovereigns did not intervene in the merchants' self-regulation of their own affairs. They had an interest in the growth of trade for it meant tax revenues, employment and access to foreign goods<sup>48</sup>. To encourage trading activities, merchants were free to set their own rules and no regulations or laws were imposed by the sovereigns. Therefore, the rules designed by the merchants responded directly to their needs and desires.

The many different regional and civic laws made it necessary for the functioning of international trade to find one universally accepted body of rules, based on mercantile needs. This system was derived from the usages and customs governing the business transactions of the travelling merchants and applied as part of the common law by their special courts<sup>49</sup>. These courts proceeded according to practices that were quite different from the common law courts, and much more expeditious. They consisted of chosen arbitrators who were familiar with the customs of the international trade and thus more apt at resolving disputes among the merchants. Thus, as early as in the 12<sup>th</sup> century, there existed Piepowder-Courts at every English marketplace<sup>50</sup>. The name is most likely derived from the French term *pieds poudreux*, an allusion to the promptness with which judgements were rendered. These courts settled all commercial disputes and mainly applied *lex mercatoria* or *lex pede pulveroso*, consisting of trade usages<sup>51</sup>. Other famous examples are the English Staple Courts (1354) and the German *Bozner Merkantilgerichtsrat* (1635). The laws and rules applied and developed by these

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<sup>47</sup> Malynes, "Consueduto vel lex mercatoria, or The ancient law merchant", (1622), reprint: Goldbach: Keip, (1997).

<sup>48</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", Boston Univ. Int'l. L. J. (1984), 318; Trakman, "The evolution of The Law Merchant: Our Commercial Heritage" (Part I), 12 J. Marit. L. & Com. (1980), 6.

<sup>49</sup> Kappus, "*Conflict avoidance durch lex mercatoria und UN-Kaufrecht 1980*", Recht der internationalen Wirtschaft (1990), 789.

<sup>50</sup> Gross, "The Court of Piepowder", 20 Quarterly Journal of Economics (1906), 231, 234.

<sup>51</sup> Bart, "La Lex Mercatoria au Moyen Age: Mythe ou Réalité?", in: Souveraineté étatique et marchés internationaux à la fin du 20<sup>ème</sup> siècle. Mélanges en l'honneur de Philippe Kahn, Litec (2000), 20.

courts constitute the medieval *lex mercatoria*. For example, the Statute of the Staple (1353) stated that "... all merchants coming to the staple ... shall be ruled by the law-merchant, as to all things touching the Staple, and not by the common law of the land, nor by usage of cities, boroughs, or other towns",<sup>52</sup>.

There are many similarities between the medieval merchant court and today's arbitral tribunals. First of all, the merchant courts were also partly composed of traders and not jurists. Secondly, the medieval courts also applied a transnational law adapted to the needs of international business, and commercial usage. The law that was applied was therefore different from the law applied by the courts of common law. Arbitral tribunals, unlike national judges, are not always bound to apply any national law, have no *lex fori* and dispose of a greater freedom than national courts<sup>53</sup>. Finally, the medieval law merchant was, like today's arbitral awards, largely self-enforcing. Merchants hardly ever refused to comply with the court's rulings as they could thereby risk their reputations and could be excluded from participation in the trade fairs. Just like today's national courts, the medieval sovereign was seldom called upon to enforce a merchant court's decision<sup>54</sup>.



To summarise, the medieval *lex mercatoria* ... governed a special class of people (merchants) in special places (fairs, markets and seaports). It was distinct from local, feudal, royal, and ecclesiastical law. Its special characteristics were that 1) it was transnational; 2) its principal source was mercantile customs; 3) it was administered not by professional judges but by merchants themselves; 4) its procedure was speedy and informal; and 5) it stressed equity, in the medieval sense of fairness, as an overriding principle.<sup>55</sup>

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<sup>52</sup> 27 Edw. III c. 2 (1353), cited in: Jones, "An Inquiry into the History of the Adjudication of Mercantile Disputes in Great Britain and the United States", 25 Univ. Chic. L. R. (1957/58), 449.

<sup>53</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 8.

<sup>54</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 Boston Univ. Int'l. L. J. (1984), 319.

<sup>55</sup> Berman/Kaufman, "The Law of International Commercial Transactions (Lex Mercatoria)", 19 Harv. Int'l. L. J. (1978), 225.

### *C. The post-medieval lex mercatoria*

Beginning in the sixteenth and seventeenth century, this medieval law merchant was transformed to merge with local influences, to reflect the policies, the political and economic interests and the procedural rules of each forum. Trade had become a very important factor for the prosperity of whole countries or regions. With the appearance of mercantilism and absolutism, the merchant community was no longer allowed to create its own rules. Power was centralized in the hands of monarchs and the merchant tribunals were forced to ... *bow down to the dictates of centralized systems of law, to dominant kings and to indigenous systems of law. As a result of the uniformity, the consistency and the unimpeded continuity of the Law Merchant as a single system of law came into some question in post-medieval Europe*<sup>56</sup>.

With the rise of the modern nation-states, *lex mercatoria* was embodied within the domestic legal systems that were influenced by state policy, national interests and domestic customs<sup>57</sup>. Through that, the *lex mercatoria* lost part of its international character, as a codification is always a creation of a national legislator. Sovereigns attempted to submit all their citizens to one national law and to bring an end to the international law merchant and its privileges for the merchants<sup>58</sup>. The special merchant courts were abolished. Yet the law merchant did not disappear and its fundamental principles were not changed. In France, Colbert's *Ordonnance sur le commerce* from 1673 and *Ordonnance sur la marine* from 1681 were clearly influenced by the principles of the law merchant<sup>59</sup>. Napoleon's Code de commerce, also inspired by the *lex mercatoria*, was introduced in 1807<sup>60</sup>.

The law merchant in England was independent from Common Law and Equity, until it was incorporated into and absorbed by the Common Law in 1756

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<sup>56</sup> Trakman, "The evolution of The Law Merchant: Our Commercial Heritage" (Part I), 12 J. Marit. L. & Com. (1980), 24.

<sup>57</sup> Trakman, "The evolution of The Law Merchant: Our Commercial Heritage" (Part II), 12 J. Marit. L. & Com. (1981), 153.

<sup>58</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 Boston Univ. Int'l. L. J. (1984), 320.

<sup>59</sup> Trakman, "The evolution of The Law Merchant: Our Commercial Heritage" (Part II), 12 J. Marit. L. & Com. (1981), 155.

<sup>60</sup> Trakman, "The evolution of The Law Merchant: Our Commercial Heritage" (Part II), 12 J. Marit. L. & Com. (1981), 155.

under Chief Justice Mansfield. One of the reasons for doing so was the fact that England was a great seafaring and trading nation and wanted to respond to the needs of international business<sup>61</sup>. Due to this incorporation, the law merchant was applied to cases involving non-merchants. Two important English codifications – or rather restatements – are the “Bills of Exchange Act” (1882) and the “Sales of Goods Act” (1893)<sup>62</sup>.

In Germany, however, the situation was different. After the fall of the Holy Roman Empire in 1806, Germany was not reunited until 1871, in spite of a strong nationalist movement. The *Allgemeines Deutsches Handelsgesetzbuch*, a uniform commercial code, only came into force in 1861 (Austria: 1862): “As a result, the Law Merchant was received sporadically into German law. Nevertheless, here too, it was altered in form; and here too, it assumed an indigenous character.”<sup>63</sup>

The internationally accepted old law merchant lost its importance with the numerous codifications of trade law in Europe in the 19<sup>th</sup> century that incorporated this field in the products of national legislation. The codes were more influenced by local usages and by social and economic considerations than by the needs of the international business community. Thus the law merchant was transformed into nationalized law and changed according to the needs of each forum<sup>64</sup>.

As noted above, in the times before the codifications there were few conflicts involving different national laws, for the law merchant or the usages of the international merchant community were the same in every country and the courts applied them as customs. There was no need for harmonization or rules of conflict. The numerous national codifications and the differences they created between the laws in different countries did, however, make it necessary to have rules of conflict to indicate the national law that is applicable to an international

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<sup>61</sup> Berman/Kaufman, “The Law of International Transactions (Lex Mercatoria)”, 19 Harv. Int’l. L. J. (1978), 226; Trakman, “The evolution of The Law Merchant: Our Commercial Heritage“ (Part II), 12 J. Marit. L. & Com. (1981), 158.

<sup>62</sup> Bainbridge, “Trade Usages”, 24 Virg. J. Int’l. L. (1984), 628.

<sup>63</sup> Trakman, “The evolution of The Law Merchant: Our Commercial Heritage“ (Part II), 12 J. Marit. L. & Com. (1981), 156.

<sup>64</sup> Trakman, “The evolution of The Law Merchant: Our Commercial Heritage“ (Part II), 12 J. Marit. L. & Com. (1981), 154.

trade dispute, which explains the importance of International Private Law in this area.

In continental Europe however, the law merchant had a strong effect on the codifications. Especially the French and German Trade Codifications, which were based upon Roman Law, reflect the principles of the medieval law merchant, for the formation of it had also been influenced by Roman Law.

After the codifications came into force, the different national concepts of International Private Law were used to resolve disputes between merchants. This regionalization did not favour international trade because the merchants were confronted with many different political, economic and legal systems. International trade has been growing rapidly since industrialization and especially from the end of the 19<sup>th</sup> century. Compared to the pre-industrialization era, it is burgeoning<sup>65</sup>. At the same time, the national laws mentioned above continued to become more and more complex and extensive. Naturally, this situation was not satisfactory for the merchant community. The different laws and regulations in every country did not meet the demands of international trade. This condition reminds one of the famous lines by Voltaire, when he was describing the confusion in France due to the great diversity in regional and municipal laws before the introduction of the Code Civil: “Is it not an absurd and terrible thing that what is true in one village is false in another? What kind of barbarism is it that citizens must live under different laws? ... When you travel in this kingdom you change legal systems as often as you change horses.”<sup>66</sup>

That situation was aggravated by the insecurity about the outcome of a dispute between two merchants, for they could not know which law would be applied and which court would judge the matter. There was a need for a universal, international conception of the law of international trade independent of the limitations of the national systems of law – a need for a “new” law merchant.

The situations that International Trade Law had to govern gradually changed. This was due to many factors. Especially in the second half of the 20<sup>th</sup> century, rapidly developing technology including computers, expanding air traffic and mass production transformed international trade. In addition to that, political

<sup>65</sup> Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 15.

<sup>66</sup> Voltaire, *Oeuvres de Voltaire VIII*, (1838),8.

factors cannot be ignored. Economically, many national states are no longer autonomous because an important number of international economic conventions have been signed and supranational organisations, such as the European Economic Community, created<sup>67</sup>.

#### ***D. Emergence of a New Law Merchant***

Beginning in the 1920s, the parties to international business relations started to choose arbitration as their mode of dispute resolution<sup>68</sup>. The disputes arising out of international trade relations were less and less frequently referred to national courts, for the arbitrators were often fellow merchants who did not have to base their decision on a particular national law and comply with the boundaries and limitations of the latter. Especially since World War II, arbitration has developed into the preferred method of dispute resolution in International Trade Law<sup>69</sup>. As a matter of fact, most international trade contracts exclude national jurisdiction and contain a clause choosing arbitration as their mode of dispute resolution<sup>70</sup>. One can infer that international commercial arbitration can be regarded as the most commonly used method of dispute resolution in international trade.

International commercial arbitration and an autonomous *lex mercatoria* are very closely connected since both depend upon the parties' choice and contractual stipulations. The growing importance of international commercial arbitration is due to its many advantages over national jurisdiction.

An international trade dispute can only be decided by arbitration if the parties have inserted an arbitral clause into their contract. The arbitrators, the applicable law and rules of procedure, place, time and language of the arbitration can be chosen by the parties. The possibility of choosing the arbitrators means that the dispute can be decided by people with a special knowledge of the parties'

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<sup>67</sup> Schmitthoff, "Das neue Recht des Welthandels", 28 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* (1964), 48.

<sup>68</sup> Langen, "Vom Internationalen Privatrecht zum Transnationalen Handelsrecht", *Neue Juristische Wochenschrift* (1969), 358.

<sup>69</sup> Carr, *Principles of International Trade Law*, 2<sup>nd</sup> ed. London (1999), 316.

<sup>70</sup> Berman/Kaufman, "The Law of International Commercial Transactions (Lex Mercatoria)", 19 *Harv. Int'l. L. J.* (1978), 277.

trading activity or branch of trade. Also, the dispute is decided by a person whom all the parties involved trust. Rigid national rules concerning the procedure, the language and the place of the proceedings and the meaning of certain terms can be avoided, for arbitral tribunals are more flexible. Arbitration can thus be regarded as a system of dispute resolution aimed at avoiding national laws with a great extent of autonomy for the parties<sup>71</sup>. They can choose the principles or rules to be applied to the dispute. Consequently, the whole arbitration is conducted consensually according to the conditions stipulated by the parties in their contract. According to a modern approach that is now being followed by most scholars and national arbitration laws, the principles chosen by the parties need not be a national law<sup>72</sup>. The arbitrators can decide the dispute in amiable composition applying equitable principles (*ex aequo et bono*) or according to the rules of the *lex mercatoria*.

Savings in cost and speed must also be mentioned, though this may not always pertain. Some authors point out that these advantages are an unwarranted generalization and call this point of view traditional<sup>73</sup>. The finality of an arbitral award is also one of the major advantages, because time and money will not be lost on appeals. It has also been submitted that the enforcement of an arbitral award is easier and the enforceability more probable compared to a non-national award: *...since finality is one of the key attractions of arbitration it is an almost universally accepted principle of national laws, as reflected in the UNCITRAL Model Law on Arbitration, that courts should be slow to interfere with arbitral awards, even if they appear to be erroneous in fact or law, with the result that it is inherently harder to upset an award than it is to reverse a judge on appeal.*<sup>74</sup> However some authors do not find this convincing because an arbitral award is

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<sup>71</sup> Carr, *Principles of International Trade Law*, 2<sup>nd</sup> ed. London (1999), 316; De Ly, *International Business Law and Lex Mercatoria*, (1992), 83.

<sup>72</sup> Stein, *Lex mercatoria: Realität und Theorie*, 87.

<sup>73</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 83.

<sup>74</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 9.

said not to guarantee voluntary compliance and enforcement allegedly depends on national courts<sup>75</sup>.

Furthermore, privacy is very important. The arbitration is kept secret from the public, press and (potential) business partners, which can be crucial for an enterprise. Because of this tendency, national jurisdictions and national rules of conflict have been losing importance in International Trade Law. Today most international disputes resolved by arbitrators involve matters of international trade<sup>76</sup>.

Another factor that is contributing to the growing popularity of arbitration is the so-called “homeward trend” of national courts<sup>77</sup>. When faced with a dispute arising out of an international trade relation and connected with more than one national law, state courts have a tendency to declare their own law applicable to the substance. This is due to the fact that judges wish to apply the law they are familiar with and attempt to avoid applying a foreign law. The classical doctrine which considered that every contract has to be governed by some national law encouraged this behaviour. The judges based their choices on the hypothetical will of the parties or the strongest connection and thus determined the applicable national law<sup>78</sup>. When having recourse to arbitration, parties expect a solution that is based rather on the facts and the circumstances of the contract than on a particular national law. The “homeward trend” is less relevant to arbitral tribunals as they are composed of arbitrators of different nationalities who know about the peculiarities of international trade and not of national judges who almost exclusively apply their own national law<sup>79</sup>.

Unsurprisingly, the nature of the disputes resolved by international arbitration is different from that dealt with by national courts. Arbitral tribunals

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<sup>75</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 84; Schmitthoff, “Das neue Recht des Welthandels”, 28 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* (1964), 72.

<sup>76</sup> Freeman, “*Lex Mercatoria: A Legal Basis for the Resolution of International Disputes*”, in: Zylva, Harrison, Jordan (ed.), *International Commercial Arbitration*, Bristol (2000), 121.

<sup>77</sup> Langen, “Vom Internationalen Privatrecht zum Transnationalen Handelsrecht“, *Neue Juristische Wochenschrift* (1969), 358.

<sup>78</sup> Langen, “Vom Internationalen Privatrecht zum Transnationalen Handelsrecht“, *Neue Juristische Wochenschrift* (1969), 358.

<sup>79</sup> Langen, “Vom Internationalen Privatrecht zum Transnationalen Handelsrecht“, *Neue Juristische Wochenschrift* (1969), 358.

are by their nature faced with international trade affairs. Needless to say arbitrators have to go beyond the boundaries of national law in order to render an award that reflects the particularities of international trade: “ ... *l’arbitrage privilégie, sans aucun doute, l’application des normes a-nationales, qu’elles résultent de sa fonction prétorienne ou de l’activité normative des agents économiques eux-mêmes.*”<sup>80</sup>

The aforementioned codifications were hindering the growing commerce. The merchant community searched for ways to rediscover universally accepted rules. Thus, the *London Corn Trade Association* used standard form contracts as early as 1877<sup>81</sup>.

In 1929, Grossmann-Doerth published an important article, in which he described the formation of an autonomous law of commerce and trade, that included the customs and usages, the standard form contracts and the uniform laws published by international organisations. According to him, the law of international trade is not formulated and regulated by jurists and national legislators but the community of international merchants. National laws are ousted by the merchant community and the importance of arbitration as mode of dispute resolution is increasing<sup>82</sup>. Out of social and technical necessities this autonomous law is evolving without the interference of the national legislator<sup>83</sup>. He also discovered that usages can override written law or a clause in a standard form contract. This was accepted by merchants and arbitral tribunals, whereas national courts were still reluctant to acknowledge this<sup>84</sup>.

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<sup>80</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 15.

<sup>81</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zürich (1989), 37.

<sup>82</sup> Grossmann-Doerth, “Der Jurist und das autonome Recht des Welthandels”, *Juristische Wochenschrift* (1929), 3451.

<sup>83</sup> Grossmann-Doerth, “Der Jurist und das autonome Recht des Welthandels”, *Juristische Wochenschrift* (1929), 3447.

<sup>84</sup> Grossmann-Doerth, “Der Jurist und das autonome Recht des Welthandels”, *Juristische Wochenschrift* (1929), 3450.

In 1935, Lambert wrote about the re-emergence of the law merchant<sup>85</sup> and thus pointed out that the new law merchant was developing without the interference of state legislators. The author also mentions the international merchant community's self-regulation of its own affairs and a certain transnationality and uniformity due to the needs of the markets and international trade. Especially after World War II and the rapidly growing, recovering and expanding international commerce of these years, there was a very liberal and *laissez faire* economic approach<sup>86</sup>. To illustrate the point, by the end of the 1980s, world export was almost fifty times the volume of 1950 and more than 130 times the volume of the late 1930s<sup>87</sup>. From 1984 to 2002 the world export volume more than tripled<sup>88</sup>. The emergence of a transnational law merchant enabled the business world to overcome economically, culturally and politically motivated differences between the national trade laws. The international merchant community created its own rules. For certain trade matters national laws could be disregarded, as arbitral tribunals were to a certain extent free to base their awards on considerations different from those of the national courts.

Today's equivalents to the medieval merchants are the multinational enterprises. They perform business transactions in many countries of the world but are usually based in one country. Like the medieval merchants mentioned above, multinational enterprises have their own law but are confronted with many different national laws through their trading activities. Consequently, with the appearance of multinational enterprises, the need for a *lex mercatoria*, for a law common to all merchants became obvious. The situation is similar to the situation

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<sup>85</sup> Lambert, Sources du droit comparé ou supra-national. Législation uniforme et jurisprudence comparative: Recueil d'études sur les sources du droit en l'honneur de François Gény, vol. III, Sirey: Paris (1934), 498: *Né comme la loi marchande médiévale de la seule force des faits économiques, et sans aucune consécration d'autorités étatiques territoriales, ce nouveau droit commercial fait par les commerçants a, comme la loi marchande médiévale, l'aptitude à se répandre librement par dessus les frontières des Etats et des nationalités. Il prend dès sa naissance un caractère accusé de cosmopolitisme, parce que les activités commerciales ou industrielles, dont il est appelé à régler le jeu, sont elles-mêmes des activités internationales. Dès aujourd'hui les commerces les plus avancés dans la voie de la rationalisation sont arrivés, non pas au général à une unification systématique et complète des usages juridiques de leurs branches commerciales, mais du moins à une uniformisation suffisante pour les besoins essentiels du commerce international.*

<sup>86</sup> De Ly, International Business Law and Lex Mercatoria, (1992), 287.

<sup>87</sup> Weise, Lex Mercatoria, Frankfurt/Main (1990), 15.

<sup>88</sup> Fischer Weltalmanach 2004, Frankfurt am Main, 1271.

of the travelling merchants during the Middle Ages<sup>89</sup>. The idea of a new law merchant was first mooted in 1956. In an article published in “*Le Monde*” the day after the nationalization of the Suez Canal, Goldman pondered the question of a multinational enterprise governed by an a-national law<sup>90</sup>. In 1964, Goldman observed the emergence of a *jus mercatorum* or *lex mercatoria* that contained all the characteristics of a system of law. According to him, this trans- or a-national law, though still incomplete, reigns all the international commercial transactions except for those involving only states or state entities, for their relationships are governed by Public International Law<sup>91</sup>.

In 1961, Goldštajn published an article about the new law merchant: *Notwithstanding the differences in the political, economic and legal systems of the world, a new law merchant is rapidly developing in the world of international trade. It is time that recognition be given to the existence of an autonomous commercial law that has grown independent of the national systems of law.*<sup>92</sup>

To him this development was due to two legal factors: the optional character of trade law and the growing popularity of arbitration as mode of dispute resolution in International Trade Law. The emergence of *lex mercatoria* is also caused by the many differences that exist between national laws and by the general inadequacy of the latter for governing international trade relations. Among the economic factors for the development of the new law merchant he lists the creation of a world market in order to achieve the highest degree of productivity and the technological developments that lead to a closer integration of the various markets<sup>93</sup>.

At about the same time as Goldman, Schmitthoff developed a similar concept. From 1954 on, he developed his theory about International Trade Law

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<sup>89</sup> Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 320.

<sup>90</sup> Goldman, “La Compagnie de Suez, société internationale”, *Le Monde* (4.10.1965), 3: “... une société internationale, relevant directement de l’ordre juridique international”; Kahn, “La *lex mercatoria*: point de vue français après quarante ans de controverses”, 37 McGill L. J. (1992), 414.

<sup>91</sup> Goldman, “Frontières du Droit et Lex Mercatoria”, *Archives de Philosophie du Droit* (1964), 177.

<sup>92</sup> Goldštajn, “The New Law Merchant”, *J. Bus. L.* (1961), 12.

<sup>93</sup> Goldštajn, “The New Law Merchant”, *J. Bus. L.* (1961), 13.

and *lex mercatoria*. He also identified the new law merchant's sources such as conventions, uniform laws, usages and rules of international organisations<sup>94</sup>.

This new law merchant was said to be an autonomous body of law. The merchants created the rules themselves: on the one hand through the influence they had on national legislators who observed the trade usages and the needs of the merchant community before creating a law, on the other hand through their participation in commissions and arbitral tribunals<sup>95</sup>. "One of the features of this emerging system is that it tends to be autonomous, i.e. to provide its own regulation as far as possible, which is independent from the solutions provided by the various national legal systems."<sup>96</sup> To these authors, *lex mercatoria*'s autonomy is derived from the fact that it is independent of and different from national laws as well as Public International Law.

For Schmitthoff, this new element in International Trade Law had developed in three stages<sup>97</sup>. First of all, during the Middle Ages, the law of international trade was composed of universal customs that were derived from the usages of the international merchant community. In the second stage, mainly in the 18<sup>th</sup> and 19<sup>th</sup> century, there was the era of national codifications of the law of international trade, during which it lost its international character and universality. In a third stage, which he considers to be contemporary, the international character reappears and becomes dominant again and the emergence of a new, universal *lex mercatoria* can be observed.

Today's national legislators are faced with the same situation as the medieval sovereigns. Merchants trade across boundaries and need their own rules to govern these activities. Just like their medieval predecessors, "... today's nations realize that piecemeal regulation of international commerce through the application of independent national laws impedes the growth of global trade."<sup>98</sup>

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<sup>94</sup> Schmitthoff, "The Law of International Trade, its Growth, Formulation and Operation", 16-18.

<sup>95</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zürich (1989), 39.

<sup>96</sup> Schmitthoff, "The Unification or Harmonisation of Law by Means of Standard Contracts and General Conditions", 17 ICLQ (1968), 564.

<sup>97</sup> Schmitthoff, "Das neue Recht des Welthandels", 28 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* (1964), 49.

<sup>98</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 *Boston Univ. Int'l. L. J.* (1984), 320.



## Chapter 3

### Definitions and theories of *lex mercatoria*

There are numerous concepts of the new law merchant. The most dissimilar ideas about the sources, scope and application of the *lex mercatoria* are being proposed. Similarly, opinions differ regarding the reality of its existence. From the plethora of literature on this subject, it is impossible to present every article ever written in the thesis. Some will be dealt with in detail to present the various concepts that exist. Before defining *lex mercatoria* and presenting the different conceptions, the meaning of other terms pertinent to the thesis needs to be explained.

#### A. *International*

First of all, which factors make arbitration international? It is international if the contract is connected with more than one legal system. In most cases, the parties have their residences in different countries<sup>99</sup>. According to Article 1 (3) of the UNCITRAL Model Law on International Commercial Arbitration:

Arbitration is international if:

- (a) the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of business in different States; or
- (b) one of the following places is situated outside the State in which the parties have their places of business:
  - (i) the place of arbitration if determined in, or pursuant to, the arbitration agreement;
  - (ii) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected; or
- (c) the parties have expressly agreed that the subject-matter of the arbitration agreement relates to more than one country.

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<sup>99</sup> Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 ICLQ (1985), 747.

The explanatory note to Article 1 (1) of the ICC Arbitration Rules states that the parties need not be of different nationalities. A foreign element in the contract, for instance the fact that the performance of the contract takes place abroad, can be a sufficient criterion for the application of the rules.

Article I 1 a of the European Convention on International Commercial Arbitration defines its scope of application as follows:

This Convention shall apply:

to arbitration agreements concluded for the purpose of settling disputes arising from international trade between physical or legal persons having, when concluding the agreement, their habitual place of residence or their seat in different Contracting States

The term “transnational law” is also being used. It is different from “international law”. Transnational law is the law that governs “...actions or events that transcend national frontiers, including public and private international law and other rules not fitting wholly into such standard categories.”<sup>100</sup> The term international describes relations between states, whereas transnational comprises all the cross-border relations<sup>101</sup>. It is therefore more adequate to use that term. Transnational law is neither “inter”national law, meaning situated somewhere between the national laws, nor “supra”national law, meaning above the national laws. Transnational law, as the term “trans” implies, is pertinent to and has an influence on all the national laws. Transnational law never exists independently of national laws, but can be found in any national law by an arbitrator<sup>102</sup>.

*Lex mercatoria* is consequently a broader concept as it also comprises a-national rules and can by its nature exist independent of national laws. However, most of its rules and principles are common to the laws of the nations engaged in international trade. It is called a-national because the arbitrators do not have to

<sup>100</sup> Goode, “Usage and its Reception in Transnational Commercial Law”, in: Ziegel (ed.), “New Developments in International Commercial and Consumer Law”, Oxford (1998), 4.

<sup>101</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 8; Goode, “Usage and its Reception in Transnational Commercial Law”, in: Ziegel (ed.), “New Developments in International Commercial and Consumer Law”, Oxford (1998), 4.

<sup>102</sup> Langen, “Transnationales Handelsrecht”, *Neue Juristische Wochenschrift* (1969), 2230.

base their decision on a particular national law whenever they apply a general principle of law or a trade usage. The a-nationality of *lex mercatoria* does not necessarily exclude national laws or rules found in most national laws from its scope. General principles common to most national laws are also part of the law merchant. “The *lex mercatoria* is making contact with national laws in more and more harmonious ways. Often presented as a-national law, it is part of a transnational legal system that is based on national laws.”<sup>103</sup>

It has been said that ... *the term transnational rule or general principle of international trade has the advantage over the term lex mercatoria of not excluding that the solution to the merchant community's problems can sometimes be found in national laws and of not insisting on the fact that the specificity of these rules derives more from their source than their contents. Other than the concept of lex mercatoria that focuses on the specificity of transnational law the term transnational rule or general principle suggests that the latter are based on national laws and that they are closely related to them.*<sup>104</sup>

A different approach is followed in the paper. The terms *lex mercatoria* and transnational law are not contradictory. The transnational rules are also part of the law merchant. Transnational law is composed of the principles found in all national laws, and these general principles of law are one of *lex mercatoria*'s elements.

## ***B. Commercial***

Secondly, the term “commercial” needs to be defined. According to a footnote of Article 1 (3) of the UNCITRAL Model Law on International Commercial Arbitration<sup>105</sup>:

The term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not.

<sup>103</sup> Loquin, “Où en est la *Lex Mercatoria*”, in: *Souveraineté étatique et marchés internationaux à la fin du 20<sup>ème</sup> siècle. Mélanges en l'honneur de Philippe Kahn*, (2000), 41.

<sup>104</sup> Gaillard, “Trente ans de *Lex Mercatoria*. Pour une application sélective de la méthode des principes généraux du droit”, *Journal du Droit International* (1995), 8.

<sup>105</sup> Available at: <http://www.uncitral.org/en-index.htm>

Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business co-operation; carriage of goods or passengers by air, sea, rail or road.

This wide interpretation will be followed throughout the whole paper because all the above matters are pertinent to international trade and can lead to conflicts and arbitral awards. Non-contractual relationships, however, will be left out of the scope as disputes arising out of them will usually not be solved by arbitrators applying *lex mercatoria*.

### ***C. Lex Mercatoria***

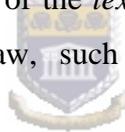
Since the existence, character and scope of *lex mercatoria* are still very controversial, there are numerous definitions. *A number of usages, each of which exists among merchants and persons engaged in mercantile transactions, not only in one particular country, but throughout the civilised world, and each of which has acquired such notoriety, not only amongst those persons, but also in the mercantile world at large, that courts of this country will take judicial notice of it*<sup>106</sup>. This definition from 1692 is still valid and could well emanate from one of the authors commenting on *lex mercatoria* today. It is convenient to group the different concepts into two categories: those in favour of *lex mercatoria* and those of its critics. There is extensive literature and articles published on *lex mercatoria*, its existence, concept and definition. For the purposes of this paper it suffices to focus on the most well-known ones and those that show the different opinions and illustrate the ongoing debates the best. The term *lex mercatoria* will be defined in the following sections, as it is convenient to do so by presenting and critically analysing the various concepts that are being proposed.

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<sup>106</sup> Lethulier's Case (1692) 2 Salk 443 (per Holt, CJ); cited in: von Bar, Internationales Privatrecht I, München (1987), 41.

## 1. Critical theories of *Lex Mercatoria*

Some authors do not believe in the existence or the practicability of an internationally accepted *lex mercatoria*. They give numerous reasons which purport to prove that the new law merchant does not exist. Thus, in a recent publication, Sandrock submitted that there is no such thing as a *lex mercatoria* as it would consist of civil law rules without any connection to national laws<sup>107</sup>. Since it is said to consist of rules common to all national laws it is necessarily incomplete and cannot be a body of rules. Also, the rules common to all national laws can only be very basic and logical, such as the *pacta sunt servanda* and *bona fides* principles, so that no contract could be governed by them. Finally, whenever none of these common principles exists the arbitrator would have to compare all national laws in order to find globally accepted rules. It is not clear whether or not all national laws (or how many and which ones) would have to concur on a certain problem in order to yield a rule of the *lex mercatoria* the arbitrator could apply. Finally, for some areas of law, such as prescription, this is said to be impossible<sup>108</sup>.



### a) Delaume

In his article, Delaume calls the *lex mercatoria* a myth<sup>109</sup>. He only studies contracts between states and natural persons.

Delaume argues that the need for *lex mercatoria* has ceased to exist, for it can no longer be said that the "... law of certain developing countries could reasonably be said not to exist ...", and that even "... third-world countries are perfectly capable of providing major categories of state contracts with a

<sup>107</sup> Sandrock, "Das Privatrecht am Ende des 20. Jahrhunderts: Deutschland – Europa – und die Welt", *Juristische Zeitung* (1996), 8.

<sup>108</sup> Sandrock, "Das Privatrecht am Ende des 20. Jahrhunderts: Deutschland – Europa – und die Welt", *Juristische Zeitung* (1996), 9.

<sup>109</sup> Delaume, "Comparative Analysis as a Basis of Law in State Contracts: The Myth of the *Lex Mercatoria*", 63 *Tul. L. R.* (1989), 575.

sophisticated legal framework”<sup>110</sup>. By presenting this argument, he overlooks the fact that even very sophisticated law systems are not usually designed to govern international trade relations but rather internal contracts between two natural persons. Also, national law takes a much longer time to adapt to changing circumstances, as the law-making process is usually very slow and rigid.

Furthermore he claims that “... in the event of litigation, recourse to the *lex mercatoria* of state contracts may not be exempt from unexpected developments which, at considerable expense, may come as a surprise to both draftsmen and their clients”<sup>111</sup>. The validity of this statement remains to be proven. Pointing out its inaccuracy is the major object of the thesis and will be demonstrated throughout the whole work.

In addition to that, he interprets Article 42 (1) of the ICSID Convention in a way that excludes the application of *lex mercatoria*<sup>112</sup>. This article states that in the absence of an express stipulation of applicable law, the tribunal “... shall apply the law of the Contracting State party to the dispute ... and such rules of international law as may be applicable”. It is clear that application of *lex mercatoria* is admitted, even encouraged. Even the applicable national law is corrected by the general principles of international trade<sup>113</sup>. The rules mentioned in Article 42 (1) do not refer only to Public International Law but also to *lex mercatoria*<sup>114</sup>.

All in all, his article is not convincing.

## b) Highet

Following and supporting Delaume, Highet labels *lex mercatoria* an enigma in his article.

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<sup>110</sup> Delaume, “Comparative Analysis as a Basis of Law in State Contracts: The Myth of the Lex Mercatoria”, 63 Tul. L. R. (1989), 610.

<sup>111</sup> Delaume, “Comparative Analysis as a Basis of Law in State Contracts: The Myth of the Lex Mercatoria”, 63 Tul. L. R. (1989), 609.

<sup>112</sup> Delaume, “Comparative Analysis as a Basis of Law in State Contracts: The Myth of the Lex Mercatoria”, 63 Tul. L. R. (1989), 591.

<sup>113</sup> Berger, *Formalisierte oder “schleichende” Kodifizierung des transnationalen Wirtschaftsrechts*, Berlin (1996), 32.

<sup>114</sup> Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 ICLQ (1985), 759; Lew, “Applicable Law in International Commercial Arbitration”, New York (1978), 345; Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 107.

To him, state-free contracts are a logical impossibility and an intellectual solecism<sup>115</sup>. He also claims that “if the contract is stateless, it is not a contract and cannot be enforced”<sup>116</sup>. This is not true. There are numerous contracts that are not based on the national law of some state. For example, marriage contracts are sometimes made according to Canon Law<sup>117</sup>. The law of the European Union is also independent from any national law<sup>118</sup>. As the German Federal Constitutional Court points out, it is an: “... autonomous system of law, that is neither Public International Law nor the law of the Member States. The law of the European Union is independent of and different from the legal systems and the national laws of its members; ...”<sup>119</sup>. Besides, the law and regulations of international organisations, such as the UN, are governed by autonomous UN law, independent from Public International Law or any national law. Also, the employment contracts of managers of multinational enterprises who work in many different countries will often be regulated according to a-national rules<sup>120</sup>.

Later on Highet defines the necessary elements of any law. These are accessibility or general applicability, authoritativeness and consistency, relative predictability, evident fairness, and enforceability<sup>121</sup>. He accredits only two of these essential elements to *lex mercatoria*. Firstly, fairness, for it “... is hard to conceive of a rule for fair dealing and in favour of good faith producing other than an evidently fair result”<sup>122</sup>. Secondly, the principles known as *lex mercatoria* are principles of general applicability and accessibility. These assumptions will be discussed throughout the thesis. Highet concludes that *lex mercatoria* is only *principia mercatoria* at best<sup>123</sup>.

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<sup>115</sup> Highet, “The Enigma of the Lex Mercatoria”, 63 Tul. L. R. (1989), 613.

<sup>116</sup> Highet, “The Enigma of the Lex Mercatoria”, 63 Tul. L. R. (1989), 615.

<sup>117</sup> Verdross, “Gibt es Verträge, die weder dem innerstaatlichen Recht noch dem Völkerrecht unterliegen?”, 6 Zeitschrift für Rechtsvergleichung (1965), 129.

<sup>118</sup> Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 64.

<sup>119</sup> BVerfGE 22, 296 = Neue Juristische Wochenschrift (1968), 348.

<sup>120</sup> Stein, *Lex mercatoria: Realität und Theorie*, 47; Verdross, “Gibt es Verträge, die weder dem innerstaatlichen Recht noch dem Völkerrecht unterliegen?”, 6 Zeitschrift für Rechtsvergleichung (1965), 129.

<sup>121</sup> Highet, “The Enigma of the Lex Mercatoria”, 63 Tul. L. R. (1989), 624.

<sup>122</sup> Highet, “The Enigma of the Lex Mercatoria”, 63 Tul. L. R. (1989), 625.

<sup>123</sup> Highet, “The Enigma of the Lex Mercatoria”, 63 Tul. L. R. (1989), 628.

### c) Mustill

According to Mustill *lex mercatoria* constitutes an autonomous legal order for the majority of authors. It is also a-national, which means not derived from any national law and having normative value independent of any national legal system<sup>124</sup>. To him, the *lex mercatoria* does not yet constitute a system of law that can be chosen by the parties whenever an arbitration convention or model law permits the choice of a “law”<sup>125</sup>. The contents are not yet precisely defined, a fact that can create great uncertainty and thereby hinder international commerce.

Yet, according to Mustill, the law merchant constitutes a law and cannot be equated with equity: *Much of the unease about lex mercatoria stems from the idea that it frees the arbitrator to apply his own unfettered standards of justice to the individual case. The fact that this misconception is so widespread is due in part of the ambivalence in much of the literature about the relationship between the lex mercatoria and the concept of amiable composition, a concept which is itself hard for the common lawyer to grasp. Nevertheless, a misconception it undoubtedly is, at least by mercatorist standards. The lex mercatoria is a lex, albeit not yet perfected. It creates norms which an arbitrator must seek out and obey in every case to which the lex applies*<sup>126</sup>. According to Mustill it is a law in the making.

Given the *lex mercatoria*'s a-nationality and autonomy, Mustill denies any connection with ongoing attempts to harmonize the law of international trade. The latter concerns exclusively national laws attempting to facilitate international trade. *Lex mercatoria* is said to be completely independent of national laws, “... save as a quarry from which to draw the raw materials for generalised rules”<sup>127</sup>.

This view is too limited. There always is an interaction between *lex mercatoria* and national laws. The mere fact that a rule is part of a national law does not automatically exclude it from the law merchant's scope.

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<sup>124</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 88.

<sup>125</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 97.

<sup>126</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 103.

<sup>127</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 88.

Furthermore, there is said to be no connection with the notion of transnational arbitration. The theory about transnational arbitration states that there exists arbitration detached of any national laws. However, exceptions are made for the law of the state in which enforcement is likely to be sought. *Lex mercatoria*, on the other hand, is said to exist only if created spontaneously by the merchant community. “Thus the debate on transnationalism is about whether it can and should be brought about. By contrast, the debate on the *lex mercatoria* is about whether it can and does exist as a viable system.”<sup>128</sup>

There are said to be two main sources of the law merchant: the principles of law common to trading nations and the usages of international trade. As to the first, he denies the existence of principles, apart from ones which are so general as to be useless, common to the legal system of the nations engaged upon international commerce<sup>129</sup>. Because of this, another concept is said to have evolved. Mustill calls it a ‘micro’ *lex mercatoria* generated with specific reference to the contract and therefore not the same throughout the world, as opposed to the classical concept that sees the law merchant “... as a universal and pervasive ‘arrière-plan’ underlying every arbitral decision in the field of international commerce.”<sup>130</sup>

The second primary source, international trade usage, is also quite controversial. Firstly, usages are defined as principles that are generally followed and can as such be important for the interpretation of a contract. However, this is not particularly pertinent to international trade and arbitration, as “Any worthwhile national court ought to be capable of taking usage into account, without the need to accord to usage the status of a prime element in self-contained system of law.”<sup>131</sup> Usage as manifested in standard forms is not without problems either, for there are numerous institutions publishing different standard forms, the

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<sup>128</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 90.

<sup>129</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 92.

<sup>130</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 94.

<sup>131</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 94.

parties tend to alter the proposed standard forms and the mechanism for transforming them into a source of law is unclear.

Mustill's view, as representing the traditional English view, has been summarised as follows: ... (i) *arbitrators may not apply lex mercatoria on their own; (ii) any agreement by parties to a contract to submit their claims to arbitration (or adjudication) pursuant to lex mercatoria or its English equivalent is void; and (iii) an award rendered by arbitrators according to lex mercatoria ought not to be enforced by English courts, at least if the award is not made in a foreign country that takes a different view and the award is required to be enforced by the New York Convention*<sup>132</sup>.

As mentioned above, Mustill's view of the *lex mercatoria* is too narrow. Today, there is no doubt about the fact that parties can choose *lex mercatoria* as the law governing their business relation and that arbitrators abide by this choice. Also, no court would deny enforcement of an award based on *lex mercatoria*<sup>133</sup>. Finally, even though he denies the existence of principles, apart from a few which are so general as to be useless<sup>134</sup>, he gives a list of twenty principles which are far from being ineffective and have been used to resolve international trade disputes<sup>135</sup>.

#### **d) F.A. Mann**

Just like Highet, Mann is no advocate of the theory of contracts that exist outside of national law. The arbitration clause in every contract is therefore valid and interpreted according to the *lex fori* that is designated by the International Private Law of the seat<sup>136</sup>. Just like International Private Law is national law, the law of every arbitration must be national law as well<sup>137</sup>.

<sup>132</sup> Lowenfeld, "Lex Mercatoria: An Arbitrator's View", 6 *Arbitration International* (1990), 135.

<sup>133</sup> Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 168.

<sup>134</sup> Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 92.

<sup>135</sup> Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 110.

<sup>136</sup> Mann, "Schiedsrichter und Recht", in: *Festschrift Flume* (1978), 596.

<sup>137</sup> Mann, "Internationale Schiedsgerichte und nationale Rechtsordnung", *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht* (1968), 101.

Mann presents the denationalization theories and the attempts to liberate international commercial arbitration from the boundaries of national law. He describes a widespread opinion that merchants and other practitioners expect and desire for an emancipation of international commercial arbitration from national legislation. For Mann, this is not true. He states that the merchant community expects predictable solutions to their problems in order to adapt their behaviour<sup>138</sup>. Only national law is said to be able to provide the needed degree of predictability and security and only the national legislator is able to avoid arbitrariness, protect the weaker party and to promote justice<sup>139</sup>.

According to Mann, other authors have described *lex mercatoria* as some incoherent rules of no practical importance whatsoever, as these rules are all comprised in the national laws or in the contracts<sup>140</sup>. Consequently, only the national laws and the expressed will of the parties, but not *lex mercatoria*, should be taken into account.

According to Mann, every arbitration is national and cannot be governed by transnational law. He states that *No one has ever or anywhere been able to point to any provision or legal principle which would permit individuals to act outside the confines of a system of municipal law; even the idea of the autonomy of the parties exists only by virtue of a given system of municipal law and in different systems may have different characteristics and effects. Similarly, every arbitration is necessarily subject to the law of a given State. No private person has the right or power to act on any level other than that of municipal law.*<sup>141</sup>

This theory cannot be followed. First of all, arbitral tribunals are not part of the national jurisdictional system. There is no original *lex fori* for the arbitrator, the mandatory rules of which could indicate the applicable rules of conflict and procedure. Even if there were a *lex fori*, it is not sure to which extent it would

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<sup>138</sup> Mann, "Schiedsrichter und Recht", in: Festschrift Flume (1978), 594.

<sup>139</sup> Mann, "Schiedsrichter und Recht", in: Festschrift Flume (1978), 595.

<sup>140</sup> Ehrlicke, "Zur Einführung: Grundstrukturen und Probleme der *lex mercatoria*", Juristische Schulung (1990), 967.

<sup>141</sup> Cited in: Von Mehren, "To what Extent Is International Commercial Arbitration Autonomous?", in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Litec: Paris (1987), 218.

have to be followed. Does it designate the applicable law, the rules of conflict, the procedural rules and reign over the arbitral tribunal, the award and the contract<sup>142</sup>?

The obligation for the arbitrator to follow a certain *lex fori* could force him to apply a system of law against the parties' expressed will. If the *lex fori* does not accept the parties' choice and does not allow the application of the set of rules they have chosen, the arbitrator is forced to disregard the parties' intention in order not to endanger the enforceability of the award<sup>143</sup>. The arbitrator derives his powers from the parties' designation and not from a national law.

Besides, in about 20 % of the cases the seat of the tribunal is not determined by the parties but by the arbitral tribunal itself, according to geographical or other practical considerations<sup>144</sup>. Especially in these cases, it would not be reasonable to connect the contract to a law that the parties might not be familiar with or the application of which they sought to avoid.

Finally, Mann states that there are no international arbitral tribunals. Even in cases involving parties of different nationalities and business activities in several states, so-called international contracts, the arbitral tribunal is necessarily national. The same applies to "International" Private Law, which is national law that is applied to cases with an element of internationality. Every arbitral tribunal has a seat and is bound by the law in order to assure the protection, security and previsibility provided for in the national law. Thus, there must be a connection between the arbitral tribunal and the law of the seat. Mann compares the *lex fori* of the national judges to the *lex arbitri* of the arbitrator. According to him, the *lex arbitri* is the law of the state where the arbitral tribunal has its seat. An arbitrator cannot disregard that national law, including that state's International Private Law. If he ignores the rules of conflict of that state he endangers the enforceability of his award<sup>145</sup>. The arbitrator is obliged to render an award that is enforceable and recognized according to the *lex arbitri* of the tribunal's seat, meaning that it cannot be set aside according to the rules of that national law.

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<sup>142</sup> Stein, *Lex mercatoria: Realität und Theorie*, 74.

<sup>143</sup> Stein, *Lex mercatoria: Realität und Theorie*, 76.

<sup>144</sup> Triebel/Petzold, "Grenzen der *lex mercatoria* in der internationalen Schiedsgerichtsbarkeit", *Recht der internationalen Wirtschaft* (1988), 248.

<sup>145</sup> Mann, "Schiedsrichter und Recht", in: *Festschrift Flume* (1978), 598.

There can be great difficulties in determining the seat of the arbitral tribunal, especially in cases involving more than one arbitrator with different nationalities, meetings and business in several countries. For Mann, these problems do not exist. He proposes to define the tribunal's seat in accordance with the residence of the arbitrator or the head of the arbitrators<sup>146</sup>.

As maintained by Mann, the arbitrator is bound by the rules of the law that is applicable according to the national rules of conflict just like a national judge<sup>147</sup>. Enforceability and setting aside of the award in other countries is not the arbitrator's business and he cannot totally disregard these problems. He is not obliged to assure a universal acceptance and enforceability of his award. Every arbitral award is national, it cannot exist in a legal vacuum. The law of the seat of the tribunal determines the composition, the procedural rules and the applicable law. Consequently, the nationality of an arbitral award can be determined according to which national court has the authority and jurisdiction to revise, and, if certain conditions, that differ from nation to nation, are met, set aside the award<sup>148</sup>.

Furthermore *lex mercatoria* is said to be lacking in content. An arbitral award could be based on general considerations and thereby not take protective rules of the national law into account. Supposedly, a decision based on the *lex mercatoria* is not a decision that is based on law but on the arbitrator's personal convictions and equitable considerations<sup>149</sup>. These assumptions will be refuted in the chapter about the existing allegations against *lex mercatoria*.

#### e) Lagarde

Lagarde is said to have described the law merchant as supra national law with a limited character. It can only exist next to the national law chosen by the

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<sup>146</sup> Mann, "Schiedsrichter und Recht", in: Festschrift Flume (1978), 598, footnote 22.

<sup>147</sup> Mann, "Schiedsrichter und Recht", in: Festschrift Flume (1978), 597.

<sup>148</sup> Mann, "Schiedsrichter und Recht", in: Festschrift Flume (1978), 598.

<sup>149</sup> Mann, ICLQ (1987), 448.

parties or the arbitrators to interpret certain terms pertinent to international trade<sup>150</sup>.

Even the constant insertion of similar clauses into contracts allegedly does not imply their belonging to the *lex mercatoria* and their existence as general principles of law<sup>151</sup>. Standard form contracts and general conditions are based on the freedom of contract rule. This general principle of law is contained in the national laws and therefore these practices cannot be considered self-regulatory or formed by the business community, but are derived from the national law in question. Standard form contracts, general conditions and usages are an expression of the freedom of will of the parties rather than part of a transnational set of rules<sup>152</sup>. The parties may always derogate from trade usages. Thus they can never be seen as legal rules that have to be observed and from which customs may be formed and consequently cannot be regarded as a formal source of the *lex mercatoria*.

Lagarde also states that the general principles of law as mentioned in Article 38 of the Statute of the International Court of Justice are not part of the *lex mercatoria*: “*Nous éprouvons pour notre part les plus grandes difficultés à admettre que les principes généraux du droit international puissent ainsi passer, par une sorte d’osmose, du droit international à la lex mercatoria*”<sup>153</sup>. According to him the general principles are part of international law that is designed for states and not merchants. They are either sources of Public International Law, or derived from national laws and therefore not part of the *lex mercatoria*.

“*Si la lex mercatoria constitue un ensemble de règles, cet ensemble est distinct de celui constitué par le droit international.*”<sup>154</sup> The only points of contact between the general principles of law and *lex mercatoria* are contracts between states and private parties. If a dispute arises out of one of these contracts, the

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<sup>150</sup> Ehrlicke, “Zur Einführung: Grundstrukturen und Probleme der *lex mercatoria*”, Juristische Schulung (1990), 967.

<sup>151</sup> Lagarde, “Approche critique de la *lex mercatoria*”, in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 129.

<sup>152</sup> Lagarde, “Approche critique de la *lex mercatoria*”, in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 129.

<sup>153</sup> Lagarde, “Approche critique de la *lex mercatoria*”, in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 131.

<sup>154</sup> Lagarde, “Approche critique de la *lex mercatoria*”, in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 132.

International Private Law would often declare the state's law applicable. The private party could fear that the state might misuse its power as a legislator. Therefore that national law might have to be corrected by the general principles of international law mentioned in Article 38.

Furthermore, according to Lagarde, there is no such thing as a community of international merchants, but many subcommunities. Consequently, there is not one *lex mercatoria* but one for each subcommunity. The term *leges mercatoriae* is said to be more suited for describing the different usages and sets of rules<sup>155</sup>.

According to Lagarde, national courts have to follow their own conflict of law rules and therefore cannot apply or enforce an award based on *lex mercatoria*<sup>156</sup>.

Lagarde's approach shows a very reduced view of the *lex mercatoria*. He puts forward a more sceptical and limited definition of the law merchant. First of all he excludes all international rules and conventions made by states from being part of the *lex mercatoria*: "*Un inventaire scrupuleux des normes de la lex mercatoria doit exclure les règles de droit matériel international de nature étatique ou interétatique.*"<sup>157</sup> For him, international conventions and substantive rules of international law are sources of Public International Law and national law. He defines *lex mercatoria* as a law created spontaneously by the *societas mercatorum*<sup>158</sup>. Thus he excludes the capacity of states to submit to arbitration<sup>159</sup>, and even the United Nations Convention on Contracts for the International Sale of Goods (CISG, Vienna 1980)<sup>160</sup> from the scope of *lex mercatoria*. According to him, these principles were not spontaneously created by the *societas mercatorum*. Formally they were created by states or state entities and consequently are not part

<sup>155</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 139.

<sup>156</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 144-146.

<sup>157</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 128.

<sup>158</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 128.

<sup>159</sup> About arbitrability as a part of the *lex mercatoria* see infra: Scope.

<sup>160</sup> CISG as a source of the *lex mercatoria* see infra: Sources.

of the law merchant<sup>161</sup>. He even goes so far as to call the hardship principle a simple clause and not a general principle of law.

This has been put forward by other authors as well. Purportedly, *lex mercatoria* only comprises those principles of law that are alike or very similar in the national laws: "... *lex mercatoria* is to express nothing other than a uniform and special regulation of international economic relations ..."<sup>162</sup>. This would mean that *lex mercatoria* is composed exclusively of national law rules similar in all states.

This definition is clearly too narrow, because *lex mercatoria* is autonomous and self-regulatory; it is the law created by the international merchant community and not by states. Even the creation of uniform or harmonized laws would still be in the hands of the national legislators and not the merchant community. "Those similarities are welcome, and could be a first step towards uniformity; but by no means can we speak here of elements of an 'autonomous' law of international commerce"<sup>163</sup>.

In a similar manner, one cannot equate *lex mercatoria* with the Uniform Laws and the conventions adopted by states. This concept is also too narrow, for it excludes the rules created by the merchant community and connects the *lex mercatoria* to state legislation. However, the conventions and Uniform Laws can be regarded as a source or an element of the *lex mercatoria*, for they might reflect general principles of law<sup>164</sup>.

## f) Grigera Naón

Another definition is proposed by Grigera Naón, who is clearly not in favour of the *lex mercatoria*: "... an a-national *lex mercatoria* or ... a hybrid system finding its sources both in national and international law and in the

<sup>161</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 128.

<sup>162</sup> Enderlein, "The Law of International Trade: A new task for national legislators or a new *lex mercatoria*?", in: UNIDROIT, New Directions in International Trade Law, 451.

<sup>163</sup> Horn, "Uniformity and Diversity in the Law of International Contracts", in Horn/Schmitthoff (ed.), The Transnational Law of International Commercial Transactions, Deventer (1982), 16.

<sup>164</sup> Berger, Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts; Berlin, New York: de Gruyter (1996), 34.

vaguely defined region of general principles of law called ‘Transnational Law’.”<sup>165</sup>

He denies the existence of an autonomous legal order *lex mercatoria* apart from the national laws and Public International Law in order to assure the protection of the weaker parties provided by the national laws: “It would be irrational madness to leave the legal responses to these problems to an uncontrolled laissez faire in a world of perpetual strife.”<sup>166</sup> In addition to these points, he criticises the sources of the law merchant: “... that the customs, usages and general legal principles of the *lex mercatoria* are not always well established, and, whatever theoreticians say, must oftentimes be alleged and proved.”<sup>167</sup>

These assumptions will also be refuted in the chapter about the existing allegations against *lex mercatoria*.

## 2. Theories in favour of *Lex Mercatoria*

For parties who do not wish to have their contract governed by a national law, numerous national laws, such as the Swiss, Dutch or French, explicitly permit the subjection of an international dispute to norms other than those provided by a single national legal system<sup>168</sup>. Thus, transnational law, generally called *lex mercatoria*, can be applied to the dispute. This becomes clear through the use of the term “*règles du droit*”. The French doctrine consistently interprets article 1496 NCPC in this way and the jurisprudence has never questioned this<sup>169</sup>. The Dutch legislator explicitly mentioned the *lex mercatoria* when explaining the

<sup>165</sup> Grigera Naón, “The UN Convention on Contracts for the International Sale of Goods”, in: Horn/Schmitthoff (ed.), *The Transnational Law of International Commercial Transactions*, Deventer (1982), 89.

<sup>166</sup> Grigera Naón, “The UN Convention on Contracts for the International Sale of Goods”, in: Horn/Schmitthoff (ed.), *The Transnational Law of International Commercial Transactions*, Deventer (1982), 91.

<sup>167</sup> Grigera Naón, *Choice-of-law problems in International Commercial Arbitration*, J.C.B. Mohr: Tübingen (1992), 28.

<sup>168</sup> Article 1496 (1) of the French Code of Civil Procedure: “*L’arbitre tranche le litige conformément aux règles de droit que les parties ont choisies; à défaut d’un tel choix, conformément à celles qu’il estime appropriées.*” (The arbitrator shall settle the dispute in accordance with the rules of law which the parties have chosen, and in the absence of such a choice, in accordance with those rules of law which he considers appropriate)

<sup>169</sup> Fouchard/Gaillard/Goldman, *Traité de l’arbitrage international*, Paris (1996), 814.

meaning of the term “*règles du droit*“, or rules of law, in the Dutch arbitration law<sup>170</sup>.

Proponents of the *lex mercatoria* have declared that national law no longer plays an important role in dispute resolution in international trade. The applicable rules are said to emanate from the parties themselves, from multinational enterprises and no longer from the national states. The rules spontaneously created by the community of international merchants have basically replaced national law in the area of international contracts and even critics admit this<sup>171</sup>. This universal acceptance is due to the fact that these rules are more complete, adapted to the needs of international business, flexible and the same throughout the world.

#### a) Goldman

As pointed out above, Goldman was one of the discoverers of the new law merchant. According to him, the international trade community had been struggling against the restrictions of national laws and trying to create an autonomous system of rules to organize international commerce for a long time. He found out that international trade was independent of national legislation, that it was largely self-governed and that the majority of international business was not regulated by national law<sup>172</sup>.

Goldman defines the theory proposed by Schmitthoff as ... *a wide conception of lex mercatoria, according to which it can be defined by the object of its constituent sources. Lex mercatoria would thus, irrespective of the origin and the nature of the sources, be the law proper to international economic relations. One would encompass not only transnational customary law, whether it is codified or not (and in the latter case revealed and clarified by arbitral awards), but also the law of an interstate, or indeed state, which relates to international trade. Thus, for example, the successive Hague (1954) and Vienna (1980) Conventions Establishing Uniform Laws for the International Sale of Goods would be part of lex mercatoria. This would also be the case with respect to*

<sup>170</sup> Berger, *Internationale Wirtschaftsschiedsgerichtsbarkeit*, 386.

<sup>171</sup> Stein, *Lex mercatoria: Realität und Theorie*, 36.

<sup>172</sup> Goldman, “*Frontières du Droit et Lex Mercatoria*”, *Le droit subjectif en question.*, *Archives de Philosophie du Droit* (1964), 181.

*national legislation whose specific and exclusive object is international trade, such as that of the German Democratic Republic.*<sup>173</sup>

He does not subscribe to this wide concept. To Goldman, the spontaneous nature of the law merchant is essential. He thus excludes rules of state or of inter-state origin. The *lex mercatoria* is composed of *ad hoc* rules which are transnational and have a customary and spontaneous nature<sup>174</sup>.

In conclusion, he gives a more succinct definition: "... a set of general principles and customary rules spontaneously referred to or elaborated in the framework of international trade, without reference to a particular national system of law."<sup>175</sup>

In *Traité de l'arbitrage international*, the following definition is proposed: *Fundamentally a doctrinal creation, the term lex mercatoria covers transnational rules (all the rules which do not emanate from a national system of law) as well as the usages of international trade (defined as the practices that are usually followed in a given trade branch).*<sup>176</sup>

Goldman defined the *lex mercatoria* as an incomplete legal system<sup>177</sup>. In his earlier works, he referred to it as an autonomous system of law that was developing outside and independent of national law. Merchants feel bound to observe the usages and customs of international trade in the same way as they feel obliged to observe national law. Due to this fact, usages and custom are another formal source of law and just as effective as national law<sup>178</sup>.

Goldman is said to have described the law merchant as supra national law with a subsidiary character, which should be applied by international arbitrators only if they are not sure which national law to apply<sup>179</sup>.

Goldman argues that amiable composition is used to achieve equitable results without limiting the arbitrator to the boundaries of a national law<sup>180</sup>. *Lex*

<sup>173</sup> Goldman, "The applicable law: general principles of law – the *lex mercatoria*", in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 113.

<sup>174</sup> Goldman, "The applicable law: general principles of law – the *lex mercatoria*", in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 14.

<sup>175</sup> Goldman, "The applicable law: general principles of law – the *lex mercatoria*", in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 116.

<sup>176</sup> Fouchard/Gaillard/Goldman, *Traité de l'arbitrage international*, Paris (1996), 818.

<sup>177</sup> Goldman, "Lex Mercatoria", *Forum Internationale*, 22.

<sup>178</sup> Goldman, "Lex Mercatoria", *Forum Internationale*, 8.

<sup>179</sup> Ehricke, "Zur Einführung: Grundstrukturen und Probleme der *lex mercatoria*", *Juristische Schulung* (1990), 967.

*mercatoria*, on the other hand, is said to be a system of law with rules that have to be observed by the arbitrator. It thus differs from amiable composition. When applying *lex mercatoria* he cannot substitute his own considerations for its binding rules, and thereby render an award that is completely arbitrary<sup>181</sup>. No party would abide by and no court would enforce an award that is not in accordance with *lex mercatoria*'s binding rules.

It is doubtful whether the international merchant community can create an autonomous system of law next to national law through the constant observance of certain customs or usages or not. In response, Goldman stated ... *that a legal order is the body of specific rules, and the organs intended to apply them (if not necessarily to promulgate them, since custom is established spontaneously – even though it may at a further stage be reinforced by codification), that emerge from the formation and the activity of a specific social group*<sup>182</sup>. The practitioners of international trade constitute such a social group. The fact that it is composed of merchants of different nationalities and trades does not exclude that quality, because the subjects of national laws are not homogenous either<sup>183</sup>.

According to Goldman, the *lex mercatoria* is composed of spontaneously created rules that exist outside national legal systems. He includes general conditions, standard form contracts, customs and usages, and general principles of law in this autonomous set of rules. Unlike Schmitthoff, he thus excludes rules that exist within national legal systems and are not exclusively designed to govern international trade matters<sup>184</sup>. On the contrary, rules comprised in national legal systems cannot be excluded from the scope of the *lex mercatoria*, because this would give too narrow a view.

## b) Schmitthoff

Following a wider conception, Schmitthoff's concept of the *lex mercatoria* is still comparable to Goldman's. In 1957, when lecturing at the University of

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<sup>180</sup> Goldman, "Lex Mercatoria", Forum Internationale, 18.

<sup>181</sup> Goldman, "Lex Mercatoria", Forum Internationale, 18.

<sup>182</sup> Goldman, "Lex Mercatoria", Forum Internationale, 21.

<sup>183</sup> Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 89.

<sup>184</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 319.

Helsinki, he stated: ... *we are beginning to rediscover the international character of commercial law and the circle completes itself. The general trend of commercial law everywhere is to move away from the restrictions of national law to a universal, international conception of the law of international trade*<sup>185</sup>. The international and universal character of the law of international trade made him realise that a new *lex mercatoria* was developing and that this area of law was not necessarily part of the national systems of trade law anymore<sup>186</sup>. *We have to face the fact that the new law merchant which is emerging before our eyes is an entirely new phenomenon. When trying to understand it, we must forget the Victorian predilection of orderliness but take it as what it was in the Middle Ages and what it will be again: unsystematic, complex and multiform, but of bewildering vigour, realism and originality.*<sup>187</sup>

As maintained by Schmitthoff, the rules governing international trade relations in all the countries are virtually identical, or at least very similar, and sufficiently detailed<sup>188</sup>. They are said to constitute a new law merchant that has a binding force upon the national courts through its incorporation into the various national laws. The practitioners of international trade are freeing themselves from the boundaries of national law and in doing so developing a trade law with a transnational character.

According to Schmitthoff, the new law merchant will be based on three fundamental elements: contracts, corporations and arbitration. These three factors are common to all national laws and are more or less similarly constructed. The contract is based on the parties' autonomy and the *pacta sunt servanda* principle. Corporations are based on the idea that there is a group of people that is authorised to act as an individual, has rights and can be taken to court (*Rechtssubjekt mit eigener Vermögensfähigkeit*). Arbitration is always based on the parties' valid agreement to have their dispute governed by a non-national

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<sup>185</sup> Cited in: Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), p. 13, footnote 27.

<sup>186</sup> Schmitthoff, "Das neue Recht des Welthandels", 28 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* (1964), 47.

<sup>187</sup> Schmitthoff, "The Unification of the Law of International Trade", *J.Bus.L.* (1968), 112.

<sup>188</sup> Schmitthoff, *Unification of the Law of International Trade* 6-8 (1964). Cited in Berman/Kaufman, "The Law of International Commercial Transactions (*Lex Mercatoria*)", 19 *Harv.Int'l.L.J.* (1978), 273, footnote 197.

court, that they will abide by the award and that the arbitrators observe the natural justice rules and do not exceed their power<sup>189</sup>.

Unlike Goldman, who concentrated his theory on the development of a-national rules, Schmitthoff focuses on the importance of international conventions and the self-regulation of the markets as the main promoters of the *lex mercatoria*. They are part of the national legal systems but have been created at an international level. *Lex mercatoria* is developing through acceptance by states, their legislative texts and the general aim of harmonizing International Trade Law<sup>190</sup>. International Private Law, according to Schmitthoff, is not only composed of rules indicating the applicable national law in cases with a foreign element, but also of the rules directly applicable to these problems<sup>191</sup>.

There seems to be a contradiction in Schmitthoff's concept. If a rule is common to all the national laws why should that make it part of *lex mercatoria*? How can the practitioners of international trade be freeing themselves from the boundaries of national law if the new law merchant is composed of national law rules created by the legislator and not by the merchant community? The different national trade laws are remarkably similar. This is partly due to the attempts by the national legislators to encourage commerce. To achieve this aim, usages common to the merchant community are incorporated into the national trade law or taken into account. Through the similarities between the national laws and the universality of the new law merchant's general principles, a greater degree of uniformity of International Trade Law can be achieved.

### c) Berman/Kaufman

*Even apart from international conventions (which may or may not be ratified by most states), the law governing international commercial transactions - the law merchant - is essentially an international body of law, founded on the commercial understandings and contract practices of an international community*

<sup>189</sup> Schmitthoff, "Das neue Recht des Welthandels", 28 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* (1964), 72.

<sup>190</sup> Schmitthoff, "Das neue Recht des Welthandels", 28 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* (1964), 61.

<sup>191</sup> Schmitthoff, "Das neue Recht des Welthandels", 28 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* (1964), 76.

*composed principally of mercantile, shipping, insurance, and banking enterprises of all countries*<sup>192</sup>. This body of law has developed through practices and principles common to the merchant community. Merchants expect certain usages and principles to be understood and to be part of the contract. The international merchant community has different needs than national traders and has developed its own set of rules appropriate to these needs.

According to Berman and Kaufman, the *lex mercatoria* constitutes an autonomous body of law that has a binding force upon national courts. For them, in order to be binding, international commercial rules need not be expressly incorporated into national laws, for ... *virtually every national legal system permits the application of the rules of the international law merchant, at least to the extent that it is adopted, expressly or by implication, by contract. The thesis presented in this article is that the commercial understandings reflected in contract practices in international trade constitute a lex mercatoria by which the parties to international commercial contracts consider themselves to be bound and which are in fact enforced in national courts and arbitral tribunals. Indeed, they are, from a historical and sociological point of view, the principal source of national and international commercial legislation.*<sup>193</sup>

#### **d) Cremades/Plehn**

There is a common movement towards the unification or harmonization of the law of international trade in order to encourage trading activities. The national approach towards the harmonization of International Trade Law, consisting of treaties, model laws and the independent examination of international business practices, does not prove as effective as commercial self-regulation. The rules embodied in treaties and model laws may not be widely ratified and incorporated

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<sup>192</sup> Berman/Kaufman, "The Law of International Commercial Transactions (Lex Mercatoria)", 19 Harv. Int'l. L. J. (1978), 272.

<sup>193</sup> Berman/Kaufman, "The Law of International Commercial Transactions (Lex Mercatoria)", 19 Harv. Int'l. L. J. (1978), 273 Fn 197.

in the national laws the same way in all the states and cannot adapt to changing circumstances, as they lack flexibility<sup>194</sup>.

The new law merchant is described as a non-national approach to the harmonization of International Trade Law, providing a greater degree of uniformity and flexibility: “The non-national New Lex Mercatoria would be a single autonomous body of law created by the international business community”<sup>195</sup>. Following the non-national approach, states must, in a first step, permit the merchants’ self-regulation and the application of non-national law and, in a second step, the *lex mercatoria* must be established as a coherent set of rules, as an alternative to national laws<sup>196</sup>.

In their concept of the *lex mercatoria* Cremades and Plehn focus on the international merchants’ self-regulation of their own affairs. In order to encourage the growth of international trading activities, national laws have a liberal point of view: “National paternalism embodied in the mandatory application of national laws to international commerce transacted within national boundaries would be limited.”<sup>197</sup> The impact of national law on international trade activities would be limited to safeguard fundamental principles of public policy.

The advantages of the non-national approach are obvious. An increased degree of harmonization is achieved through the significant role of customs and usages of international trade and general principles of law. The disputes arising out of international trade relations would be resolved by arbitration: *A non-national New Lex Mercatoria would be encouraged if businessmen submitted their disputes to arbitration to be decided on the basis of the prevailing standards of the international business community and not national law. These standards would reflect customs as well as general principles of law.*<sup>198</sup>

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<sup>194</sup> Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 322.

<sup>195</sup> Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 317.

<sup>196</sup> Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 324.

<sup>197</sup> Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 323.

<sup>198</sup> Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 324.

However, one great disadvantage of the non-national approach becomes apparent when the parties are dealing with matters concerning public policy. Whenever the contractual stipulation or a rule of the law merchant does not correspond with a given nation's public policy, its courts will refuse to enforce that rule or an award based on it. No national court would ever enforce an award that is contrary to its public policy<sup>199</sup>. Arbitration and the application of non-national rules are dependent on the national laws' tolerance.

Obviously, the national approach does not contradict public policy. Cremades and Plehn do not conceal the *lex mercatoria's* dependence on the national legislators. They describe it as being "... autonomous from, rather than independent of, national control."<sup>200</sup> Because of that interdependence, the non-national approach has to be complemented with the help of the methods of the national approach, which means complemented by international treaties, model laws and national legislation. "The two approaches are best seen as complementary rather than mutually exclusive."<sup>201</sup>



#### e) Goode

According to Goode, only general principles and uncodified usages are part of *lex mercatoria*: ... *the phrase lex mercatoria is used to indicate that part of transnational commercial law which is unwritten and consists of customary commercial law, customary rules of evidence and procedure and general principles of commercial law, including international public policy*<sup>202</sup>.

Goode does not equate transnational law with *lex mercatoria*. Transnational law is defined as the law that governs ... *actions or events that transcend national frontiers, including public and private international law and other rules not fitting wholly into such standard categories. But in relation to*

<sup>199</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 Boston Univ. Int'l. L. J. (1984), 327.

<sup>200</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 Boston Univ. Int'l. L. J. (1984), 324.

<sup>201</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 Boston Univ. Int'l. L. J. (1984), 327.

<sup>202</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 5.

*commercial law, at any rate, this description is too broad, for it includes national law of international and national conflict of laws rules. By contrast, 'transnational commercial law' is conceived as law which is not particular to or the product of any one legal system but represents a convergence of rules drawn from several legal systems or even, in the view of its more expansive exponents, a collection of rules which are entirely a-national and have their force by virtue of international usage and its observance by the merchant community. In other words, it is the rules, not merely the actions or events, that cross national boundaries.*<sup>203</sup>

Thus transnational law comprises conventions and all the principles and rules that are common to a number of national laws, regardless of their source, be it customary, conventional, contractual or any other<sup>204</sup>. *Lex mercatoria*, on the other hand, is the law fashioned by the merchants; it is uncodified, non-statutory and non-conventional. Allegedly, the rules of international conventions cannot be part of the law merchant, as they are embodied in the national laws by the will of nations and not by the practitioners of international trade<sup>205</sup>. The same applies to unwritten usages that are codified in a standard set of rules. These usages are thereby incorporated into a national law and cease to be part of the law merchant. He sees this assumption justified by the fact that conventions, standard sets of rules and the like do not simply reproduce usages, but also attempt to change them.

This concept is too narrow. How can a rule, by the mere fact of its incorporation into a convention, cease to be common usage and practice between merchants if they still act according to it? Many of the *lex mercatoria's* principles are comprised in national trade laws. This fact does not exclude them from the scope of the law merchant. If a trade usage has been incorporated into national law it does not automatically cease to be a trade usage and change its status.

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<sup>203</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 4.

<sup>204</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 5.

<sup>205</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 4.

Rather, this confirms that rule's status as a commonly accepted principle of international trade.

Contrary to Goode's point of view, it cannot be observed that through the incorporation of a certain rule into national law it ceases to be part of *lex mercatoria*. There is no exclusiveness that would contradict the fact that one of *lex mercatoria*'s principles can also be found in national laws or international conventions. Rules and principles comprised in national law can still be part of *lex mercatoria*: ... *certainly the principles proclaimed can be found in national laws; some of them are even part of international conventions, like the Vienna Convention on the International Sale of Goods. But proclaimed and applied by arbitrators they are distorted in two ways or reflect their originality in two ways: first, they are being applied all over the world to international trade affairs. Second, they are transformed, simplified and detached from national law and thereby transnationalised through their application by the arbitrators even if they have their origins or equivalents in national law.*<sup>206</sup>



#### f) Lando

Lando proposes the following definition: *The parties to an international contract sometimes agree not to have their dispute governed by national law. Instead they submit it to the customs and usages of international trade, to the rules of law which are common to all or most of the States engaged in international trade or to those States which are connected with the dispute. Where such common rules are not ascertainable, the arbitrator applies the rule or chooses the solution which appears to him to be the most appropriate and equitable. In doing so he considers the laws of several legal systems. This judicial process, which is partly an application of legal rules and partly a selective and creative process, is here called application of the lex mercatoria.*<sup>207</sup>

<sup>206</sup> Kahn, "Vers une institutionnalisation de la lex mercatoria", Liber Amicorum Commission Droit et Vie des Affaires, Bruxelles, Bruylant, (1998), 125, cited in: Loquin, "Où en est la *Lex Mercatoria*", in: Souveraineté étatique et marchés internationaux à la fin du 20<sup>ème</sup> siècle. Mélanges en l'honneur de Philippe Kahn, (2000), 36.

<sup>207</sup> Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 747.

For him, *lex mercatoria* is combined with national law in international arbitration. The mandatory rules of the national law are applied to the contract and the directory rules, i.e. those from which the parties may derogate by agreement, are used to fill the *lex mercatoria*'s gaps<sup>208</sup>. As sources he identified Public International Law, uniform laws, the general principles of law, the rules of international organisations, customs and usages, standard form contracts and the reporting of arbitral awards.

Arbitrators are reputedly applying *lex mercatoria* more and more to resolve disputes in international trade<sup>209</sup>. The main advantages of this a-national legal order are its independence of national laws, its flexibility, adjustment and conformity to the needs of international commerce. When applying the *lex mercatoria*, arbitrators act as inventors, as they are free to select what they think to be the most appropriate and equitable solution to the dispute<sup>210</sup>.

In a more recent publication, Lando describes *lex mercatoria* as follows: *The arbitrators are often in search of general principles of law. When the relevant legal systems lead to conflicting solutions, many arbitrators, instead of applying the law of one of the systems, will look for rules which express general principles of law, rules which may become commonly accepted for international contracts. Several writers – some of them arbitrators – have encouraged arbitrators to develop such a lex mercatoria and arbitrators often feel the need for it.*<sup>211</sup> This time its sources are “...the rules of international conventions and uniform laws, of some international usages and customs, and of the common core of the legal systems. Another important element is the awards made by the application of the *lex mercatoria*.”<sup>212</sup>

In this article he gives a more sceptical picture of the law merchant, as he describes it as a fairly meagre body of law in need of further contributions. Also,

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<sup>208</sup> Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 ICLQ (1985), 748.

<sup>209</sup> Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 ICLQ (1985), 747.

<sup>210</sup> Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 ICLQ (1985), 753.

<sup>211</sup> Lando, “Principles of European Contract Law: An Alternative to or a Precursor of European Legislation?”, 40 Am. J. Comp. L. (1992), 578.

<sup>212</sup> Lando, “Principles of European Contract Law: An Alternative to or a Precursor of European Legislation?”, 40 Am. J. Comp. L. (1992), 578.

the sources are said to be not very valuable, since "... the common core of the European legal systems is often difficult to ascertain because the information available is scant or cumbersome to obtain, and the awards are very often not published."<sup>213</sup>

### **g) Craig/Park/Paulsson**

In their book "International Chamber of Commerce Arbitration", Craig, Park and Paulsson present three different concepts, for which the term *lex mercatoria* is said to be used. According to them, the different theories can be grouped in three categories, to the third of which they subscribe. The two others are said to be "... ideals rather than current realities."<sup>214</sup>

There is a first, very ambitious concept that sees *lex mercatoria* as "... an autonomous legal order, created spontaneously by parties involved in international economic relations and existing independently of national orders."<sup>215</sup> The rules of this autonomous legal order govern international commerce and are independent of any national law. The authors point out the weak points in this theory. It is unclear where the normative power is derived from<sup>216</sup>. No obligatory international commercial court exists. Is this autonomous order automatically applied or only if the parties have explicitly referred to it? When applying *lex mercatoria*, does the arbitrator have to create new rules and thereby add to it or base his decision on precedents or existing law? They also purport that it is not clear whether an autonomous legal order, which the parties have to take into consideration and know, facilitates international trade. Finally, its present incompleteness is said to make it unfit to resolve all aspects of an international trade dispute<sup>217</sup>.

In a second concept, "... *lex mercatoria* has been viewed as a body of rules sufficient to decide a dispute, operating as an alternative to an otherwise applicable national law."<sup>218</sup> According to the authors, hundreds of arbitral awards

<sup>213</sup> Lando, "Principles of European Contract Law: An Alternative to or a Precursor of European Legislation?", 40 Am. J. Comp. L. (1992), 578.

<sup>214</sup> Craig, Park, Paulsson, "ICC Arbitration", New York (2000), 626.

<sup>215</sup> Craig, Park, Paulsson, "ICC Arbitration", New York (2000), 623.

<sup>216</sup> Craig, Park, Paulsson, "ICC Arbitration", New York (2000), 629.

<sup>217</sup> Craig, Park, Paulsson, "ICC Arbitration", New York (2000), 629.

<sup>218</sup> Craig, Park, Paulsson, "ICC Arbitration", New York (2000), 623.

have been published and play an important role as precedents. Yet *lex mercatoria* is said not to be sufficient to decide a conflict. Arbitrators cannot derive general principles of law from national laws, since these are too complex and one cannot intimately know many different legal systems. Awards that are to serve as precedents would have to be rendered by experienced arbitrators with a profound knowledge of comparative law. There is said to be a shortage of them. Furthermore, *lex mercatoria* could be used as an excuse to solve the dispute according to the arbitrator's personal preferences. The parties' intentions and expectations could thus be disregarded<sup>219</sup>.

According to a third – and to Craig, Park and Paulsson significant – concept of *lex mercatoria*, “... it may be considered as a complement to otherwise applicable law, viewed as nothing more than the gradual consolidation of usage and settled expectations in international trade.”<sup>220</sup> *Lex mercatoria* is thus viewed as international trade usage and it ... *may cover the notion of international trade usages sufficiently established to warrant that parties to international contracts – whether generally or by category of contracts – be considered bound by them. This is the concept that the present authors deem to be practically significant today.*<sup>221</sup> *Lex mercatoria* covers usages that are due to the internationality of the contract or the business relationship. Arbitral awards are seen as precedents that contribute to the law merchant insofar as they reflect and confirm usages of international trade. *Lex mercatoria* supposedly consists of some unclear and some obvious principles. This limited concept follows from the assumption that harmony in International Trade Law can only be achieved with regard to these few basic rules<sup>222</sup>.

#### **h) Lew**

According to Lew, ... *there certainly has developed a body of rules, practices and customs which convenience has recognized as having a special character in international trade. Whether or not one accepts and acknowledges*

<sup>219</sup> Craig, Park, Paulsson, „ICC Arbitration“, New York (2000), 632.

<sup>220</sup> Craig, Park, Paulsson, „ICC Arbitration“, New York (2000), 623.

<sup>221</sup> Craig, Park, Paulsson, „ICC Arbitration“, New York (2000), 633.

<sup>222</sup> Craig, Park, Paulsson, „ICC Arbitration“, New York (2000), 640.

*the lex mercatoria as a viable and effective system of law, the existence of these rules cannot be denied. The controversy is in fact only concerned with the actual character of these rules and customs.*<sup>223</sup>

As put forward by Lew, contracts can be governed by an a-national legal standard. A body of rules is said to have developed “... due to the expediency or directly through the efforts of various public and private international commercial organisations.”<sup>224</sup> In addition to this, business terms and practices have the same meaning throughout the world, regardless of the political or economic differences. When negotiating, international traders have in mind these customs, practices and rules, not their or the other party’s national law.

By stating this, Lew alleges the universality of trade customs and business terms throughout the whole world. This is doubtful, as the differences from one country to the next and from trade to trade can be huge. The same applies to business terms. Different abbreviations might be in use and confuse an international trader. Because of the different languages there are many different business terms and some might not even have an equivalent term when being translated into another language.



### **3. Conclusion**

To conclude, *lex mercatoria* can be seen as an effective system of law. There can be no doubt about its existence and practicability, as will be shown throughout the whole thesis. Concerning its sources and elements, a wide conception is proposed, which includes customs and usages, public international law, international conventions, general principles of law, codes of conduct, standard form contracts, the reporting of arbitral awards, the public policy of the countries that are likely to be concerned by the award and the compilations of the *lex mercatoria*’s published by comparative lawyers<sup>225</sup>.

Nevertheless, minor gaps do exist when it comes to questions that are hardly ever pertinent to international trade disputes, such as questions of consent,

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<sup>223</sup> Lew, “Applicable Law in International Commercial Arbitration”, New York (1978), 437.

<sup>224</sup> Lew, “Applicable Law in International Commercial Arbitration”, New York (1978), 116.

<sup>225</sup> See infra, Chapter 4, A.

fraud, incapacity to conclude a contract, and majority. However, *lex mercatoria* can still be regarded as a viable system of law for dispute resolution in international trade, as an arbitrator can still seek guidance in national laws in the rare cases in which one of these questions are concerned<sup>226</sup>.



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See *infra*, Chapter 5, C, 3.

## Chapter 4

### Sources and Scope of the *lex mercatoria*

#### A. Sources of the *lex mercatoria*

There is no clear consensus on the sources of the *lex mercatoria*. In this chapter the different starting points, the origins and places from which the *lex mercatoria* is obtained will be presented. It is true that the sources are of very different kinds: some create law, some declare law and some are evidence of law<sup>227</sup>.

There are two different approaches as to what constitutes the *lex mercatoria*. One has to differentiate between a broad and a narrow concept. The advocates of the narrow approach emphasize on the spontaneous and non-statutory character of the law merchant<sup>228</sup>. They thus exclude international conventions and uniform laws. Emphasis is put on the non-national character of the *lex mercatoria*, consequently international conventions and uniform laws cannot be part of it once they come into force and are transformed into national law. Therefore none of the rules emanating from national laws or Public International Law can be part of the *lex mercatoria*.

The broad approach, on the other hand, puts less emphasis on the customary and spontaneous character but defines *lex mercatoria* as being transnational commercial law. All the rules applicable to international trade relations are part of the *lex mercatoria*. It is said that international trade follows different rules than domestic trading activities and that the international merchant community regulates its own affairs and creates its own rules. This law is internationally uniform in order to avoid conflicts between the different national laws<sup>229</sup>. According to this broad concept, international conventions, uniform laws,

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<sup>227</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 6.

<sup>228</sup> Berman/Kaufman, "The Law of International Commercial Transactions (Lex Mercatoria)", 19 Harv. Int'l. L. J. (1978), 272.

<sup>229</sup> Stein, *Lex mercatoria: Realität und Theorie*, 184.

general principles of law, codes of conduct, customs and usages, standard form contracts and rules of international organisations are part of the *lex mercatoria*.

Critics argue that through the incorporation of some of these sources of the *lex mercatoria* by states these have ceased to be part of it and have to be regarded as national law<sup>230</sup>. Through the incorporation by the national legislator or judge former rules of the *lex mercatoria* are said to be transformed into national law. As it has been pointed out above, this theory is not convincing<sup>231</sup>. How can one rule of a certain system of law cease to be part of it and be transformed into a rule of a given national law through the mere act of its incorporation into the latter? The fact that a rule is part of the *lex mercatoria* does not exclude the possibility of that rule or principle being incorporated into some national law. Besides, most of the *lex mercatoria*'s general principles are embedded in most national laws, for they reflect considerations of fair trade and dealing and rules crucial to the smooth functioning of business under any condition or legislation.

Schmitthoff identifies two different categories of sources: products of international legislation and usages of international trade<sup>232</sup>. Products of international legislation are either international conventions or model laws that are more or less uniform in all the adhering states through their incorporation into national law. The difference between the two is said to be that the former rules are applied *ipso iure* and the latter have to be incorporated into the contract by the parties.

Lew identifies three different sources of the *lex mercatoria*: the substantive rules of international trade, the codes of practice for international trade and the customs and usages of international trade<sup>233</sup>. The third source comprises customs and usages in general as well as those specific to particular trades. To Lew, the contract types, standard clauses, uniform rules and general definitions proposed by public or private organisations are part of the second source.

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<sup>230</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 4.

<sup>231</sup> See *supra*, Chapter 3, C, 2, e).

<sup>232</sup> Schmitthoff, "Das neue Recht des Welthandels", 28 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* (1964), 61.

<sup>233</sup> Lew, "Applicable Law in International Commercial Arbitration", New York (1978), 442.

Lando named seven sources of the *lex mercatoria*<sup>234</sup>. This list of elements has become widely accepted and cited<sup>235</sup>. Mustill, who is hostile to the broad concept of *lex mercatoria* and sceptical about its ability to govern international business relations, follows Lando on this point, but adds the “public policy of the country in which the enforcement of the award is likely to be requested” to the list<sup>236</sup>. According to Fouchard, the *lex mercatoria* is composed of codes of conduct and rules of professional organisations, customs and usages, general conditions and standard form contracts, arbitral case law, conventions on arbitration and arbitration rules and general principles of law.<sup>237</sup> As noted above, according to Goode there are only two elements of the *lex mercatoria*, general principles and usages, as all the others do not represent rules fashioned by merchants but ones incorporated into national law<sup>238</sup>.

The different elements of the *lex mercatoria* will be critically analysed to find out whether or not they can be regarded as formal sources of law.

## 1. Public International Law



The first element identified by Lando is the Public International Law. Public International Law is the law of the political system of nation-states. “It is a distinct and self-contained system of law, independent of the national systems with which it interacts, and dealing with relations which they do not effectively govern.”<sup>239</sup> This has been criticised because Public International Law governs the

<sup>234</sup> Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 ICLQ (1985), 749.

<sup>235</sup> Draetta, Lake, Nanda, *Breach and Adaptation of International Contracts*, Butterworth (1992), 13; Mustill, “The New *Lex Mercatoria*: The First Twenty-five Years”, 4 *Arbitration International* (1988), 109.

<sup>236</sup> Mustill, “The New *Lex Mercatoria*: The First Twenty-five Years”, 4 *Arbitration International* (1988), 109.

<sup>237</sup> Fouchard, *L’Arbitrage Commercial International*, 46: *C’est à partir de contrats-types, établis d’abord par des firmes unilatéralement, puis par des accords entre firmes, par des corporations nationales, par des accords inter-corporatifs, par des corporations internationales, à partir de la rédaction d’usages opérés par les mêmes accords ou les mêmes corporations que se forme progressivement cette coutume internationale: les observations qui ont pu être faites au sujet d’un droit commercial substantiel de la ‘société internationale des vendeurs et des acheteurs’ pourront être transposées en matière d’arbitrage commercial international.*

<sup>238</sup> Goode, “Usage and its Reception in Transnational Commercial Law”, in: Ziegel (ed.), “New Developments in International Commercial and Consumer Law”, Oxford (1998), 4.

<sup>239</sup> <http://library.law.columbia.edu/pubint/background.shtml>

relations between states and not between private parties. It has also been said that it does not necessarily reflect an understanding of the needs of international trade and the merchant community<sup>240</sup>.

However, in trade relations involving a state or a state entity and a private party, the application of Public International Law can serve as a security mechanism, for the state should not have the opportunity of referring to his own law<sup>241</sup>. To this must be added that there is no question of applying Public International Law as such but only the common general principles of law and customary clauses that constitute elements of the *lex mercatoria*<sup>242</sup>.

The national states are also part of the commercial world. They engage in trading activities in the same way private merchants do. A commercial Public International Law evolved through the trading activities between states<sup>243</sup>. However, in cases where the state's trading partner is not another state but a private merchant the state is treated like a private person as well. Thus the state cannot refuse to include a valid arbitration clause in a contract on the grounds that this would impinge on its sovereignty. Rules of Public International Law have inspired the general principles of trade law, insofar as they illustrate the general acceptance of a rule.

Pellet claims that the *lex mercatoria* and Public International Law have many main characteristics in common<sup>244</sup>. Both are delocalized and have a decentralized system of creating norms and rules. Both are applied to certain legal situations and not to geographically determined ones. Secondly, just like Public International Law, the law merchant is created by the subjects themselves and not forced upon them. Their expressed will plays an important role in the making of it. In the case of non-compliance with an arbitral award based on *lex mercatoria*, there is no perfect mechanism that forces the recalcitrant party to abide by it. The same problem exists in Public International Law as the States have the "...

<sup>240</sup> Draetta, Lake, Nanda, *Breach and Adaptation of International Contracts*, Butterworth (1992), 13; Stoecker, "The Lex Mercatoria: To what extent does it really exist?", 120.

<sup>241</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 106.

<sup>242</sup> Draetta, Lake, Nanda, *Breach and Adaptation of International Contracts*, Butterworth (1992), 14.

<sup>243</sup> Gal, "The Commercial Law of Nations and the Law of International Trade", 6 *Cornell Int'l. L. J.* (1973), 55.

<sup>244</sup> Pellet, "La Lex Mercatoria, tiers ordre juridique? Remarques ingénues d'un internationaliste de droit public", 59.

*monopole de la contrainte repressive dans le monde contemporain.*”<sup>245</sup> Finally, the general principles of law recognized by the civilized nations are a source of Public International Law and of the law merchant. Also, contracts are said to be essential to the development of the *lex mercatoria*: “... *Ici encore l’analogie avec le droit international public est frappante: les contrats sont, à l’ordre mercatique, ce que les traités sont au droit international; et, à leur tour, les contrats contribuent à la formation des usages, comme les traités à celle de la coutume.*”<sup>246</sup>

To resolve disputes between a state and a private party, arbitrators refer to Public International Law, especially in cases where compensation is claimed for expropriations<sup>247</sup>. Thus, Article 42 of the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States allows the arbitrator to apply rules of Public International Law in the absence of a choice of law by the parties<sup>248</sup>.

In addition, the 1969 Vienna Convention on the Law of Treaties codified usages of international trade and international public law. Since a major part of the Convention consists of codified customary law of treaties, its rules are applicable to contracts involving states that have not ratified the (whole) Convention. Although Article 1 states that the Convention applies to treaties between states, several of its rules can be applied to settle disputes between states and private parties<sup>249</sup>. Some very important principles included in the Vienna Convention that show how much it is influenced by the usages of the international

<sup>245</sup> Pellet, “La Lex Mercatoria, tiers ordre juridique? Remarques ingénues d’un internationaliste de droit public”, 59.

<sup>246</sup> Pellet, “La Lex Mercatoria, tiers ordre juridique? Remarques ingénues d’un internationaliste de droit public”, 62.

<sup>247</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 104; Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 749.

<sup>248</sup> Art. 42 (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.

<sup>249</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 104; Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 749; Weise, *Lex Mercatoria*, 117.

trade are the following: *pacta sunt servanda*<sup>250</sup>, *bona fides*<sup>251</sup>, *clausula rebus sic stantibus*<sup>252</sup>.

Mustill admits that parties can choose Public International Law as the law governing their business relationships and that this occasionally happens where one of the parties is a state or a state enterprise<sup>253</sup>. However, he does not derive from the application of Public International Law in these instances the fact that it is part of the *lex mercatoria*<sup>254</sup>. But as Public International Law is influencing international business relations and dispute resolution because of the conventions mentioned above, it is surely a source of the *lex mercatoria*. In addition to that, Article 38 of the International Court of Justice Statute explicitly allows the application of Public International Law.

## 2. Conventions

Conventions are important sources of the *lex mercatoria*. The conventions drawn up by the *Institut pour l'Unification du Droit* (UNIDROIT), such as the Convention relating to a Uniform Law on the International Sale of Goods (The Hague, 1964), the United Nations Commission on International Trade Law (UNCITRAL) and the United Nations Convention on Contracts for the International Sale of Goods (CISG, Vienna 1980) are well known.

There is an important difference between model laws and international conventions. The conventions are ratified by the states and become legally binding, thereby producing a greater degree of uniformity. “Model laws, for their

<sup>250</sup> Article 26 (*pacta sunt servanda*): Every treaty in force is binding upon the parties to it and must be performed by them in good faith.

<sup>251</sup> Article 31 (1) (general rule of interpretation): A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

<sup>252</sup> Article 62 (1) (Fundamental change of circumstances): A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless: (a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and (b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty.

<sup>253</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 109.

<sup>254</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 110.

part, serve merely as guidelines for national legislation and lead only to 'harmonized', not uniform, law."<sup>255</sup>

The question has been raised as to whether or not these conventions can be regarded as a formal source of the *lex mercatoria*<sup>256</sup>. The operators in international trade, the merchants, are not subjects of Public International Law and because of that the conventions do not bind their addressees. If a uniform law has been adopted by a state, the rules that this state explicitly consented to will become part of the national law of that country<sup>257</sup>. Therefore the international uniform laws themselves are a part of the *lex mercatoria* only insofar as they reflect international trade usages common to all the states that adhered to the uniform law.

The relation between international conventions and trade usages can be of different kinds. Conventions can be evidence of a usage, displace or alter the usage, or even create a new usage<sup>258</sup>. It has been suggested that written texts, such as trade conventions, can never reflect usages because these are flexible and uncertain by their very nature. Whenever a convention is drafted, the authors want not only to reproduce usages, but to find the best solution available or principles common to all the existing laws<sup>259</sup>. Conventions can indicate a change concerning an existing practice or usage, or even modify it. On the other hand, constant usage can override a convention<sup>260</sup>. Therefore, it is unclear whether conventions can be regarded as a formal source of the *lex mercatoria*.

There are numerous disadvantages to conventions as a way to govern international trade. The fast-changing circumstances and conditions under which international trade is conducted, implies that conventions regulating it could be

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<sup>255</sup> Blaurock, "The Law of Transnational Commerce", in: Ferrari (ed.), *The Unification of International Commercial Law*, (1998), 15.

<sup>256</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 205.

<sup>257</sup> Lew, "Applicable Law in International Commercial Arbitration", New York (1978), 350.

<sup>258</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 20.

<sup>259</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 21.

<sup>260</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 26.

out of date even before they have come into force. Also, it is unclear whether conventions can contribute to a greater uniformity of International Trade Law and harmony between the national laws. States tend to adopt conventions only partially and with certain exceptions. Griggs listed six reasons that could explain the low level of support for conventions<sup>261</sup>. First, the ratification of a convention obliges the ratifying state to incorporate the convention into its national law. There might not be enough time to take the necessary steps, as international conventions are often considered to be of minor political importance. Second, the national legislator might be reluctant to incorporate a convention into its national law, as either the existing regime could be considered adequate or due to a general inertia. Third, it has been observed that the longer and the more detailed a convention is, the less it will be supported and successful. “Fourth, any convention that requires a government to incur onetime or continuing expenditures is likely to receive only limited support.”<sup>262</sup> Fifth, there could be a trend away from mandatory attempts to unify trade law, such as through the ratification of conventions, back to the freedom of contract principle, according to which the parties themselves can determine the applicable rules. Sixth, the long period of time between the adoption and the entry into force of a convention is said to constitute a problem. The slow international legislation process creates frustration and, sometimes, more than ten years elapse between the preparatory work of the convention and it coming into force. This shows why solutions other than conventions are often adopted<sup>263</sup>.

Nevertheless, they certainly have an influence on transnational trade law. National courts of adhering states are obliged to apply the convention’s rules, as well as an arbitrator who wants to render a decision in accordance with that particular law<sup>264</sup>. Even in cases where conventions are not applicable, they are of great importance to the arbitrator, for they contribute to the codification of general

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<sup>261</sup> Griggs, “Uniformity of Maritime Law – An International Perspective”, 73 Tul. L. R. (1999), 1568.

<sup>262</sup> Griggs, “Uniformity of Maritime Law – An International Perspective”, 73 Tul. L. R. (1999), 1568.

<sup>263</sup> Griggs, “Uniformity of Maritime Law – An International Perspective”, 73 Tul. L. R. (1999), 1569.

<sup>264</sup> Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 749; Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 Arbitration International (1988), 110.

principles of trade law and to international harmonization. Their influence in these cases is therefore not direct, but the arbitrators refer to the codified rules and general principles of trade law that they base their decision on to show that an a-national standard would have led to the same result. The uniform laws, which are neutral and in conformity with the practices of the international merchant community, guide the arbitrators<sup>265</sup>.

### 3. The General Principles of Law

In Article 38, the Statute of the International Court of Justice makes reference to the general principles of law:

1. The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

...

c. the general principles of law recognized by civilized nations; ....



According to a majority view, the principles mentioned in this article are the principles of law of national states and not the principles of international law<sup>266</sup>. General principles are those that are common to the laws of the commercial nations<sup>267</sup>. By comparing the different national laws, principles and rules common to all of them will be found. Among these principles are *pacta sunt servanda*, *clausula rebus sic stantibus* and *bona fides*<sup>268</sup>. Critics have argued that the general principles of law are too incomplete to fill gaps and that they are derived from national law and therefore cannot constitute part of an a-national legal system. It has also been said that international trade has its own general

<sup>265</sup> Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 749; Lew, “Applicable Law in International Commercial Arbitration”, New York (1978), 351; Weise, Lex Mercatoria, 122.

<sup>266</sup> De Ly, International Business Law and Lex Mercatoria, (1992), 199.

<sup>267</sup> Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 749.

<sup>268</sup> Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 750; Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 Arbitration International (1988), 111; Weise, Lex Mercatoria, 123.

principles of law. These should be distinguished from the principles found in national laws with the help of comparative law<sup>269</sup>.

One might feel reluctant to include the general principles of law in the list of elements and sources of the *lex mercatoria*, for they have not been formed by the merchant community but by national legislators and should be applied by virtue of the applicable national law. The fact that these rules have been codified by national legislators cannot, however, automatically exclude them from the scope of the law merchant. What a reasonable merchant feels inclined to do in a given situation is also inspired by national laws and not exclusively by trade usages. There is a great interdependence between the general principals of law, trade usages and the national laws. Naturally, the national legislator takes the practice and usages into consideration before making a law concerning matters of international trade. The manifestation of general principles of law in national laws only shows their universality.

In addition, the national laws are not complete either. In order to fill the gaps, arbitrators, national judges and practitioners often have recourse to the general principles of law. It has been argued that "... general principles of law are not formal sources of law but constitute guiding principles within the legal system which may provide a basis for deduction of legal rules"<sup>270</sup>.

Although there is no accepted definition of the term "general principles of law", many national laws make reference to them.

Thus, the Civil Code of Quebec, Preliminary Provision, Clause One:

The Civil Code of Quebec, in harmony with the Charter of human rights and freedoms and the general principles of law, governs persons, relations between persons, and property.

Another example is Article 7 of the UN Sales Convention. This article reads as follows:

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<sup>269</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 279.

<sup>270</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 194.

(1) In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.

(2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of private international law.

Also, the Swiss Civil Code Article 4:

*Pouvoir d'appréciation du juge: Le juge applique les règles du droit et de l'équité, lorsque la loi réserve son pouvoir d'appréciation ou qu'elle le charge de prononcer en tenant compte soit des circonstances, soit des justes motifs.*

The law of the European Union can also be added to the preceding examples. Article 288 of the Treaty establishing the European Union declares:



The contractual liability of the Community shall be governed by the law applicable to the contract in question.

In the case of non-contractual liability, the Community shall, in accordance with the general principles common to the laws of the Member States, make good any damage caused by its institutions or by its servants in the performance of their duties.

The texts cited above illustrate that national legislators, as well as advocates of the *lex mercatoria*, are well aware of the fact that their laws can never be complete. One has to include a reference to the general principals of law in order to fill gaps that inevitably exist as the problems that are not resolved by the national laws nevertheless need to be decided. Therefore judges and arbitrators seek inspiration and guidance in the general principles of law.

Finally, ICC Award No. 3327 shows that the arbitrators who rendered it also consider the general principles of law to be part of *lex mercatoria*: “*Le Tribunal arbitral estime qu'en vertu des principes généraux du droit faisant*

*partie de la lex mercatoria ...*<sup>271</sup>. On the other hand, to be a general principle of law, a rule does not necessarily have to be common to all the systems of law. Otherwise, small nations would dispose of a sort of veto by refusing to introduce a certain rule in their national laws. It is sufficient that there is a generally accepted tendency about this rule as a general principle of law<sup>272</sup>. *A principle of law is a general one if it is being applied by the most representative systems of municipal law. That universality of application is not a prerequisite of a general principle of law emphasized by most authors. It should be equally clear that a single system of municipal law cannot provide a general principle within the meaning of Article 38. What is usually required is that the principle pervades the municipal law of nations in general.*<sup>273</sup> In any case, general principles of law constitute interpretative guidelines for arbitrators and practitioners.

#### **4. The Rules of International Organisations/Codes of Conduct**

International Organisations play a major role in international relations. Their members are governments and they have the capacity to create law within the boundaries of their competence. Many of them, such as the European Union have tribunals that render binding decisions concerning the application or interpretation of the law of that international organisation. The American Law Institute proposes a definition in Restatement of the Law (Third), the Foreign Relations of the United States:

§ 223 Subject to the international agreement creating it, an international organization has:

- (a) status as a legal person, with capacity to own, acquire, and transfer property, to make contracts, to enter into international agreements with states and other international organizations, and to pursue legal remedies; and
- (b) rights and duties created by international law or agreement.

<sup>271</sup> ICC Award No. 3327/81, *Journal du Droit International* (1982), 973.

<sup>272</sup> Fouchard/Gaillard/Goldman, *Traité de l'arbitrage international*, Paris (1996), 828.

<sup>273</sup> Mann, "Reflections on a Commercial Law of Nations", 33 *British Yearbook of Int'l Law* (1957), 39.

Due to the growth and internationalization of trade, the national laws no longer provide satisfactory solutions for problems arising from international trade relations. The international organisations created codes of conduct and resolutions concerning International Trade Law. These codes of conduct are addressed to multinational enterprises that are active in business in many countries<sup>274</sup>. An example of such a code of conduct would be the OECD Guidelines for Multinational Enterprises. It was adopted on 21 June 1976 and the last review dates back to 2000. According to the definition proposed by the OECD on its website ... *the Guidelines are recommendations addressed by governments to multinational enterprises operating in or from adhering countries. They provide voluntary principles and standards for responsible business conduct in a variety of areas including employment and industrial relations, human rights, environment, information disclosure, competition, taxation, and science and technology.*<sup>275</sup>

The adhering governments declare ... *that they jointly recommend to multinational enterprises operating in or from their territories the observance of the Guidelines, having regard to the considerations and understandings that are set out in the Preface and are an integral part of them.*<sup>276</sup>

Codes of conduct are not binding. They have been called soft law, as they only reflect the expectations of political and economical circles regarding the behaviour of global or multinational enterprises, especially for the relationship between these enterprises and the state they are operating in<sup>277</sup>. However, the rules of these private organisations can be binding upon the members of that organisation if the acceptance is a condition of membership<sup>278</sup>.

These codes of conduct have an influence on the *lex mercatoria*. According to Metaxas<sup>279</sup>, this influence reveals itself on at least three occasions:

<sup>274</sup> Sanders, "Codes of conduct and sources of law", in: *Le droit des relations économiques internationales. Etudes offertes à Berthold Goldman*, Paris (1987), 281.

<sup>275</sup> Available at: <http://www.oecd.org/daf/investment/guidelines/>

<sup>276</sup> Available at: <http://www.oecd.org/daf/investment/guidelines/>

<sup>277</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 97; Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 283.

<sup>278</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 165.

<sup>279</sup> Metaxas, *Entreprises transnationales et Codes de conduite. Cadre juridique et questions d'effectivité.*, Zurich (1988), 300.

First, the codes are supposed to establish an ideal relation between the parties in an international trade relation. Since they formulate the rules of behaviour for international trade as they ought to be, they are legally non-binding<sup>280</sup>. On the other hand, unlike national law, they may persuade multinational enterprises to obey a certain rule because of its international character and acceptance by the merchant community. An impact on the behaviour of multinational enterprises cannot be denied<sup>281</sup>.

Secondly, they can contribute to the formation of rules and usages for the merchant community and thereby play a role in the strengthening of the *lex mercatoria*. These texts do not have a binding force, but nevertheless influence the business community and arbitrators. However, the more important the organisation that has rendered the text and the more numerous the states that have adhered to it, the more the arbitrator is going to feel compelled to take the rules into account<sup>282</sup>. The code of conduct's rules become usage among merchants, and therefore part of the *lex mercatoria*, by being constantly observed and continuously practiced. Their effectiveness depends largely on a particular code's general acceptance and the merchants feeling obliged to abide by the rules<sup>283</sup>.

Thirdly, it is very likely that the adoption of the non-binding codes has an influence on other organisations and associations, especially in determining whether or not the practice of a transnational enterprise complies with the principles of international trade. Arbitrators and national judges will make reference to codes of conduct when interpreting a merchant's behaviour or an international trade contract. They can be regarded as an element of the *lex mercatoria* to the extent that the codes reflect the behaviour of a diligent and sensible merchant<sup>284</sup>. Similarly, to the extent that they reflect general principles of law, arbitrators can regard them as a formal source of law for an a-national legal order. As Sanders puts it: *In this respect Codes of conduct, not in their entirety but*

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<sup>280</sup> Sanders, "Codes of conduct and sources of law", in: *Le droit des relations économiques internationales. Etudes offertes à Berthold Goldman*, Paris (1987), 281.

<sup>281</sup> Sanders, "Codes of conduct and sources of law", in: *Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman*, Paris (1987), 281.

<sup>282</sup> Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 *ICLQ* (1985), 750; Lew, „Applicable Law in International Commercial Arbitration“, New York (1978), 350.

<sup>283</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 287.

<sup>284</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 291.

*those provisions which are more specific and contain norm-setting standards, could be a source of law. Courts as well as arbitrators may be guided by these provisions when rendering their decision.*<sup>285</sup>

## 5. Customs and Usages

Customs and usages are another source of the *lex mercatoria*, in commerce in general as well as in particular branches of commerce<sup>286</sup>. The Uniform Commercial Code gives a definition of usages in § 1-205 (2):

A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question.

Also, the UN Convention for the International Sale of Goods makes reference to usages in its Article 9 (2):



The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned.

A definition for customs is proposed in § 102 of the Restatement of the Law (Third), the Foreign Relations of the United States:

(1) A rule of international law is one that has been accepted as such by the international community of states

a) in the form of customary law

...

<sup>285</sup> Sanders, "Codes of conduct and sources of law", in: *Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman*, Paris (1987), 289.

<sup>286</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 90; Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 *ICLQ* (1985), 750; Lew, "Applicable Law in International Commercial Arbitration", New York (1978), 366.

(2) Customary international law results from a general and consistent practice of states followed by them from a common sense of legal obligation.

One must not confuse the terms customs and usages. First, customs are applied without the parties' explicit consent and choice and even without their knowledge. Usages, however, have to be referred to and chosen by the parties in order to be applicable to a specific contract<sup>287</sup>. Customs are constantly observed and merchants feel legally obliged to abide by them. Hence custom could be acknowledged as a formal source of law. Usages, however, can be chosen and referred to, and therefore altered as well, by the parties without any need to abide by them. They do not constitute a formal source of law but are devices that are used to form and interpret contracts<sup>288</sup>.

Fouchard chooses a different approach. For him, parties have to prove the existence of a usage, unlike customs as rules of law, before a national court. Arbitrators should know all the usages. As a consequence, there is no fundamental difference between usage and custom before an arbitral tribunal: *Mais, dans l'arbitrage commercial international, l'application d'office par les arbitres des usages ou coutumes commerciales est le principe. En effet, aucune distinction ne saurait, ici, être faite entre les usages, auxquels on ne reconnaît qu'une nature conventionnelle, et les coutumes, qui seules seraient sources de droit objectif*<sup>289</sup>. Goode makes no distinction between customs and usages: "The modern approach is to treat the two terms as interchangeable. In transnational commercial law, the term 'usage' or 'usages' is that generally adopted; in international law the reference is usually to custom."<sup>290</sup>

It is presumed that the parties wish to conduct their business according to the usages and that they want them to be binding. It also follows from § 1-205 (2) of the Uniform Commercial Code that usages are presumed to be observed even in cases where the parties did not explicitly make reference to them.

<sup>287</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 152.

<sup>288</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 158.

<sup>289</sup> Fouchard, *L'Arbitrage Commercial International*, 414.

<sup>290</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 9.

Naturally, the parties' explicit or tacit stipulations always have priority over usages, i.e. only if the *lex contractus* is silent concerning a certain point can there be recourse to the usages pertinent to that trade problem. According to § 1-205 (4) of the Uniform Commercial Code, express stipulations by the parties control customs and usages. Usages of international trade are therefore used to fill gaps in the contracts and to interpret certain clauses and stipulations. Being practices, they are subsidiary to mandatory rules but nevertheless play a crucial role in the development of the *lex mercatoria*. Usages influence decisions to a great extent and have even been called the core of the *lex mercatoria*<sup>291</sup>.

There is no clear consensus regarding the UNIDROIT principles as an element or source of the *lex mercatoria*<sup>292</sup>. This debate started anew with the publications of the UNIDROIT Principles of International Commercial Contracts in 1994. In the Preamble, where the purposes of the Principles are explained, it is stated that: "They may be applied when the parties have agreed that their contract be governed by "general principles of law", the "lex mercatoria" or the like."<sup>293</sup> By putting it like this, the principles explicitly claim their status as an element of the *lex mercatoria*. This also becomes clear in 4 b) of the comment of the Preamble:

4. ... b. The Principles applied as *lex mercatoria*:

Parties to international commercial contracts who cannot agree on the choice of a particular domestic law as the law applicable to their contract sometimes provide that it shall be governed by the "general principles of law", by the "usages and customs of international trade", by the *lex mercatoria*, etc. Hitherto, such reference by the parties to not better identified principles and rules of a supra-national or transnational character has been criticized, among other grounds, because of the extreme vagueness of such concepts. In order to avoid, or at least considerably reduce, the uncertainty accompanying the use of such vague concepts for the determination of their content,

<sup>291</sup> Kappus, *Lex mercatoria in Europa und Wiener UN-Kaufrechtskonvention 1980*, Frankfurt am Main (1990), 143.

<sup>292</sup> Loquin, "Où en est la *Lex Mercatoria*", in: *Souveraineté étatique et marchés internationaux à la fin du 20<sup>ème</sup> siècle. Mélanges en l'honneur de Philippe Kahn*, (2000), 36.

<sup>293</sup> Available at: <http://www.unidroit.org/english/principles/contents.htm>

it might be advisable to have recourse to a systematic and well-defined set of rules such as the Principles.

Kahn expressed his doubts, since the Principles do not (yet) originate from the merchant community and have not yet been accepted by the arbitrators, although some arbitral awards refer to them<sup>294</sup>. The insertion of the Principles in the *lex mercatoria* will depend upon their reception by the merchant community and their application by arbitral tribunals<sup>295</sup>. Nevertheless, a strong influence on the *lex mercatoria* cannot be denied. Since the Principles reflect ideas and concepts found in many, if not in all laws, they may serve as a guide to arbitrators and merchants. Insofar as trade usages and general principles of law are listed in the Principles, they are still part of the *lex mercatoria*. It is safe to say that the Principles have now become accepted by the international merchant community and arbitration lawyers and academics<sup>296</sup>. The Principles are being applied as generally accepted principles of International Trade Law. To cite Berger's appraisal: *This worldwide movement towards a growing acceptance of the Principles, ranging from the state of contract negotiations to dispute settlement through international arbitral tribunals and even domestic courts, will, in turn, give new impetus to the doctrine and practice of a law merchant, a new lex mercatoria.*<sup>297</sup>

It follows from the fact the Principles exist in writing that they cannot be as flexible and adapt to changing circumstances as easily as the rules of the *lex mercatoria*. One could conclude that the principles are within the scope of the law merchant as long as they continue to represent an up-to-date compilation of International Trade Law<sup>298</sup>.

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<sup>294</sup> Kahn, "Vers l'institutionnalisation de la *lex mercatoria*. A propos des principes Unidroit relatifs aux contrats du commerce international", in: *Liber Amicorum Commission Droit et Vie des Affaires*, Brussels, (1998), 132.

<sup>295</sup> Loquin, "Où en est la *Lex Mercatoria*", in: *Souveraineté étatique et marchés internationaux à la fin du 20<sup>ème</sup> siècle. Mélanges en l'honneur de Philippe Kahn*, (2000), 36.

<sup>296</sup> Berger, "International Arbitral Practice and the UNIDROIT Principles of International Commercial Contracts", 46 *Am. J.Comp. L.* (1998), 149.

<sup>297</sup> Berger, "International Arbitral Practice and the UNIDROIT Principles of International Commercial Contracts", 46 *Am. J. Comp. L.* (1998), 150.

<sup>298</sup> Frick, "Die UNIDROIT-Prinzipien für internationale Handelsverträge", *Recht der internationalen Wirtschaft* (2001), 421.

The same applies to codified usages, such as the INCOTERMS developed by the International Chamber of Commerce. They are also part of this group, for the codification does not change their nature. The INCOTERMS are international rules for the interpretation of trade terms or standard trade definitions. The trade terms were not used and interpreted in the same way throughout the world before the INCOTERMS became universally accepted and thereby made international trade easier. “The application of the INCOTERMS and the meanings which they are acknowledged to have is so well established that it is difficult to find actual examples.”<sup>299</sup> Thus, in ICC Award No. 2438, the INCOTERMS have been classified as truly transnational sales customs<sup>300</sup>.

The usages vary from trade to trade, because every commercial field has its peculiarities, special needs and practices. Thus, the trade usages are different in many ways: geographically, politically, economically, legally and commercially<sup>301</sup>. The merchants in the different areas of commerce are very familiar with the special usages and presume their automatic application even if no choice-of-law clause has been inserted in the contract<sup>302</sup>. However, the point of view declaring that by submitting their dispute to international commercial arbitration, the parties automatically wish to have the dispute governed by the usages of that trade, goes too far<sup>303</sup>. One cannot interpret the insertion of an arbitral clause into a contract that way. The parties may have expected to see the national rules of conflict of the arbitral seat applied and designate an applicable national or transnational law.

One must not confuse the general principles of law and international trade usages. A trade usage only exists in one particular area of international trade. All the general principles of law emanate from trade usages but have ceased to be trade usages, for they have become generally accepted and eminent to all the forms of international trade. Trade usages seldom represent broad principles and

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<sup>299</sup> Lew, “Applicable Law in International Commercial Arbitration”, New York (1978), 458.

<sup>300</sup> ICC Award No. 2438/1975, in: Collection of ICC Arbitral Awards, Vol. I, 253.

<sup>301</sup> Goode, “Usage and its Reception in Transnational Commercial Law”, in: Ziegel (ed.), “New Developments in International Commercial and Consumer Law”, Oxford (1998), 13.

<sup>302</sup> Lew, “Applicable Law in International Commercial Arbitration”, New York (1978), 366.

<sup>303</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 278.

general considerations, but specific rules pertinent to that given form of international trade<sup>304</sup>.

It is questionable whether usages can be considered a formal source of law. Usages emanate from private persons and, to the extent that they are not recognized by a national law, cannot be binding. Only a state authority is said to be able to create binding rules. This approach cannot be followed in International Trade Law. As shown above, customs and usages influence arbitrators and national courts to a large extent. Since national laws often have gaps, one has to take usages into consideration. International trade matters are more and more complex and technical. National law can no longer regulate everything without having recourse to a-national sources such as usages. Furthermore, the parties have the right to designate the applicable law and procedural rules of any arbitration. If they consider a particular usage to be binding an arbitrator has to do the same and cannot ignore that rule. Many national laws also make reference to customs and usages. Thus, Article 1 of the Swiss Civil Code:



- (1) *La loi régit toutes les matières auxquelles se rapportent la lettre ou l'esprit de l'une de ses dispositions.*
- (2) *A défaut d'une disposition légale applicable, le juge prononce selon le droit coutumier et, à défaut d'une coutume, selon les règles qu'il établirait s'il avait à faire acte de législateur.*
- (3) *Il s'inspire des solutions consacrées par la doctrine et la jurisprudence.*

The main source of the *lex mercatoria* is said to be the incorporation of certain rules in contracts or consistent behaviour of the merchant community, i.e. customs and usages<sup>305</sup>. Their normative force is based on *usus* and *opinio juris*, meaning that they are observed because the parties feel that the usages are binding. The parties are presumed to have incorporated them into the contract. It has been criticised that the parties might not be aware of the insertion

<sup>304</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 91; Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 18.

<sup>305</sup> Berman/Kaufman, "The Law of International Commercial Transactions (Lex Mercatoria)", 19 *Harv. Int'l. L. J.* (1978), 274.

of a given usage into the contract. But merchants have to be aware of the pertinent usages, and contracts are always interpreted like a reasonable businessman would interpret them<sup>306</sup>. Also, the international merchant community can create, apply and alter *lex mercatoria* without being aware of it. It is only rarely invoked by its real name. In most cases, parties or arbitrators refer to general principles of International Trade Law, usages of international commerce and the like. *Lex mercatoria* exists not because of the debate that is going on among scholars or because international merchants and arbitrators know about the ongoing discussion. Its existence is a fact independent of its recognition by the aforementioned. *Lex mercatoria* can therefore be altered and applied without their knowledge.

As to the relation between arbitration and customs and trade usages, arbitrators have to take them into consideration when interpreting a contract. Thus, Article VII (1) of the European Convention on International Commercial Arbitration states that:



The parties shall be free to determine, by agreement, the law to be applied by the arbitrators to the substance of the dispute. Failing any indication by the parties as to the applicable law, the arbitrators shall apply the proper law under the rule of conflict that the arbitrators deem applicable. In both cases the arbitrators shall take account of the terms of the contract and trade usages.

An arbitral tribunal can assert the existence of a trade usage in three situations: first, if the usage is widely known and accepted, second, if the usage is proven by testimony of expert witnesses, and third, where the usage can be derived from international conventions, uniform rules, standard form contracts and the like<sup>307</sup>.

To summarise, even if usages are not the same in all the trades, they are a formal source of law and common principles exist. They are said to constitute

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<sup>306</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 6.

<sup>307</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 17.

formal source of the *lex mercatoria* because they form a more or less heterogeneous set of rules<sup>308</sup>. Or, as Lew put it: *Generally a judge, seized of a dispute arising out of a contract, will resort to relevant customs and usages to fill lacunae which may exist in his law. More accurately, he will give effect to customs or usages because they form an integral part of the contract; indeed, frequently performance or meaning will depend largely on customs and usages. Hence the judge will aim to interpret the contract in the light of the applicable law and the determinable intention of the parties. As most legal systems so allow, there is little possibility of a relevant custom or usage not being applied. For the international arbitrator, the situation is even clearer. He is not the representative or official of any State; he also has no lex fori.*<sup>309</sup>

International commercial custom and trade usages are the core of the *lex mercatoria*. They are created by the community of international merchants itself and reflect its needs and expectations perfectly.

## 6. Standard Form Contracts

Another source of the *lex mercatoria* is standard form contracts and general conditions. These are developed by private, commercial and trading organisations<sup>310</sup>. A standard form contract is a pre-established contract or clauses of a contract with pre-formulated legal terms and conditions regularly used by an enterprise when dealing with customers or other merchants. The customer has no choice but to agree to the standard form contract that contains terms favourable to the party presenting it in order to do business. As early as the seventies, Slawson claimed that “standard form contracts probably account for more than ninety-nine percent of all contracts now made and they were said to undermine the theoretical

<sup>308</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 308: ... *un ensemble normatif dont le contenu est de moins en moins hétéroclite. Ces modes d'expression de la pratique s'insèrent dans une perspective de codification, cette dernière remplissant simultanément une fonction de constatation et d'édification de normes et que l'on peut considérer d'ores et déjà comme une manifestation tangible de la lex mercatoria. Il s'agit d'usages dont l'observation montre qu'ils constituent des instruments qui contribuent à l'énoncé de normes a-nationales, si bien qu'ils ont vocation à être érigés en source formelle de la lex mercatoria.*

<sup>309</sup> Lew, “Applicable Law in International Commercial Arbitration”, New York (1978), 465.

<sup>310</sup> Lew, “Applicable Law in International Commercial Arbitration”, New York (1978), 361.

framework of traditional contract law”<sup>311</sup>. Some authors even go so far as to call standard form contracts the primary source of the *lex mercatoria*<sup>312</sup>. Contract practice has been standardized through the automatic use of these standard form contracts and general conditions<sup>313</sup>.

Mustill points out the standard forms should not be used as a source of law<sup>314</sup>. First, there are numerous institutions that publish and provide different and inconsistent documents. Also, the parties tend to alter these standard forms in order to adapt them to their particular needs. Thus, there is little homogeneity. Furthermore it can be asked “... why a participant in one trade should be supposed to have consented to having his contract governed by rules drawn from contract forms current in a quite different trade.”<sup>315</sup> In addition, Mustill criticizes that the mechanism whereby the use of standard form contracts becomes a source of law is not clear<sup>316</sup>.

The general conditions are also part of this group. Merchants use general conditions as a framework of their trade relation to settle all the points that are not discussed anew upon signing a contract. Legal guides are also closely related to standard form contracts and general conditions. They give advice to merchants about how they should formulate their contract or their general conditions<sup>317</sup>.

However, there is an important difference between standard forms and general conditions. Standard form contracts are written and drafted by professional organisations. General conditions on the other hand, have been written by (one of) the parties<sup>318</sup>. Thus, standard form contracts reflect usages of that particular trade and innovate at the same time. The professional organisation drafting the standard form contract might alter an existing usage in order to adapt

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<sup>311</sup> Slawson, “Standard Form Contracts and Democratic Control of Lawmaking Power”, 84 Harv. L. Rev. (1971), 529.

<sup>312</sup> Loquin, “Où en est la *Lex Mercatoria*”, in: Souveraineté étatique et marchés internationaux à la fin du 20<sup>ème</sup> siècle. Mélanges en l’honneur de Philippe Kahn, (2000), 29.

<sup>313</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 133.

<sup>314</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 94, 95.

<sup>315</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 95.

<sup>316</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 95.

<sup>317</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 77.

<sup>318</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 269.

to the market's demands. The validity of general conditions and their application by the arbitrator are due to their being incorporated into the contract. Since the parties themselves created the general conditions and inserted them into the contract, their validity follows from the *pacta sunt servanda* and the freedom of contract principles. When applying standard form contracts, the arbitrator has to reveal which rules are only reflections of international trade usages and which rules are innovative and trying to provide guidelines considered to be perfect for that trade<sup>319</sup>. Some of these innovative rules and general conditions become trade usages themselves. Another difference is that standard form contracts are often designed to be self-regulatory, to settle all future eventualities and provide for all the parts of the contractual relationship. General conditions often govern only parts of the contract, such as its performance.

The *London Corn Trade Association* used standard form contracts as early as 1878<sup>320</sup>. The grain merchants who were members of this association believed that the grain trade would benefit from the use of standard contract terms. In 1971, this association merged with the *Cattle Food Trade Association*, and the *Grain and Feed Trade Association* (GAFTA) was formed. GAFTA is still providing its members with standard form contracts and arbitration<sup>321</sup>.

Two other important examples are the standard form contracts issued by the FIDIC (*Fédération Internationale des Ingénieurs-Conseils*) and the IATA (International Air Transport Association). FIDIC is the most widely used contract form in international engineering.

In the air transport business, the need for uniform laws and commonly accepted standard form contracts is evident. On 31<sup>st</sup> December 2002, some 273 airlines from 143 countries were IATA members and the flights of these airlines comprised more than 95 percent of all international scheduled air traffic<sup>322</sup>. The IATA published standard contract forms and a uniform airway bill. As it says on its homepage, "IATA helps to ensure that Members' aircraft can operate safely,

<sup>319</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 269.

<sup>320</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 37; De Ly, *International Business Law and Lex Mercatoria*, (1992), 187; <http://www.gafta.com/New/NewAllAboutGaftaHistory.htm>

<sup>321</sup> <http://www.gafta.com/NewMembership.htm>

<sup>322</sup> Available at: <http://www.iata.org>

securely, efficiently and economically under clearly defined and understood rules”<sup>323</sup>. The general conditions of contract proposed by IATA are generally followed by the members. These conditions are printed on the tickets issued by the airlines. The conditions of carriage proposed by IATA are not always followed by the member airlines. These conditions are only referred to on the tickets and they only apply in cases where two member airlines are involved<sup>324</sup>. According to a decision of the German Supreme Court, the IATA standard forms were considered as being binding only between the members. The court also declared that the IATA standard forms could not be viewed as customs under international public law for they emanate from a private organisation<sup>325</sup>.

The standard clauses and contracts provided by these organisations are regarded as an element of the *lex mercatoria*, for they are predominant in their area of business and commonly applied.

The United Nations Economic Commission for Europe (UNECE) has also published contract practices, standard form contracts and general conditions of sale. For example, from 1953-1961 the Group of Experts on International Contract Practices in Industry drew up the general conditions of sale for the export and import of engineering equipment Supply of Plant and Machinery for Export<sup>326</sup>.

It has been stated that contracts cannot create law, but only contractual rights for the parties involved. These rights are derived from the national law that protects the contract. Naturally it must be remembered that contracts themselves do not create law. They only create rights that might be enforceable with the help of the law. One limitation of the rights contracts can create is the mandatory rules of the law of the country in which the enforcement is attempted. However through the constant use of standard form contracts as a means of self-regulation and their paramount influence on contractual practice, they constitute a source of the *lex mercatoria*. In addition, just as in Public International Law, there is no monopoly or centralized system of lawmaking in the area of international trade. Trying to

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<sup>323</sup> Available at: <http://www.iata.org>

<sup>324</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 188.

<sup>325</sup> BGH, 20.1.1983, *European Transport Law*, (1984), 535.

<sup>326</sup> <http://www.unece.org/leginstr/cvlegpract.htm>

avoid the application of national law, the international business community creates its own rules, mainly through contracts<sup>327</sup>.

Standard form contracts are said to play the most important role in the process of substituting *lex mercatoria* for national laws, as they provide the business world with pre-formulated and basically self-regulative contracts<sup>328</sup>. In addition, they promote the harmonization of International Trade Law and the development of the *lex mercatoria* since they reflect the usages of international merchants and contribute to the uniformity of international trade practice. *What is more, the codification and standardisation through these professional documents is strengthened by the use of arbitration. This mode of dispute resolution allows the application of customs mentioned in the standard form contract and the general conditions of contract, which are the real instruments of codification and elaboration of usages.*<sup>329</sup>

Consequently, standard form contracts and general conditions are a formal source of the *lex mercatoria*.



## 7. Reporting of Arbitral Awards

The activities of international arbitral tribunals are different from those of national courts. By their nature, they are called upon to resolve disputes involving parties from different states and contracts connected to more than one national law. Consequently, an arbitrator has to take the particularities of international trade into consideration. But when applying the *lex mercatoria*, he is not free to base his decision on equity or to create new rules: *Arbitrators do not make up law as they go along, and contrary to popular view, most arbitrators do not look first of all for a compromise. International arbitrators do seek to achieve just results within a legal framework, and that framework is by definition wider than the frontiers of any state.*<sup>330</sup>

<sup>327</sup> Pellet, “La Lex Mercatoria, tiers ordre juridique? Remarques ingénues d’un internationaliste de droit public”, 63.

<sup>328</sup> Stein, *Lex mercatoria: Realität und Theorie*, 39.

<sup>329</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 274.

<sup>330</sup> Lowenfeld, “Lex Mercatoria: An Arbitrator’s View”, (1990) 6 *Arbitration International*, 135.

On the other hand, given the incomplete and spontaneous character of the law merchant, the arbitrator sometimes has to act as an inventor or creator of new rules. Thus, his influence on the elaboration of the *lex mercatoria* is also significant. *This means that the arbitrator does not just note the customs promoted by the operators of international trade and the ones that are imposed on him. He also creates rules of an increasing quantitative and qualitative importance. ... The praetorian function of arbitration tribunals is thus further emphasised by the lex mercatoria's scarceness of mandatory rules, due to the absence of a formal authority with legislative powers.*<sup>331</sup>

The interaction between international arbitration and the *lex mercatoria* needs to be analysed. Can the law merchant exist outside of arbitration and does it apply to all international commercial transactions? National judges might also seek inspiration from the law merchant when interpreting an international trade contract.

Mustill points out the different theories about the relationship between *lex mercatoria* and arbitration in situations where the arbitrator is faced with a previous award that could serve as a precedent, since the very same question of law is concerned: *If the arbitrator's function is simply that of an exponent, then the second arbitrator need do no more than pay appropriate respect to the reasons of his colleague, without being obliged to arrive at the same decision. If he thinks fit, he is at liberty to hold that his predecessor misunderstood the lex mercatoria. Again, at the other extreme, if the first arbitrator has exercised a creative function as a social engineer, his successor can fairly regard him as no more than a part of the self-regulating mechanism of the contract under which he acted, and can thus feel free to exercise the same function, in a different sense, under his own contract. But if the intermediate theory is correct, an award which enunciates a new rule thereby adds to the corpus; and since the lex mercatoria is conceived to be a binding law, the subsequent arbitrator must apply it, whether he agrees with the conclusion or not.*<sup>332</sup>

<sup>331</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 15.

<sup>332</sup> Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 98.

Arbitration is the preferred method of dispute resolution in International Trade Law and most of the parties include an arbitration clause in their contracts<sup>333</sup>. Since most of the problems and disputes are therefore resolved by arbitrators, they have a very significant impact on international trade. Their awards could serve as guidelines and the business community would know how the arbitrators had decided in similar cases. Judgements from national courts are sometimes binding on other courts when being faced with a similar question whereas arbitral awards cannot serve as precedents in this way for they do not legally compel other arbitral tribunals to decide accordingly.

Unfortunately, not many arbitral awards are published. This is due, among other reasons, to the fact that the parties usually do not have to seek enforcement of an award before another court since they consent to the arbitrators' decision<sup>334</sup>. Another factor is the will to keep the dispute secret from other business partners and rivals. The parties are trying to protect trade secrets and business practices from their competitors, and the influence of public opinion on the trade dispute to be resolved is minimized<sup>335</sup>. As Hunter puts it: *... while it is easy to sympathize with those who rightly seek to promote the development of the lex mercatoria, the broader interests of the international arbitration community are likely to be best served by upholding the inherent confidentiality of the arbitral process.*<sup>336</sup> Although this fact is one of the advantages of arbitration for enterprises, the publication of more awards could help to make International Trade Law more predictable by creating a case law and advance *lex mercatoria* even further<sup>337</sup>. Thus, some published awards that are based on *lex mercatoria* advanced its acceptance by the international business community and arbitrators<sup>338</sup>. In the

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<sup>333</sup> Berger, *Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 62; Carr, *Principles of International Trade Law*, 2<sup>nd</sup> ed. London (1999), 316.

<sup>334</sup> Draetta, Lake, Nanda, *Breach and Adaptation of International Contracts*, Butterworth (1992), 20.

<sup>335</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 *Boston Univ. Int'l. L. J.* (1984), 336.

<sup>336</sup> Hunter, "Lex Mercatoria – Deutsche Schachtbau- und Tiefbohrergesellschaft mbh v. R'As Al Khaimah National Oil Co.", *Lloyd's Mar. & Com. L.Q.*, (1987), 142.

<sup>337</sup> Lando, "The *lex mercatoria* in International Commercial Arbitration", 34 *ICLQ* (1985), 751.

<sup>338</sup> Craig, Park, Paulsson, "ICC Arbitration", New York (2000), 639.

seventies, the ICC started to publish selected arbitral awards in the Yearbook of Commercial Arbitration and in the *Journal du Droit International*.

Nevertheless, in order to respect the confidentiality, awards often have to be made anonymously, which sometimes excludes further scientific use because important facts that led to the decision are not mentioned. Furthermore, many arbitral awards cannot serve as precedents because no reasons and foundations are given or because they are settlements between the parties. Unlike national courts' awards, arbitral awards can only be published with the parties' consent. In many cases, no facts or dates are provided, the countries and the national laws involved not mentioned. Therefore the arguments, the compromises and the discussions that led to the decision are not fully known<sup>339</sup>.

It has been argued that it is difficult to achieve uniformity between arbitral awards because of the lack of hierarchy between the arbitration tribunals and the absence of reasons for giving previous arbitral awards the binding force of a precedent<sup>340</sup>. To this must be added, that the binding force should not emanate from the hierarchy of the arbitral tribunals but from the correct application of a generally accepted *lex mercatoria* and based on the merits of the award that serves as a precedent<sup>341</sup>. On the other hand, it can be difficult to determine which award is meritorious or not as there is no hierarchy between the tribunals and appeals to verify and confirm are not possible. *Considering that ICC arbitral tribunals have already pronounced themselves to this effect. The decisions of these tribunals progressively create case law which should be taken into account, because it draws conclusions from economic reality and conforms to the needs of international commerce, to which rules specific to international arbitration, themselves successively elaborated, should respond.*<sup>342</sup>

Even though there exists no official hierarchy between arbitral tribunals, arbitrators do base their decisions on precedents and cite them to support their own solution. Thus, in a case in which the parties have omitted to decide on the applicable law, the arbitrators decided: *That, however, the arbitral tribunal,*

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<sup>339</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 122.

<sup>340</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 202.

<sup>341</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 203.

<sup>342</sup> ICC Award No. 4131, YCA vol. IX (1984), 136.

*deciding moreover as amiable compositeur, holds that it is not necessary to deal with the latter hypothesis by ordering oral evidence, but will examine which is the applicable law by analysing the indications given to it and by finding its inspiration in the general principles developed in this respect by the recent case law of arbitral tribunals, particularly those constituted under the auspices of the ICC; ...*<sup>343</sup>.

But not only when acting as *amiabiles compositeurs* do the arbitrators use other arbitral awards as precedents. It is a fact that arbitrators often refer to arbitral precedents and their importance is increasingly important. *Such references may be found not only in cases where the arbitrators have been given the authority to act as amiables compositeurs and thus without founding their decision in law, nor only in cases where the parties have stipulated by various formulations that general principles of law (rather than a specified national law) should apply, but indeed in cases where a specific national law is acknowledged in principle as being applicable.*<sup>344</sup>

One has to emphasise the arbitrators' important role in the formation of the *lex mercatoria*. It is important to underline that it is not a law already formed and having binding force upon the arbitrator. The fact should not be ignored that it is also created by him and not only by the merchant community. According to Goldman, the insertion of an arbitration clause into a contract by itself means the internationalization of this contract and the acceptance of the general principals of International Trade Law, even if these are not mentioned<sup>345</sup>. The arbitrators create general principles of law, and therefore a part of the *lex mercatoria* by taking the needs of the international merchant community into account and by applying the general rules and principles to concrete disputes. They do not merely apply the already existing principles explicitly chosen by the parties, but also produce new ones<sup>346</sup>. Another point that underlines their importance is that arbitrators often have to search for already existing rules of the *lex mercatoria* by comparing trade usages and different laws.

<sup>343</sup> YCA vol. VII (1982), 127.

<sup>344</sup> Craig, Park, Paulsson, „ICC Arbitration“, New York (2000), 624.

<sup>345</sup> Goldman, “La *lex mercatoria* dans les contrats et l’arbitrage internationaux: réalité et perspectives“, JDI (1979), 481.

<sup>346</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 14.

With an increasing number of published arbitral awards, their importance as a source of the law merchant will continue to grow. A case law will develop, through the critical analysis of awards by other arbitrators, merchants or scholars, through the reference to precedent awards, the adaptation of grounds and motivations and the elaboration of common principles<sup>347</sup>.

Another fact cannot be ignored. The emergence of an arbitral case law is further supported by the informal “publication” of arbitral awards. Arbitrators sometimes hand their awards to other arbitrators to assist them by providing precedents. The confidentiality of arbitration is respected but, since the awards are not officially published, no transparent arbitral case law can emerge.

In addition to this, the practices of arbitral tribunals have a huge impact on the elaboration of procedural rules. The national arbitration rules grant great freedom to arbitral tribunals concerning their procedures. Arbitrators influence the development of transnational procedural rules in two different ways: first, through their practice; second, through their collaboration and participation whenever international conventions or model laws are drafted<sup>348</sup>.

*The decisions of [ICC] tribunals progressively create case law which should be taken into account, because it draws conclusions from economic reality and conforms to the needs of international commerce, to which rules specific to international arbitration, themselves successively elaborated, should respond.*<sup>349</sup>

According to this approach, arbitral awards reflect and confirm the usages of international trade. Given the significance of usages, arbitral awards that are based on them also have to be respected. A set of rules in the form of precedents could develop. *Aussi la jurisprudence arbitrale est-elle, grâce à la fonction normative assumée par les arbitres, une source formelle autonome de la lex mercatoria, à l'origine de l'énoncé d'une certaine nombre de principes généraux régissant l'interprétation (du contrat et du droit), la formation et l'exécution du contrat international.*<sup>350</sup>

<sup>347</sup> Berger, Formalisierte oder “schleichende” Kodifizierung des transnationalen Wirtschaftsrechts; Berlin, New York: de Gruyter (1996), 72.

<sup>348</sup> Stein, *Lex mercatoria: Realität und Theorie*, 99.

<sup>349</sup> Case 4131/1982, I ICC Awards 146, 465, cited in: Craig, Park, Paulsson, “ICC Arbitration”, New York (2000), 639.

<sup>350</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 316.

Finally, Berger points to the development of an arbitral case law due to the growing acceptance of the UNIDROIT Principles on International Commercial Contracts: *At the same time, the increasing reference of international arbitrators to the Principles promotes the development of genuine transnational case law of international arbitral tribunals. Since arbitral awards more and more assume a genuine precedential value within the international arbitration process, it can be expected that the general trend towards denationalizing the arbitrators' decision on the merits of their cases gains new momentum.*<sup>351</sup>

For these reasons, arbitral awards can be regarded as yet another source of the *lex mercatoria*<sup>352</sup>.

### **8. Public Policy of the Countries likely to be concerned by the Award**

It has been contended that by applying *lex mercatoria* mandatory rules of national laws can be avoided. Thus a stronger party might be able to force a weaker one to accept its terms for the conclusion of a contract and thereby avoid national rules designed to protect the socially or economically weaker party. Parties to international trade contracts are freed from the restrictions and boundaries of national law, except for the rules belonging to the so-called *ordre public international*<sup>353</sup>.

First, one has to remember that *lex mercatoria* is only applied between merchants and never in relations involving a consumer<sup>354</sup>. A professional businessman does not need the same degree of protection that national laws provide for consumers or private parties, for a merchant is aware of the risks he is taking.

Furthermore an arbitrator cannot ignore the public policy of the states that are connected to the contract. Unlike a court, he is not forced to take those

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<sup>351</sup> Berger, "International Arbitral Practice and the UNIDROIT Principles of International Commercial Contracts", 46 Am. J. Comp. L. (1998), 149.

<sup>352</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 Boston Univ. Int'l. L. J. (1984), 318.

<sup>353</sup> Grigera Naón, Choice-of-law problems in International Commercial Arbitration, J.C.B. Mohr: Tübingen (1992), 27.

<sup>354</sup> Berger, Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts; Berlin, New York: de Gruyter (1996), 73.

mandatory rules into account. On the other hand, he has to consider the enforceability of the award that he renders<sup>355</sup>. Even if there were an a-national law in existence, known and applied by the merchant community governing the international trade transactions, national states will necessarily be linked with executing the contract. As the ICC arbitrators put it: ... *it cannot be contested that there exists a general principle of law recognized by civilised nations that contracts which seriously violate bonos mores or international public policy are invalid or at least unenforceable and that they cannot be sanctioned by courts or arbitrators. This principle is especially apt for use before international arbitral tribunals that lack a 'law of the forum' in the ordinary sense of the term.*<sup>356</sup>

Consequently, even the non-bound arbitrator has to give effect to the mandatory rules (*lois de police*) of these countries, for the national courts will refuse to enforce the arbitral judgement if it violates the public policy or mandatory rules they are bound to obey. If the national laws of two countries connected to the contract collide, the arbitrator has to decide according to the law of the country where the enforcement of his award is likely to be requested<sup>357</sup>. This becomes clear in the following award: *Attendu que, indépendamment même de l'exception ainsi invoquée par une partie, l'arbitre aurait d'ailleurs le devoir de soulever d'office la nullité de toute convention ou clause qui serait contraire à l'ordre public espagnol, au même titre qu'une juridiction ordinaire espagnole; Qu'en l'espèce, l'arbitre doit avoir égard à l'ordre public interne et non uniquement à l'ordre public international espagnol, les relations des parties étant soumises au droit espagnol; ...*<sup>358</sup>.

In this context, Lew states the following: *These two awards reflect the obligations of the arbitrators, accepted as private guardians of international commercial transactions and the developers of the lex mercatoria, to uphold the*

<sup>355</sup> Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 765; Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 Arbitration International (1988), 109; Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 395; Weise, *Lex Mercatoria*, 135.

<sup>356</sup> ICC Award No. 1110/1963, YCA vol. XXI (1996), 47; Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 765; Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 136.

<sup>357</sup> Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 766.

<sup>358</sup> ICC Award No. 6142, *Journal du Droit International* (1990), 1041.

*fundamental and accepted standards of international trade and not to fall into the role of enforcing international practices regardless of whether they concur with prevailing applicable law and accepted international commercial standards. In this capacity, there is justification for the arbitrator to react to a manifest violation of international public policy, even though the issue has not been raised by either party.*<sup>359</sup>

Arbitrators would not disregard the public policy as they are obliged to render an enforceable award<sup>360</sup>. Arbitration can only exist because it is provided for in national laws and arbitral awards can only be valid if they concur with the mandatory rules of the national law in question. Even if an express choice or a clause inserted into the contract by the parties is contrary to the public policy of the state the award is likely to be enforced in, the arbitrators have to disregard the parties' stipulations and interpret the contract in such a way that is in harmony with these rules. *Thus, it may be, though perhaps it would be unusual, that the parties could validly agree that a part, or the whole, of their legal relations should be decided by the arbitral tribunal on the basis of a foreign system of law, or perhaps on the basis of principles of international law; ... and I see no reason why an arbitral tribunal in England should not, in a proper case, where the parties have so agreed, apply foreign law or international law. ... There is no possible objection to that, so long as there is nothing contrary to public policy in the exclusion or alteration of the provisions which, in the absence of agreement, would attach.*<sup>361</sup>

Or even more clearly: *I do not believe that the presence of such a clause makes the whole contract void or a nullity. It is a perfectly good contract. If there is anything wrong with the provision, it can only be on the ground that it is contrary to public policy for parties so to agree.*<sup>362</sup>

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<sup>359</sup> Lew, "Determination of Arbitrators' Jurisdiction and the Public Policy Limitations on that Jurisdiction", in: Contemporary Problems in International Arbitration, (1986), 85.

<sup>360</sup> Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 765; Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 Arbitration International (1988), 109; Osman, Les Principes Généraux de la *Lex Mercatoria*, Paris (1992), 395; Weise, *Lex Mercatoria*, 135.

<sup>361</sup> YCA vol. XIII (1988), 532.

<sup>362</sup> YCA vol. XIII (1988), 533.

A different situation exists in cases where a national judge is asked to base his decision on the *lex mercatoria* and not on his national law. He cannot possibly ignore the mandatory rules or the public policy of his own law, the *lex fori*. There are certain national rules that alter the stipulations of contracts for political, economical or social reasons, regardless of the parties' nationality or the nature of the contract.

To summarise, Mustill is right by adding the public policy of the country in which the enforcement of the award is likely to be requested to the list of sources of the *lex mercatoria*. It is one of the arbitrator's main duties to assure the effectiveness and the enforceability of his award. Since enforcement would never be granted if the award were contrary to a state's public policy, it would be useless for the winning party as he cannot force the recalcitrant one to abide by the award. Even when applying usages of international trade or the contract's express stipulations, the arbitrator is bound by the mandatory rules of the national law: *Art. 1496 of the new French Law requires the Arbitrator in all cases to take into account trade usages. Art. 13 (5) of the ICC Rules requires him in all cases to take into account the terms of the contract and trade usages. It goes without saying that the Arbitrator shall have regard to these bases to the extent that they do not deviate from the mandatory rules of the applicable law.*<sup>363</sup>

A point of contact between national laws and the *lex mercatoria* is the recognition and enforcement of an arbitral award or the denial thereof. Thus, the states have not totally lost control over the development and the contents of the law merchant. The national courts are empowered to decide if a rule is legitimate or not, as they can always deny recognition or enforcement of an award if it is not in harmony with the state's public policy. By so doing, they cannot oust that particular rule from the scope of the *lex mercatoria*, but can certainly influence its effectiveness, for no arbitrator wishes to render an award that will not be recognized and enforced. However, due to the rather technical and less political

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<sup>363</sup> ICC Award No. 4237/84, YCA vol. X (1985), 55.

character of the law merchant, it is extremely rare that its rules are against the public policy of any state<sup>364</sup>.

### 9. Comparative Law/List-making

Berger has named one of his books “The Creeping Codification of the Lex Mercatoria”<sup>365</sup> and in it he describes the phenomenon of a slow codification of the *lex mercatoria* through list-making. Whereas a list published by Mustill named 20 principles of the *lex mercatoria*<sup>366</sup>, recent compilations list more than 60<sup>367</sup>!

Gaillard criticizes the lists<sup>368</sup>. According to him, they can never have any authority and certainty. When having to apply transnational law, the arbitrator should always find the rules himself using the techniques of comparative law. First, he is to peruse the contract for indications regarding the procedure according to which the parties want him to find the norms. Thus, in many contracts, parties wish to have their disputes governed by the principles common to the national laws involved<sup>369</sup>. If the parties have made no indications, the arbitrator is to search for principles common to the national laws connected with the contract. According to Gaillard, this approach should be exclusive, arbitral precedents or international conventions can only be used as indicators or inspirations<sup>370</sup>. When looking for rules of transnational law and using the comparative method, there need not be unanimity among all laws. Otherwise any country could prevent arbitrators from finding rules of transnational law by introducing laws that differ from others. Also, if unanimity were necessary, only

<sup>364</sup> Loquin, “Où en est la *Lex Mercatoria*”, in: *Souveraineté étatique et marchés internationaux à la fin du 20<sup>ème</sup> siècle. Mélanges en l’honneur de Philippe Kahn*, (2000), 47.

<sup>365</sup> Berger, *The Creeping Codification of the Lex Mercatoria*, Kluwer, (1999).

<sup>366</sup> Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 110.

<sup>367</sup> Berger, *Formalisierte oder “schleichende” Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 217; The Center for Transnational Law (CENTRAL) published a list with more than 60 principles of the *lex mercatoria*, available at the Transnational Law Database: <http://www.tldb.de/>.

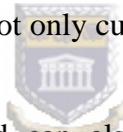
<sup>368</sup> Gaillard, “Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit”, *Journal du Droit International* (1995), 22.

<sup>369</sup> Gaillard, “Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit”, *Journal du Droit International* (1995), 23.

<sup>370</sup> Gaillard, “Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit”, *Journal du Droit International* (1995), 24.

very few and basic principles such as good faith and fair dealing or sanctity of the contracts could be found<sup>371</sup>. Gaillard also states that there are certain regional differences in transnational law.

One can also mention the works of comparative lawyers. Unification tendencies or unifying effects are discovered by comparing different national laws or conventions. One can find principles common to all or most of them. The method consists of the following: the solutions to the same problem provided for in the different legal systems or sources of law are perused. Through that comparison, similarities or common principles are discovered and identified. By publishing their conclusions they help practitioners and arbitrators alike. They are provided with a list of principles common to international trade that they cannot ignore and that they have to take into account when concluding a contract or when interpreting a certain clause. General principles of law may also be derived according to the methods of comparative law. Thus, national law can be a source of the transnational *lex mercatoria*. According to some authors, the main source of the *lex mercatoria* is said to be not only customs and usages, but also comparative law<sup>372</sup>.



The comparative method can also be found in many arbitral awards involving matters of international trade<sup>373</sup>. “*Une évolution pour le moins inattendue de la lex mercatoria a été sa capacité à absorber les enseignements du droit comparé et à intégrer dans sa substance les règles communes au systèmes juridiques étatiques.*”<sup>374</sup> By basing their decision on general principles of law or rules common to the laws of all the trading nations, arbitrators use rules that have been discovered with the help of the comparative method. *Comparative law provides the means to do justice to all legal systems involved. This is exemplified, e.g., by the international arbitrators’ comparative approach to conflict of laws problems. International arbitrators very often apply the so-called “cumulative*

<sup>371</sup> Gaillard, “Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit”, *Journal du Droit International* (1995), 27.

<sup>372</sup> Berman/Kaufman, “The Law of International Commercial Transactions (Lex Mercatoria)”, 19 *Harv. Int’l. L. J.* (1978), 274.

<sup>373</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 306.

<sup>374</sup> Loquin, “Où en est la *Lex Mercatoria*”, in: *Souveraineté étatique et marchés internationaux à la fin du 20<sup>ème</sup> siècle. Mélanges en l’honneur de Philippe Kahn*, (2000), 34.

*approach”. Instead of referring to just one conflict of law rule, they justify their choice of law decision with reference to all conflict of law rules concerned (i.e., that of the seat of the arbitration and of the respective home countries of the parties); The same comparative orientation is to be found in those cases where the arbitrators do not apply a domestic conflict of laws rule but general principles of private international law.<sup>375</sup>*

One of the great advantages of this method is to make the arbitral award reasonable and explicable to all the parties and arbitrators involved, despite their often different cultural, linguistic, economic and legal backgrounds<sup>376</sup>.

As national laws sometimes provide the same rules and are based upon the same principles it is likely to find the same or a similar answer to some problems in different laws. By pointing out that the same solution can be found in all the laws connected to the dispute or in many different national laws, the solution seems to be better-founded and correct. In addition to that, arbitrators might be able to avoid problems concerning the acceptance of the award, as it is more convincing.

Finally, in arbitral tribunals composed of arbitrators of different nationalities, it is easier to achieve a unanimous decision if the solution provided for by everybody's law is the same<sup>377</sup>. But these tribunals have never had great difficulty in achieving decisions, because few arbitrators insist on applying their own national law but search for an appropriate and equitable solution. They often have the same ideas and convictions of law and justice and also of how international trade should be conducted<sup>378</sup>.

A denial of enforcement, a review or setting aside of the award seems a lot less likely if it is based on all the pertinent national laws and especially on the national law of the country in which the enforcement, review or setting aside is being sought. Whenever two or more national laws are equally linked to the contract, it seems equitable and less arbitrary to look for a solution that is found in

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<sup>375</sup> Berger, “International Arbitral Practice and the UNIDROIT Principles of International Commercial Contracts”, 46 Am. J. Comp. L. (1998), 130.

<sup>376</sup> Berger, “International Arbitral Practice and the UNIDROIT Principles of International Commercial Contracts”, 46 Am. J. Comp. L. (1998), 132.

<sup>377</sup> De Ly, International Business Law and Lex Mercatoria, (1992), 307.

<sup>378</sup> Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 753.

all these laws. *The ultimate legal source of an international relationship is to be found simultaneously in all the States whose courts may be called upon to hand down a decision with regard to it, either directly or on the occasion of granting leave to enforce an arbitral award. No legal order is fundamental for the relationship; the Grundlegung does not exist.*<sup>379</sup>

As to the method of comparative law, Gaillard, among others, suggests that there are certain regional differences in the *lex mercatoria*, that the latter is consequently not uniform all over the world<sup>380</sup>. According to him, there are regional differences in transnational law. Thus, Arab states use law and rules different from those in the Western world. There are also different groups of law, such as the national laws based on Roman traditions or Common Law. When trying to find rules of transnational law by comparing national laws, should the arbitrator take regional peculiarities into consideration if the contract is connected exclusively to national laws of the same tradition or group? *In the first instance, the use of regional principles or principles emanating from certain families of law appears very tempting. In a case that is only connected with two Arab states for example, it appears adequate to make an exclusive application of principles common to the legal systems of all Arab states. In the same way, if a case is only connected with France and Argentina it would seem appropriate to apply principles common to civil law systems.*<sup>381</sup>

On the contrary, difficulties can arise in situations where the national laws concerned, despite the fact that they belong to the same regional or cultural background, provide two different solutions. Thus, having recourse to truly international sources only and always considering the solutions provided by national laws that are common to all the nations involved in international trade, without taking regional peculiarities and national particularities into account,

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<sup>379</sup> “Le mythe de l’ordre juridique de base (ou Grundlegung)”, in: *Le droit des relations économiques internationales, Liber Amicorum for Prof. Goldman*, (1982), 216.

<sup>380</sup> Gaillard, “Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit”, *Journal du Droit International* (1995), 26.

<sup>381</sup> Gaillard, “Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit”, *Journal du Droit International* (1995), 29.

could lead to better results and be more adapted to the needs of international commercial arbitration<sup>382</sup>.

Although the sources named in this section do not create law, they do merit being named in the list. The works of comparative lawyers declare law; their authors discover existing law and principles. Nevertheless their influence is important, because merchants and arbitrators might not be aware of the fact that a certain rule constitutes a principle that is always observed.

## 10. Conclusion

For the above reasons, Lando's approach is followed<sup>383</sup>, but the public policy of the country in which the enforcement is likely to be requested, as proposed by Mustill<sup>384</sup>, is added to the list. The works of comparative jurists and their publications present yet another source of the *lex mercatoria*. As has been shown, the new law merchant has many different sources and elements and cannot be reduced to usages or general principles of law.



### *B. Scope of the lex mercatoria*

*Lex mercatoria* only concerns international trade relations. There is no need to apply it between two parties from the same state for they both know their national law and expect it to be applied. In addition, *lex mercatoria* is applicable only when professional merchants or merchants and states or state entities are involved. To assure consumer protection, the national laws remain the only applicable laws in cases involving them. *Lex mercatoria* is designed to assure that international trading activities run smoothly, adapted to the special needs of the merchant community. As a consequence, there is no need to apply it to contracts concerning consumers.

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<sup>382</sup> Gaillard, "Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit", *Journal du Droit International* (1995), 30.

<sup>383</sup> Lando, "The lex mercatoria in International Commercial Arbitration", 34 *ICLQ* (1985), 749.

<sup>384</sup> Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 109.

It is impossible to provide a complete list of all the contents and principles of the *lex mercatoria*<sup>385</sup>. Because the parties often insist on discretion, it is difficult to create such a list, though there have been many attempts to do so<sup>386</sup>. This list-making leads to a “creeping” codification of the *lex mercatoria*, because arbitrators may use the lists and thereby increase the *lex mercatoria*’s acceptance<sup>387</sup>. This tendency helps to develop a clearer picture of the *lex mercatoria* and provides the arbitrators and merchants with an up-to-date compilation. As mentioned before, recent compilations name more than 60 principles which are part of the *lex mercatoria*<sup>388</sup>!

Gaillard suggested that transnational rules cannot result from a list, but have to be discovered using a specific method<sup>389</sup>. Thus, whenever arbitrators have to apply transnational rules they have to find these rules using a particular method and cannot simply use a list. In a first step, the arbitrators have to find out whether the parties have indicated the method to be used to find the transnational rules in their contractual stipulations<sup>390</sup>. Merchants often opt for principles common to the national laws of the parties involved to be applied. In the Eurotunnel contract, for example, the principles common to English and French law were chosen as the law governing the conflict<sup>391</sup>. If the contract is silent as to the method to be used, the arbitrators should use methods of comparative law to find the rules pertinent to the case. Arbitral awards can certainly be used as an inspiration, but can never

<sup>385</sup> Goode, “Usage and its Reception in Transnational Commercial Law”, in: Ziegel (ed.), “New Developments in International Commercial and Consumer Law”, Oxford (1998), 5; Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 ICLQ (1985), 749.

<sup>386</sup> Berger, *Formalisierte oder “schleichende” Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 217; Craig, Park, Paulsson, “ICC Arbitration”, New York (2000), 642; Mustill, “The New *Lex Mercatoria*: The First Twenty-five Years”, 4 *Arbitration International* (1988), 111; Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992).

<sup>387</sup> Berger, *Formalisierte oder “schleichende” Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 194.

<sup>388</sup> Berger, *Formalisierte oder “schleichende” Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 217; The Center for Transnational Law (CENTRAL) published a list with more than 60 principles of the *lex mercatoria*, available at the Transnational Law Database at: <http://www.tldb.de/>.

<sup>389</sup> Gaillard, “Trente ans de *Lex Mercatoria*. Pour une application sélective de la méthode des principes généraux du droit”, *Journal du Droit International* (1995), 22.

<sup>390</sup> Gaillard, “Trente ans de *Lex Mercatoria*. Pour une application sélective de la méthode des principes généraux du droit”, *Journal du Droit International* (1995), 22.

<sup>391</sup> Gaillard, “Trente ans de *Lex Mercatoria*. Pour une application sélective de la méthode des principes généraux du droit”, *Journal du Droit International* (1995), 22.

be the only source. Products of international legislation, such as the Vienna Convention can also be regarded as indicators, but cannot replace the comparative work. Arbitrators are said to be obliged to find rules that exist commonly in the national laws involved and can therefore be regarded as rules of transnational law<sup>392</sup>. According to Gaillard, this method assures that the *lex mercatoria* is complete and has no gaps.

However, lists can still be regarded as a valid source of the *lex mercatoria*. The following list is by no means complete, but rather another modest haul. The principles governing the *lex mercatoria* are always general and have to be applied according to the circumstances. As noted above, the arbitrator will act as an inventor: *An arbitrator who relies solely on the 'general principles of law' is often unable to find principles which are truly 'general' in the sense that they belong to the common core of all legal systems or even the laws connected with the dispute. He will therefore, to a large extent, have to use his creativity and act as a social engineer.*<sup>393</sup>

In order to assure the flexibility and adaptability of the law merchant, it can only consist of some general principles. The more detailed and exhaustive a body of law is, the sooner it needs to be reformed and the sooner it no longer fulfils its original purpose.

## 1. Freedom of Contract

The freedom of contract principle provides that the parties are free to enter into binding contracts, to determine their contents and the applicable law. This rule, also known as the principle of party autonomy, is common to the laws of all civilized nations. Certain limits exist, such as the mandatory rules of public policy of a particular nation. This principle is essential to the evolution of the *lex mercatoria* as it allows the parties to adapt their contract to their particular needs, to have recourse to arbitration and to conclude self-regulatory contracts and thus

<sup>392</sup> Gaillard, "Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit", *Journal du Droit International* (1995), 24.

<sup>393</sup> Lando, "The law applicable to the merits of the dispute", in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 110.

act independently of national laws<sup>394</sup>. This contractual freedom minimizes the need to apply national law as the parties are free to create and choose their own rules governing the contract.

## 2. Pacta sunt servanda

This sanctity of the contract principle constitutes the fundamental rule of the whole *lex mercatoria*<sup>395</sup>. A contract concluded according to the general rules has a binding force upon the parties and can only be modified by their mutual consent. It is cited in many arbitral awards, such as in the Sapphire case: “Moreover, it is a fundamental principle of law, which is constantly being proclaimed by international courts, that contractual undertakings must be respected. The *pacta sunt servanda* rule is the basis of every contractual relationship.”<sup>396</sup>

The paramount importance of the principle that contracts should be performed according to the terms has also been criticized<sup>397</sup>. Opponents argue that the mandatory rules of national laws designed to protect the weaker party are ousted and that the contract is above the law because the economically stronger party is said to be able to dictate the contract’s terms and his business partner to be bound by the stipulations he has been driven to accept<sup>398</sup>.

Still, contracts are to be enforced even in cases where drastic price changes take place or circumstances otherwise change. Parties are presumed to have negotiated the contract by taking such uncertainties and risks into account. International traders are presumed to know the particular risks of international trade. Unless a currency stabilisation clause is inserted into the contract, the parties are bound to perform<sup>399</sup>.

<sup>394</sup> CENTRAL-List No. IV.1.1, available at: <http://www.tldb.de/>; Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 328.

<sup>395</sup> CENTRAL-List No. IV.1.2, available at: <http://www.tldb.de/>; Mustill, “The New *Lex Mercatoria*: The First Twenty-five Years”, 4 Arbitration International (1988), 110.

<sup>396</sup> *Sapphire v. NIOC*, 35 Int’l. L. Rep. (1967), 181.

<sup>397</sup> Virally, “Un tiers droit? Réflexions théoriques”, in: Etudes Goldman (1982), 381.

<sup>398</sup> Mann, “Schiedsrichter und Recht”, in: Festschrift Flume (1978), 595.

<sup>399</sup> Craig, Park, Paulsson, „ICC Arbitration“, New York (2000), 642.

To respond to the reproach mentioned above it needs to be said that the impact of *pacta sunt servanda* should not be overestimated. The contract is not the sole law of the contract. On the one hand its content is logical and understood, but on the other there are many exceptions, for example the contestation (*Anfechtung, recours en annulation*) of the contract or frustration. Especially in long-term contracts, there are possibilities to alter the contract's contents and stipulations.

The exceptions to and limits of that general principle are more interesting to study and more pertinent to dispute resolution<sup>400</sup>. This principle finds its limits in the good faith principle, which means that no contract that is against *bona fides* has to be performed. One could also say that the *pacta sunt servanda* principle is embodied in almost every national law and therefore not part of the *lex mercatoria*. However, whenever arbitrators make reference to it, they do not refer to a specific national law but to the principle as a general principle of law and as such part of the *lex mercatoria*<sup>401</sup>.

### 3. Clausula rebus sic stantibus



The following definition of hardship is proposed by the Transnational Law Database<sup>402</sup>:

#### No. VIII.1 - Definition and legal consequences of Hardship

- (a) Any event of legal, economic, technical, political or financial nature
  - i) which occurs after the conclusion of the contract
  - ii) which could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract and
  - iii) which fundamentally alters the equilibrium of the contractual obligations, thereby rendering the performance of the contract excessively onerous for that

<sup>400</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 282; Virally, "Un tiers droit? Réflexions théoriques", in: *Etudes Goldman* (1982), 381: *Ce qui est intéressant n'est pas seulement de poser la règle, qui va de soi et est de portée universelle, mais de déterminer ses limites et ses exceptions.*

<sup>401</sup> Goldman, "The applicable law: general principles of law – the *lex mercatoria*", in: Lew (ed.), *Contemporary Problems in International Arbitration*", (1987), 125.

<sup>402</sup> [http://tldb.uni-koeln.de/php/pub\\_show\\_principle.php?pubdocid=951000&pubwithmeta=ja](http://tldb.uni-koeln.de/php/pub_show_principle.php?pubdocid=951000&pubwithmeta=ja)

party provided that party has not, through express stipulation or by the nature of the contract, assumed the risk of that event

constitutes hardship ("Wegfall der Geschäftsgrundlage", "clausula rebus sic stantibus", "frustration of purpose").

(b) In case of hardship, the aggrieved party may claim renegotiation of the contract with a view to reach agreement on alternative contractual terms which reasonably allow for the consequences of the event. If the parties fail to reach agreement on these alternative terms within reasonable time, either party may apply to a court or arbitral tribunal in order to have the contract adapted to the changed circumstances (provided the applicable procedural law allows for such adaptation) or terminated at a date and on terms to be determined by the court or arbitral tribunal.

When arbitrators refer to it, they apply it as an element of the *lex mercatoria*<sup>403</sup>. Some elements of this principle are common to the national laws and the usages of international trade. Lagarde classifies the hardship doctrine as a simple clause, and not as a general principle of law<sup>404</sup>. This principle is an exception to the fundamental rule of *pacta sunt servanda*<sup>405</sup>. Since the sanctity of contracts is of paramount importance, hardship can only be invoked exceptionally: *The principle 'Rebus sic stantibus' is universally considered as being of strict and narrow interpretation, as a dangerous exception to the principle of sanctity of contracts. ... necessity to limit the application of the so-called 'doctrine rebus sic stantibus' to cases where compelling reasons justify it, having regard not only to the fundamental character of the changes, but also to the particular type of the contract involved, to the requirements of fairness and equity and to all the circumstances of the case.*<sup>406</sup>

<sup>403</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 Boston Univ. Int'l. L. J. (1984), 338; Goldman, "La *lex mercatoria* dans les contrats et l'arbitrage internationaux: réalité et perspectives", Journal du Droit International (1979), 488; Goldman, "The applicable law: general principles of law – the *lex mercatoria*", in: Lew (ed.), Contemporary Problems in International Arbitration", (1987), 125.

<sup>404</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 129.

<sup>405</sup> Mustill, "The New *Lex Mercatoria*: The First Twenty-five Years", 4 Arbitration International (1988), 111.

<sup>406</sup> ICC Award No. 1512/1971, YCA vol. I (1976), 129.

#### 4. Force majeure

A *force majeure* situation exists when the (further) execution of the contract is made impossible by circumstances that were not foreseeable when the contract was concluded. The following definition of *force majeure* is proposed by the Transnational Law Database<sup>407</sup>:

No. VI.3 - Force majeure:

If non-performance of a party is due to an impediment which is beyond the reasonable control of that party and could not have reasonably been foreseen by that party at the time of conclusion of the contract, such as (unless otherwise agreed by the parties expressly or impliedly) war, whether declared or not, civil war or any other armed conflict, military or non-military, interference by any third party state or states, acts of terrorism, sabotage or piracy, strike or boycott, acts of governments or any other acts of authority, whether lawful or unlawful, blockade, siege or sanctions, accidents, fire, explosions, plagues, natural disasters such as but not limited to storm, cyclone, hurricane, earthquake, landslide, flood, drought etc, and neither the impediment nor its consequences could have been avoided or overcome by the non-performing party ("acts of God; "force majeure", "höhere Gewalt"), that party's non-performance is excused. If non-performance is temporary, performance of the contract is suspended during that time and that party is not liable for damages to the other party. If the period of non-performance becomes unreasonable and amounts to a fundamental non-performance, the other party may claim damages and terminate the contract.

The performance of the contract has to be impossible, whilst mere difficulties would be a case for renegotiation. This means that no other trader is able to perform according to the contractual duties<sup>408</sup>. In addition to this, the circumstances rendering the contract's performance impossible have to be unforeseeable. Not even drastic price changes are considered to be unforeseeable,

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<sup>407</sup> available at:[http://tldb.uni-koeln.de/php/pub\\_show\\_principle.php?pubdocid=944000&pubwithmeta=ja](http://tldb.uni-koeln.de/php/pub_show_principle.php?pubdocid=944000&pubwithmeta=ja)

<sup>408</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 Boston Univ. Int'l. L. J. (1984), 339.

for they are a well-known element of the business world<sup>409</sup>. Three conditions need to be given: the event has not been caused by the parties (*événement extérieur*), it is unforeseeable (*imprévisibilité*) and cannot be surmounted with reasonable means (*insurmontabilité*)<sup>410</sup>. These conditions are interpreted very strictly by the courts, for the parties are supposed to know that the future may hold surprises and far-reaching changes of circumstances. One can expect international merchants to consider every eventuality before concluding a contract. They have to calculate all possible risks, such as currency changes, drastic price changes and even political events, such as civil war in areas that tend to be dangerous and unstable<sup>411</sup>. As a matter of fact, speculations and uncertainties about the factors mentioned before are often part of the scheme and motivation behind the business transaction<sup>412</sup>. To overcome any of these, they have the possibility of inserting clauses that minimize the risks into the contract (e.g. “gold” or currency stabilisation clauses).

## 5. Abus de droit

The *abus de droit* principle provides that unfair clauses and contracts cannot be enforced<sup>413</sup>. It is a general principal of law and part of the *lex mercatoria*. Arbitrators can invoke this rule even if they do not act as *amiables compositeurs*:... *an arbitral tribunal, even without the powers to act as amiable compositeur, had the authority to reject an abuse of right and that furthermore, an amiable compositeur could also depart from the general principles of the lex mercatoria or from the contract itself when such departure was justified by fairness or equity.*<sup>414</sup>

<sup>409</sup> Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 340.

<sup>410</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 111.

<sup>411</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 111.

<sup>412</sup> Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 340.

<sup>413</sup> Mustill, “The New *Lex Mercatoria*: The First Twenty-five Years”, 4 *Arbitration International* (1988), 111.

<sup>414</sup> YCA vol. XII (1987), 73.

## 6. Culpa in contrahendo

... *c'est un principe du droit suisse (culpa in contrahendo) – conforme du reste à un principe général du droit – que celui qui cause un dommage à l'occasion d'une négociation, en manquant à ses devoirs de diligence ou à des devoirs dictés par la bonne foi et l'équité, doit réparer le dommage.*<sup>415</sup> The pre-contractual liability includes the cases where damage is caused by one party to the other before the actual conclusion of the contract, for example breaking off the negotiations in bad faith and without reason<sup>416</sup>. The *culpa in contrahendo* doctrine was first developed by the German Rudolf von Jhering saying that a quasi-contractual responsibility exists before the conclusion of the contract, namely with the first contact in preparation for the contract, the negotiations. The agreement to negotiate obligates the parties to continue and not to break off the negotiations without reason. In the presence of such an agreement, the negotiations have a contractual character and force the parties not to cause any damages to their future business partner<sup>417</sup>. This becomes clear in the NORSOLOR award: Such an agreement ... *ne constitue donc qu'un simple accord de principe, c'est-à-dire un engagement contractuel de faire une offre de poursuivre une négociation en cours afin d'aboutir à la conclusion d'un contrat. ... donne à la sanction de la rupture des pourparlers un fondement contractuel. Cette analyse correspond d'ailleurs à la pratique commerciale internationale.*<sup>418</sup>

An important problem in this matter is the question of the arbitrability of precontractual or extracontractual relations between the parties, for no contract with an arbitration clause yet exists. According to Osman, there are three possibilities that result in the arbitrability of a precontractual relation<sup>419</sup>: First, the arbitrators could qualify the negotiations as being a contractual engagement by the parties<sup>420</sup>. On the other hand, arbitrators have not yet done that. Nevertheless, the further negotiations are advanced the more the parties might feel inclined to conclude a pre-contract or a promise to conclude a contract. From these, the

<sup>415</sup> ICC Award No. 2540.

<sup>416</sup> CENTRAL-List No. IV.7.1, available at: <http://www.tldb.de/>; Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 111.

<sup>417</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 71.

<sup>418</sup> *Société Norsolor c/ Pabalk*, *Revue arbitrale* (1983), 529.

<sup>419</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 73.

<sup>420</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 73.

arbitrators can derive the existence of a contractual engagement. Secondly, the arbitrability could be the parties' explicit choice<sup>421</sup>. They could include an arbitration clause covering all their extracontractual responsibilities. Thirdly, there could be a strong connection between the *responsabilité contractuelle* and the *responsabilité délictuelle*<sup>422</sup>. Arbitrators draw their ability to decide about the latter from this strong connection: *Each of (the) claims pertains directly to performance of the contracts. The arbitrator finds that each of these claims is sufficiently related to the subject matter of the contracts to be considered as 'arising under' them within the meaning of the contractual arbitration clauses... Hence, the arbitrator finds that he has jurisdiction to consider them.*<sup>423</sup>

In addition to the link, it seems to be essential that there be no objection: *The Tribunal considers that these claims are so closely interlinked that they are both within the jurisdiction of the tribunal conferred by (the arbitration agreement) of the contract. Indeed, in order to assess damages properly, and to avoid overlapping, it is unavoidable to consider both claims together. They depend upon the same set of facts and no objection was raised by either party to the jurisdiction of the Tribunal in respect of them. They are included in the Terms of Reference.*<sup>424</sup>



## 7. Bona fides

The principle of good faith (*bona fides, bonne foi, Treu und Glauben, ...*) is common to all the laws and the foundation of International Trade Law: “Throughout the evolution of the Law Merchant, the principle of consensuality appears as the bastion of international commerce. ... Among merchants good faith is paramount.”<sup>425</sup>

<sup>421</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 73.

<sup>422</sup> Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 73.

<sup>423</sup> ICC Award No. 5779/1988, cited in: *Journal du Droit International* (1988), 1206.

<sup>424</sup> ICC Award No. 5477/1988, *Journal du Droit International* (1988), 1205.

<sup>425</sup> Trakman, “The evolution of The Law Merchant: Our Commercial Heritage“ (Part I), 12 *J. Marit. L. & Com.* (1980), 2. Later (page 7) he adds: “Good faith was the essence of mercantile agreement.”

*Bona fides* means the performance of the contract in good faith and fair dealing<sup>426</sup>. The contract must at all times be performed in good faith and fair dealing. This principle is common to all the modern laws and constitutes a general principle of law. Good faith is and has always been the basis of any mercantile agreement and can be regarded as the source of all other general principles of law<sup>427</sup>. The Uniform Commercial Code gives a useful example in § 1-203:

Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

Good faith is defined as “honesty in fact in the conduct or transaction concerned”, § 2-201 (19) UCC, and, in addition to that, for merchants the “observance of reasonable commercial standards of fair dealing in the trade”, § 2-207 (1) (b) UCC.

*Bona fides* can be regarded as the fundamental principle of the *lex mercatoria*: *Argument de raison et d'évidence ou principe général de droit et de justice universellement admis, la bonne foi est, en tout cas, au centre et au cœur de la majorité des sentences arbitrales. Elle constitue une règle d'interprétation et le guide de toute action comme de tout jugement.*<sup>428</sup>

On the other hand, it has been observed that the performance of the contract in good faith and fair dealing is just affirming the fundamental rule of *pacta sunt servanda*. Not performing the contract in good faith and fair dealing would mean not respecting the contract, i.e. breaking the *pacta sunt servanda* rule<sup>429</sup>. Good faith is also a rather vague rule and cannot provide precise solutions to a given situation. It can be regarded as a general attitude of behaviour when engaging in international business. *One of the principles which inspires the latter*

<sup>426</sup> CENTRAL-List No. I.1, available at: <http://www.tldb.de/>; Goldman, “La lex mercatoria dans les contrats et l’arbitrage internationaux: réalité et perspectives”, *Journal du Droit International* (1979), 492; Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 111.

<sup>427</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 109; Trakman, “The evolution of The Law Merchant: Our Commercial Heritage” (Part I), 12 *J. Marit. L. & Com.* (1980), 7.

<sup>428</sup> Horsmans, “L’interprétation des contrats internationaux”, *L’arbitrage commercial international. L’apport de la jurisprudence arbitrale*, ICC Publication, 153; cited in: Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 19.

<sup>429</sup> Fouchard/Gaillard/Goldman, *Traité de l’arbitrage international*, Paris (1996), 831.

*[the lex mercatoria] is that of good faith which must preside the formation and the performance of contracts. The emphasis placed on contractual good faith is moreover one of the dominant tendencies revealed by the convergence of national laws on the matter.*<sup>430</sup>

## **8. No bribery or corruption**

No bribes or other dishonest means may be used to obtain a contract. Bribery is any misuse of a certain political or economic power to obtain an undue advantage of any kind or an offer to a person in such a situation. A contract based on bribery or corruption is void and unenforceable. This rule constitutes a general principle of law, public policy and morality common to all civilized nations. Contracts produced by bribery are void and unenforceable even if bribery is common in the locality where the contract was concluded<sup>431</sup>. It makes no difference whether the contract is obtained by bribing a private person or a state official<sup>432</sup>.



## **9. Capacity of state entity to arbitrate**

The problem is whether or not a state or a state entity can submit its business relations to arbitration. There are some national laws that exclude the possibility of public entities referring their dispute to an arbitrator. Nevertheless, it is now generally accepted that such exclusions are not valid. Once a public entity has agreed to include an arbitral clause into the contract, it has to submit to the arbitrator's jurisdiction, for it cannot deny its own capacity to conclude an arbitral agreement<sup>433</sup>. *A State entity cannot be permitted to evade the enforcement of its obligations by denying its own capacity to make a binding agreement to arbitrate,*

<sup>430</sup> ICC Award No. 3131, (26 October 1979), YCA vol. IX (1984), 110.

<sup>431</sup> CENTRAL-List No. IV.6.2, available at: <http://www.tldb.de/>; De Ly, *International Business Law and Lex Mercatoria*, (1992), 283; Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 20. Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 111.

<sup>432</sup> Gaillard, "Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit", *Journal du Droit International* (1995), 11.

<sup>433</sup> Goldman, "The applicable law: general principles of law – the *lex mercatoria*", in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 124.

or by asserting that the agreement is unenforceable for want of procedural formalities to which the entity is subject.<sup>434</sup>

The same principle is mentioned in the following arbitral award: “It is not necessary to add that a general principal which is today universally accepted ... forbids the Iranian state from disregarding the arbitral clause which has been signed by the Iranian state or a public entity.”<sup>435</sup>

## 10. Agent acting on behalf of group of companies

The controlling interest of a group of enterprises or a corporate entity acting on behalf of a group of corporate entities is contractually binding on all the members of the group<sup>436</sup>. The conclusion and negotiation of a contract by the head of a group of enterprises binds all the members of the group. This principle has been confirmed in numerous arbitral awards<sup>437</sup>.

## 11. Renegotiation in Good Faith



If unforeseen circumstances arise, the parties have to negotiate to overcome the difficulties in the execution of the contract, even if no such clause exists in the contract<sup>438</sup>. This is valid only when there is a need for renegotiation and if the parties can reasonably be expected to continue to perform the contract<sup>439</sup>.

<sup>434</sup> Goldman, “The applicable law: general principles of law – the *lex mercatoria*”, in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 123; Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 112.

<sup>435</sup> *Framatome et Al. c/ A.E.O.I.*, *Journal du Droit International* (1984), 72.

<sup>436</sup> CENTRAL-List No. II.2, available at: <http://www.tldb.de/>; Goldman, “La lex mercatoria dans les contrats et l’arbitrage internationaux: réalité et perspectives”, *Journal du Droit International* (1979), 496; Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 112.

<sup>437</sup> ICC Award No. 2138, *Journal du Droit International* (1975), 934; ICC Award No. 2375, *Journal du Droit International* (1976), 973.

<sup>438</sup> Fouchard/Gaillard/Goldman, *Traité de l’arbitrage international*, Paris (1996), 843; Goldman, “La lex mercatoria dans les contrats et l’arbitrage internationaux: réalité et perspectives”, *Journal du Droit International* (1979), 496; Mustill, “The New Lex Mercatoria: The First Twenty-five Years”, 4 *Arbitration International* (1988), 112.

<sup>439</sup> CENTRAL-List No. IV.5.7, available at: <http://www.tldb.de/>.

## 12. *Falsa demonstratio non nocet*

*Falsa demonstratio non nocet* is another general principle of law<sup>440</sup>. It does not matter which name the parties give to anything related to the contract, as long as everybody involved means the same thing. For example, if two traders call apples pears, but both of them mean apples, a contract about apples is concluded and valid.

## 13. Currency stabilisation agreements are valid and enforceable

The parties attach the currency to a certain index when concluding the contract to minimize the risk of fluctuations. This can help assure that changes in the real value of the contract are minimized. If such a clause is inserted into the contract, the parties are considered to have accepted the risk of currency fluctuations. Currency stabilisation clauses have a non-national character and will be enforced by the arbitrators, if inserted into the contract<sup>441</sup>.



## 14. *Exceptio non adimpleti contractus*

If one party fails to fulfil its obligations or commits another breach, the other party is discharged from its own obligations. Naturally, the breach has to be substantial, otherwise the other party cannot assert this right. It would be contrary to the *bona fides* principle if a certain amount of proportionality were not respected and one could call upon the *exceptio non adimpleti contractus* for any minor breach of contract or the non-respect of any secondary obligation. This principle has been called part of the general principles of law forming the *lex mercatoria*<sup>442</sup>. *There is a general rule of private law to be found in positive systems of law, which says that a failure by one party to a synallagmatic contract to perform its obligations in breach of contract releases the other party from its*

<sup>440</sup> BERGER, Klaus Peter, *Internationale Wirtschaftsschiedsgerichtsbarkeit*, 381.

<sup>441</sup> Mustill, "The New *Lex Mercatoria*: The First Twenty-five Years", 4 *Arbitration International* (1988), 112; Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 *Boston Univ. Int'l. L. J.* (1984), 344.

<sup>442</sup> Fouchard/Gaillard/Goldman, *Traité de l'arbitrage international*, Paris (1996), 843; ICC Award No. 2583/1976, *Journal du Droit International* (1976), 950; Mustill, "The New *Lex Mercatoria*: The First Twenty-five Years", 4 *Arbitration International* (1988), 113.

*obligations and gives rise to a right to pecuniary compensation in the form of damages. Although the methods of applying this principle differ, particularly with regard to judicial techniques and the formalities required for the implementing of this right, this rule is a general rule, and constitutes a general principle of law recognized by the civilized nations.*<sup>443</sup>

## **15. Interpretation of contract according to true meaning**

The arbitrator can interpret the contract according to its true meaning and is not bound by the parties' characterization<sup>444</sup>. Arbitrators have the right to characterize clauses or contracts according to their true meanings. They are not bound by the meaning of the terms employed by the parties. Thus the ICC considered a contract characterized as a sales contract as comprising a contract of services<sup>445</sup>.

## **16. Foreseeability of loss**



Damages for a breach of contract are always limited to what could have reasonably been expected or foreseen as the likely damage caused by non-performance<sup>446</sup>.

## **17. Mitigation of loss**

The duty to mitigate principle provides that "... a party which has suffered a breach of contract must take reasonable steps to mitigate its loss"<sup>447</sup>. As a matter

<sup>443</sup> *Sapphire v. NIOC*, 35 Int'l. L. Rep. (1967), 182.

<sup>444</sup> Fouchard/Gaillard/Goldman, *Traité de l'arbitrage international*, Paris (1996), 840; Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 113.

<sup>445</sup> ICC Award No. 3243, *Journal du Droit International* (1982), 968: *Le Tribunal arbitral retient en conséquence que, en dépit des termes utilisés pour caractériser le contrat, les parties n'ont pas conclu un simple contrat de vente de matériel; elles ont aussi conclu un contrat de livraison d'équipement, assorti, à la suite des études faites par la demanderesse et de leur discussion avec la défenderesse, d'une garantie de rendement donnée par la demanderesse.*

<sup>446</sup> CENTRAL-List No. VII.2, available at: <http://www.tldb.de/>; Fouchard/ Gaillard/ Goldman, *Traité de l'arbitrage international*, Paris (1996), 846; Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 113.

of fact, the obligation to minimize one's loss is one of the best established principles of the *lex mercatoria*<sup>448</sup>. If a party does not take such steps as it could reasonably have taken to mitigate the loss, the damages can be reduced by the amount that could have been mitigated.

## 18. Coherence

According to this principle, the same term in the same document is always given the same meaning. This has been confirmed by arbitral jurisprudence<sup>449</sup>.

## 19. Ut res magis valeat quam pereat<sup>450</sup>

According to the *ut res magis valeat quam pereat* rule (so that the thing be held valid rather than perish), when interpreting the contract one presumes that the parties wanted the agreement to work and the contract to make sense (*signification réelle et une portée opérante*). This has been principle has been confirmed by ICC arbitrators<sup>451</sup>.

Thus, whenever a contractual stipulation has more than one meaning, it is interpreted in a way that assures the validity of the contract. This follows from the presumed intention of the parties that their agreement should work.

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<sup>447</sup> Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 113.

<sup>448</sup> CENTRAL-List No. VII.4, available at: <http://www.tldb.de/>; Fouchard/ Gaillard/ Goldman, *Traité de l'arbitrage international*, Paris (1996), 845.

<sup>449</sup> Fouchard/Gaillard/Goldman, *Traité de l'arbitrage international*, Paris (1996), 839; ICC Award No. 1434, *Journal du Droit International* (1976), 978.

<sup>450</sup> Craig, Park, Paulsson, „ICC Arbitration“, New York (2000), 646; Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 114.

<sup>451</sup> ICC Award No. 1434/1975, *Journal du Droit International* (1976), 982: ... *une règle d'interprétation universellement reconnue veut que, en présence de deux interprétations contraires ou de deux sens possibles des mêmes termes d'un contrat, on doive, dans le doute, préférer l'interprétation qui conserve aux mots une certaine portée plutôt que celle qui les considère comme inutiles ou mêmes absurdes. Ce 'principe de l'effet utile', appelé aussi 'principe de l'effectivité' (ut res magis valeat quam pereat) est consacré, notamment par l'article 1157 du Code civil.*

## 20. Estoppel by representation

Whenever a merchant makes a business partner believe, be it by tolerating the agent's behaviour or by creating or tolerating the appearance of proper authority, that one of his agents has the proper authority to engage in contractual responsibilities, the merchant cannot invoke the lack of authority of that agent if the business partner had no reason to doubt the agent's authority. This rule has been confirmed by the arbitral jurisprudence and derives from the general principle of *bona fides*<sup>452</sup>.

## 21. Contra proferentem

If there is a doubt about the meaning of a certain clause or term, it is interpreted against the party that introduced it into the contract. Thus, the introduction of clauses that can be interpreted ambiguously is discouraged. Through this rule, the party drawing up the contract has to draft it very carefully, not leaving anything to doubt. The parties are encouraged to throw light on every clause to avoid the arbitrator interpreting the contract to their detriment<sup>453</sup>.



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<sup>452</sup> CENTRAL-List No. II.4, available at: <http://www.tldb.de/>; Fouchard/ Gaillard/ Goldman, *Traité de l'arbitrage international*, Paris (1996), 832.

<sup>453</sup> CENTRAL-List No. IV.4.3, available at: <http://www.tldb.de/>; Fouchard/ Gaillard/ Goldman, *Traité de l'arbitrage international*, Paris (1996), 840.

## Chapter 5

### Reasons for choosing *lex mercatoria*

It is clear that international contracts are different from national ones, i.e. involving parties from one country only. They often involve more money and different countries, currencies, languages, taxes, legislations etc. Therefore there tends to be a greater degree of insecurity. No international or transnational court has compulsory jurisdiction in international trade disputes<sup>454</sup>. It follows from this that international merchants have to submit their dispute to a national court. However, the nationalization of international commercial disputes has many disadvantages. For these reasons, the parties develop transnational devices or submit to those already developed<sup>455</sup>.

To avoid the application of national law, international traders use different techniques. Stein has identified three main procedures for substituting transnational trade law for national law. First, the standardization of contractual practice has the greatest impact on transnational trade law. The business world is being provided with pre-formulated and basically self-regulative contracts. Therefore there is no need to have recourse to national laws<sup>456</sup>. Secondly, the self-regulating contracts also contribute to the disappearance of national law in the area of international trade. Thirdly, the formation of transnational enterprises and international organisations further promotes the emergence of transnational law. They are autonomous and create their own rules as they cannot be linked to a specific national law<sup>457</sup>.

In addition to this, Stein mentions two techniques to further protect *lex mercatoria* against the influence of national law. If the contract shows gaps or the rules that are being used to resolve conflicts do not provide answers to all the questions, one needs to find another set of rules. In most cases this would be a

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<sup>454</sup> Booyesen, "Principles of International Trade Law as a monistic system", Pretoria (2003), 751.

<sup>455</sup> Draetta, Lake, Nanda, Breach and Adaptation of International Contracts, Butterworth (1992), 3.

<sup>456</sup> Stein, *Lex mercatoria: Realität und Theorie*, 39.

<sup>457</sup> Stein, *Lex mercatoria: Realität und Theorie*, 44.

national law. To prevent national law from being applied to their dispute, it is essential that the parties either explicitly oust the application of any national law or choose transnational law, *lex mercatoria* or the like, to govern the contract. Second, there are procedural techniques such as conflict avoidance, alternative dispute resolution or the insertion of an arbitral clause into the contract<sup>458</sup>.

### ***A. Disadvantages of the Nationalization of International Relations***

According to the classic school of International Private Law, the relation between two private parties is necessarily governed by a national law, for there is no private law at the international level<sup>459</sup>. International Private Law is national law made to govern international conflicts, i.e. conflicts involving parties from more than one state. The applicable law will be determined by the national rules of conflict and it can only be the law of a state. A contract is international if it is connected with more than one legal system. The approach most commonly used is to search for the closest connection. Whichever national law the contract is most closely connected with should be applied. Thus international trade relations are nationalized<sup>460</sup>.

The *lex mercatoria* school follows a completely different approach. National law cannot be applied to settle disputes in international trade, not even to fill possible gaps<sup>461</sup>. There are numerous disadvantages to this nationalization of international relations<sup>462</sup>.

#### **1. Unpredictability of the Applicable Law and the Solution**

First, the basis for all these problems is the fact that not all national laws provide the same solutions for identical problems, for all of them take different criteria into account in determining which rule should be applied and how the

<sup>458</sup> Stein, *Lex mercatoria: Realität und Theorie*, 52.

<sup>459</sup> Kegel/Schurig, *Internationales Privatrecht*, 9.

<sup>460</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 22.

<sup>461</sup> Kappus, *Lex mercatoria in Europa und Wiener UN-Kaufrechtskonvention 1980*, Frankfurt am Main (1990), 83.

<sup>462</sup> Von Hoffmann, "Grundsätzliches zur Anwendung der 'lex mercatoria' durch internationale Schiedsgerichte", in: *Festschrift Kegel*, 218.

dispute should be resolved<sup>463</sup>. If the different national laws provided the same solutions and rules, i.e. if there were a truly uniform law of international trade in all countries, this problem would not be pertinent for the parties would be familiar with the rules, solutions would be predictable and equality assured because it would not matter whose national law one applied.

Courts from different countries and with totally different legal systems can declare themselves competent in the affair. Circumstances become even more complex when there are more than two parties from more than two states involved, a condition that is very common in modern business relationships. It always seems capricious and arbitrary to declare one national law applicable to regulate the relations of a contract concerning parties of more than one nationality.

To be on the safe side, a merchant needs advisors and lawyers who are familiar with the laws of all the countries the contract has any connection to because he cannot be sure which national law is going to be applied in case of conflict. He therefore has to take into account all the rules and provisions of these national laws, which seems to be very inconvenient. One of the great advantages of law – to provide security and a certain, foreseeable solution to disputes – is not relevant in the law of international trade for the above reasons: the parties cannot be sure which law is going to be applied in case of a dispute and they might not be familiar with it<sup>464</sup>.

Due to a lack of an internationally accepted procedure to indicate the competent tribunal and a tendency by courts to declare themselves competent, there could be more than one state whose courts have jurisdiction over a given matter. This leads to insecurity regarding the outcome of the dispute and also to so-called forum-shopping, where one party chooses the national law which provides the solution it is looking for. It could also occur that two different tribunals in two different states pass judgements with different solutions to the very same dispute<sup>465</sup>. The problem described above worsens in proportion to the number of nationalities of the parties involved.

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<sup>463</sup> Stein, *Lex mercatoria: Realität und Theorie*, 19.

<sup>464</sup> Stein, *Lex mercatoria: Realität und Theorie*, 24.

<sup>465</sup> Stein, *Lex mercatoria: Realität und Theorie*, 31.

There is no need to apply national law even in cases where all the national laws connected to the contract provide the same solution to the same problem. It does not make sense for the arbitrator to search for the applicable law if all the national laws in question provide the same rule. This fact can rather be seen as an indication of the rule's being part of the *lex mercatoria*. It is more convenient to base the decision directly on the *lex mercatoria* than to oblige the arbitrator to first search for the applicable law<sup>466</sup>.

On the other hand, if the solutions provided by the national laws in question are different, the arbitral tribunal might find it difficult to prefer one to the other. Especially in cases where the different solutions all seem to be just and well-founded and the contract is connected to more than two national laws, *lex mercatoria* could facilitate the choice for the arbitrators<sup>467</sup>.

## 2. Arbitrary Nature of the Designation of Applicable Law

Secondly, the choice of a national law based on which state the contract is more closely connected with is often arbitrary. Unlike persons or objects, contracts are not always linked to one place and one national law. Especially with the growing importance of internet and e-commerce, it is difficult to always find one national law that seems to be closely connected to the business relation. In many cases the business relation will be equally linked to two legal systems and the international contract could well be governed by both states' laws. The designation of only one of them is compulsory and necessarily arbitrary. As one has to choose one of the laws, the criteria used for that designation are necessarily random, if the contract is equally connected to two legal systems<sup>468</sup>. If, for example, one party sells a good to another party, buyer and seller are equally connected with the contract and it is arbitrary to declare one law applicable. As

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<sup>466</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 31.

<sup>467</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 32.

<sup>468</sup> Stein, *Lex mercatoria: Realität und Theorie*, 22; Von Hoffmann, "Grundsätzliches zur Anwendung der 'lex mercatoria' durch internationale Schiedsgerichte", in: *Festschrift Kegel*, 218.

noted above, due to this fact a party might not be sure which law is governing the contract and thus might have to deal with a law it does not know or the requirements of which it does not comply with.

As mentioned above, rules of conflict are used to determine the applicable law. It is a general principle of law that the rules of conflict stipulate that the applicable law is the one with the closest and most real connection, the most significant relationship, the centre of gravity, *les liens les plus étroits* etc<sup>469</sup>. This can prove to be difficult in cases where no connection exists because neither of the parties has fulfilled the obligations resulting from the contract. This is also valid for very complex construction contracts involving many parties and many sub-contracts. International private law and its rules of conflict always indicate a national law that is applicable in the matter. Contracts in international trade are not comparable to national ones, for which the national laws were primarily made. The designation of a national law is arbitrary because the states the contract is linked to are often chosen by chance. Thus, the place where the contract is concluded is not necessarily connected to the contract. For example a Canadian and a Mexican merchant could sign a contract to build a factory in Poland. Because it is more convenient for both parties, the papers are signed in Egypt. This business relation is in no way connected to Egyptian law or usages merely because the parties signed the papers there.

In cases where the contract is equally linked to two national laws, only one of the parties can have his own law applied. Thus there seems to be a law of the winner, as it is already familiar with that law<sup>470</sup>. *Lex mercatoria* could provide a neutral set of rules and none of the parties would have an advantage over the other. There is a risk that the stronger party might force its own national law on its business partner.

Furthermore, after having found the applicable national law indicated by rules of conflict, the arbitrator might be faced with a law that he is completely

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<sup>469</sup> Berger, *Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 11.

<sup>470</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 31.

unfamiliar with. If forced to apply this law, he could easily make mistakes when interpreting and using these rules.

If the parties omit to designate a national law to be the law governing the contract, they may have made a “negative choice”<sup>471</sup>. In many cases an agreement was not reached. Each party tried to impose its own national law on the other and none of them was stipulated, as their opinions do not conform and neither of the parties wanted to abide by the other’s national law. In this case, the parties clearly agreed on the point that none of the national laws should govern the contract. They did not simply forget to indicate a national law, they deliberately omitted to do so. If the arbitrator were to apply one of their national laws to govern the substance of the dispute, he would disrespect their intentions.

### 3. Inequality of the Parties

Thirdly, equality is not ensured if an international business relation is ruled by one party’s national law. This party has certain advantages during the life of the contract as well as facing a trial in case of a dispute. Obviously, the arbitrator is supposed to be impartial. However, one of the parties has the advantage of having the dispute tried in its own language and according to the procedural rules of its own national law. It is thus “... playing at home”<sup>472</sup>. This problem is not that pertinent if the parties have chosen the applicable law themselves. In this case one of them submits to the application of a law that is not his national law. He can calculate the risks before the contract’s conclusion or he might even be familiar with the foreign law. In most cases it will be the economically more powerful party that can determine the applicable law and thereby strengthen its position even further. Application of the *lex mercatoria* provides the arbitrator with a neutral set of rules that does not favour the stronger party.

In international business relations, parties often do not trust the jurisdictions of the other party’s state. Especially in contracts involving states or

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<sup>471</sup> Craig, Park, Paulsson, „ICC Arbitration“, New York (2000), 635.

<sup>472</sup> Lando, “The law applicable to the merits of the dispute”, in: Lew (ed.), Contemporary Problems in International Arbitration”, (1987), 102.

state entities, this mistrust can sometimes be justified<sup>473</sup>. This problem could be solved by submitting the dispute to the courts of a third country, the legal system of which is alien to both parties. In practice, however, it can also be difficult to agree on a third legal system. In addition to this, both parties are now likely not to be acquainted with the peculiarities of this third legal system. True neutrality and freedom can only be provided by submitting the dispute to a non-national arbitral tribunal applying transnational law<sup>474</sup>.

#### 4. Unsuitability of National Laws

Finally, national laws do not seem apt for the regulation of international relations. They were primarily made to regulate national conflicts and do not take into account the peculiarities, customs and usages of international trade<sup>475</sup>. The individuality of national laws is not in harmony with the universality of international trade<sup>476</sup>. For example, the delivery and limitation periods of national laws are generally much briefer than those common to international trade because the national legislator does not take the long distances and the transportation difficulties into consideration. Other examples that are not satisfactorily solved by most national laws are the repartition of currency stability and transport risks<sup>477</sup>.

There are unsophisticated laws of undeveloped countries that seem not to provide suitable solutions to international trade disputes<sup>478</sup>. The problem has arisen in cases where the law of an Islamic nation that was primarily religious in character was involved<sup>479</sup>. In these cases the parties might wish to oust that law's application or at least some of its rules.

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<sup>473</sup> Stein, *Lex mercatoria: Realität und Theorie*, 32.

<sup>474</sup> Lando, "The law applicable to the merits of the dispute", in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 102.

<sup>475</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 32; Mehren, "Special Substantive Rules for Multistate Problems", 88 *Harv. L. R.* (1974), 361.

<sup>476</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 386.

<sup>477</sup> Stein, *Lex mercatoria: Realität und Theorie*, 28.

<sup>478</sup> Rivkin, "Enforceability of Arbitral Awards Based on *Lex Mercatoria*", 9 *Arbitration International* (1993), 67.

<sup>479</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 31.

The parties could also avoid certain unsuitable rules by choosing *lex mercatoria*. One of the earliest examples of the unsuitability of a national law to resolve a dispute was the case *Petroleum Development Ltd. v. Sheik of Abu Dhabi*<sup>480</sup>: *This is a contract made in Abu Dhabi and wholly to be performed in that country. If any municipal system of law were applicable, it would prima facie be that of Abu Dhabi. But no such law can reasonably be said to exist. The Sheik administers a purely discretionary justice with the assistance of the Koran; and it would be fanciful to suggest that in this very primitive region there is any settled body of legal principles applicable to the construction of modern commercial instruments.*

Especially in cases involving many parties of different nationalities, it is very difficult and time-consuming to choose the applicable law out of the many national laws connected to the contract. In such a complex business relation, it would be inadequate to govern the relationships between the parties according to their national rules of conflict. One needs only to imagine a business relationship dealing with the construction of a dam, a factory or an airport involving parties from 20 different countries to realize the unsuitability of national law for resolving conflicts in international trade. If their disputes were to be governed by their national laws, there are 20 different ones that could be applicable and many possible solutions. If no law has been chosen by the parties, all the different laws could be applied, depending on which parties are in dispute or what it is about. Clearly, this inconsistency is harmful to the course of the contract and the whole business relation.

There are two possible solutions to this problem. Firstly, one could attach all the sub-contracts to the main contract or all the sub-entrepreneurs to the main business relation. By doing this, the rules of conflict would declare only one law applicable for all the disputes connected with the whole business. Secondly, the parties could stipulate that all disputes related to the contract should be ruled by a non-national set of rules such as the *lex mercatoria*. Because of all the other disadvantages of dispute resolution according to national law in international trade, it is convenient for these parties to declare the *lex mercatoria* applicable.

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<sup>480</sup> ICLQ (1952), 247.

Thus, article 46 of the concession contract between the “National Iranian Oil Company” and nine foreign oil companies states: *In view of the diverse nationalities of the parties to this Agreement, it shall be governed by ... the principles of law common to Iran and the several nations in which the other parties to this Agreement are incorporated, and, in the absence of such common principles, by ... the principles of law recognized by civilized nations in general, including such of those principles as may have been applied by international tribunals.*<sup>481</sup>

In addition to that, there might be a so-called “*vide législatif*”, or gap, in the national laws. The transactions and the trade practices of the international merchant community are very complex<sup>482</sup>. Especially for trade matters where new usages or practices are being used and in fast-changing areas, national laws are often not flexible and quick enough to adapt to the changing needs of the merchant community. Therefore they are incomplete and cannot provide answers to all the problems concerning the new contracts<sup>483</sup>. Also, rigid and long legislative procedures prevent the national laws from being up-to-date and force the parties to employ traditional contracts and business procedures.

Even if there is a national law in the matter, this has primarily been made to govern purely national conflicts and might not take all the special needs of international trade into account<sup>484</sup>. National laws are often old and designed according to the needs of small businesses working only on the national level. Disputes arising out of international business relations are to a great part resolved by arbitrators. In fact, 90 % of the dispute resolution in international trade is assigned to arbitrators and thereby taken away from national courts<sup>485</sup>. Unlike the national courts, arbitrators are not strictly bound by certain rules and can make exceptions if appropriate. Even if the parties explicitly authorized the judge to resolve their dispute by taking into account the general principles and usages of

<sup>481</sup> cited in: Berger, *Formalisierte oder “schleichende” Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 31.

<sup>482</sup> Lando, „The lex mercatoria in International Commercial Arbitration“, 34 ICLQ (1985), 753.

<sup>483</sup> Rivkin, “Enforceability of Arbitral Awards Based on *Lex Mercatoria*”, 9 *Arbitration International* (1993), 67.

<sup>484</sup> Stein, *Lex mercatoria: Realität und Theorie*, 26.

<sup>485</sup> Berger, *Formalisierte oder “schleichende” Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 62.

international trade, national jurisdictions have to apply their national laws without regard to contrary rules of that particular trade. They are generally less experienced in international trade conflicts than arbitrators, who are usually familiar with all the special customs and usages of the branch of trade concerned<sup>486</sup>. Due to this trend toward arbitration, the national jurisdictions are not often called upon to judge matters of international trade. The national legislators and jurisdictions do not have the knowledge and experience of the arbitral tribunals at their disposal<sup>487</sup>.

Finally, there is definitely a practical need for an a-national legal standard such as *lex mercatoria* to govern international trade activities and disputes. One only needs to look at the business practices: parties to international contracts and arbitrators try in many different ways to avoid national laws with its complicated peculiarities<sup>488</sup>.

### ***B. Advantages of lex mercatoria***

There can be numerous reasons for the parties to choose *lex mercatoria* as the law governing their contract. First, a private enterprise dealing with a government may be reluctant to have a future dispute resolved by that foreign State's national law since this could always be changed in favour of the foreign state after the contract is formed<sup>489</sup>. The private party could also have doubts about receiving fair and neutral treatment before a court in the state it is dealing with. On the other hand, a government or a public enterprise may, for political reasons, not wish to have the contract governed by the laws of a foreign state. They have a tendency to be sceptical about being subject to another state's law<sup>490</sup>. Even in relations not involving a government or a public enterprise, it can be inappropriate to apply national law. The latter might not be neutral, modern, complete or advanced enough for the parties' needs.

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<sup>486</sup> Stein, *Lex mercatoria: Realität und Theorie*, 32.

<sup>487</sup> Stein, *Lex mercatoria: Realität und Theorie*, 27.

<sup>488</sup> Stein, *Lex mercatoria: Realität und Theorie*, 213.

<sup>489</sup> Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 *ICLQ* (1985), 748.

<sup>490</sup> Rivkin, „Enforceability of Arbitral Awards Based on *Lex Mercatoria*“, 9 *Arbitration International* (1993), 67.

Furthermore, if in business relations involving many parties from different countries no law has been chosen, any of the national courts connected with the contract can be approached. This court has a tendency to apply its own national law<sup>491</sup>. This means that the solution of a dispute between the parties to an international commercial transaction is not predictable and depends on which national court is approached. Even if a national court has been agreed upon by the parties, this court may judge that its jurisdiction is excluded. Other national courts can also be reluctant to accept that their jurisdiction is excluded<sup>492</sup>. The parties may not know which national system of law is governing their contract and therefore be unable to comply with that law's requirements.

It is said that the parties' freedom to choose any national law to be the law governing the contract gives them enough options. There is supposedly no need for an a-national legal standard for the parties to choose from, as their autonomy and freedom is respected by letting them designate any national law they consider appropriate to govern their conflict. In addition, many national laws allow amiable composition in order to respect the parties' special needs and wishes. However, the national laws' growing liberalism and options to oust the applicability of it only shows the inadequateness of national laws for international trade conflicts<sup>493</sup>.

The freedom of choice between the national laws does not help to alleviate the aforementioned disadvantages of the nationalization of international trade relations. First, the parties can only choose national laws, therefore the advantages of an a-national legal standard are of no consequence and the disadvantages of national law are not avoided. Furthermore, to provide a neutral set of rules the parties would have to choose a third law, foreign to both of them. However, international merchants are unlikely to be familiar with many different legal systems and thus unable to choose the one that is perfect for their trade relation. Also, only little attention is given to the choice of law, as the parties do not want to endanger the conclusion of the contract and do not think that a dispute is likely or that an unfavourable law is applicable in case of conflict. Nevertheless,

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<sup>491</sup> Langen, "Vom Internationalen Privatrecht zum Transnationalen Handelsrecht", *Neue Juristische Wochenschrift* (1969), 358.

<sup>492</sup> Booysen, *Principles of International Trade Law as a monistic system*, Pretoria (2003), 753.

<sup>493</sup> Stein, *Lex mercatoria: Realität und Theorie*, 213.

merchants hardly ever agree to have the contract governed by the law of their business partner<sup>494</sup>.

To authorize the arbitrator to act as *amiable compositeur* does not always provide a way out of these problems, because national courts might not enforce such an award. Also, amiable composition as mode of dispute resolution is not popular among merchants<sup>495</sup>. They seem to be reluctant to confer such great freedom on an arbitrator. The need for an a-national legal system such as *lex mercatoria* is therefore evident.

Thus, it seems convenient to submit to a transnational set of rules.

### 1. Uniformity of International Trade Law

If every state had a different set of rules to regulate international commerce there would be little or no homogeneity. Even if the laws were harmonized by way of treaties or model laws, national courts could interpret the same rules differently. Also, before the implementation of the treaty or the model law, rules and clauses are often changed for individual reasons<sup>496</sup>. The fact that *lex mercatoria* is the same all over the world greatly facilitates international commerce. This constitutes one important advantage of the law merchant over national laws. Since the latter ones are all different, the merchant can never be sure what a certain national law is like and how it will solve a certain problem.

### 2. Flexibility of Transnational Law

By its very nature, *lex mercatoria* is a very flexible set of rules<sup>497</sup>. It can easily adapt to changing circumstances. To change a state law, there are rigid rules that have to be observed. It is often a long process and the product of it can already be out of date again. The problem is the same for treaties that have been signed to achieve harmonious state trade laws. First, all the parties have to get

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<sup>494</sup> Stein, *Lex mercatoria: Realität und Theorie*, 221.

<sup>495</sup> Stein, *Lex mercatoria: Realität und Theorie*, 228.

<sup>496</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 *Boston Univ. Int'l. L. J.* (1984), 326.

<sup>497</sup> Rivkin, "Enforceability of Arbitral Awards Based on *Lex Mercatoria*", 9 *Arbitration International* (1993), 67.

together again to discuss the new project and the changes. Second, since the treaties are binding, all the states have to approve of every small change<sup>498</sup>. *Lex mercatoria* also comprises the rules spontaneously created by practitioners and is therefore always up-to-date. The work of the formulating agencies ought to be mentioned to further illustrate the flexibility of the *lex mercatoria*. They publish principles of international trade and greatly contribute to a codification of the transnational law of international trade. They not only collect and publish established practices and usages but constantly adapt their texts to changed circumstances and thereby evolve the law merchant.

National laws do not adapt as easily to changed circumstances and needs. They were mostly created to govern small internal trade conflicts. Most of the changes and reforms that are made only concern this area as well, since national courts and legislators are hardly ever faced with international trade conflicts. Most of these are resolved by arbitrators who dispose of a long experience and inside knowledge of international trade practices.



### 3. Growing commerce

A harmonized law of international trade contributes to the growth of international commerce. If one followed the national approach, the only way to achieve similar and harmonious commercial laws would be for all the states involved in international business to adopt the same trade law. This could happen through international treaties, model laws or the independent examination of international business practices<sup>499</sup>. The advantages of the treaty method are obvious. According to international law, the rules of the treaty are binding on all the parties and perfect uniformity is assured. On the other hand, few treaties concerning international trade have been ratified, for it is difficult to achieve an agreement between states with different trade laws and policies<sup>500</sup>.

<sup>498</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 Boston Univ. Int'l. L. J. (1984), 327.

<sup>499</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 Boston Univ. Int'l. L. J. (1984), 321.

<sup>500</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 Boston Univ. Int'l. L. J. (1984), 321.

Cremades and Plehn put forward a different approach to the harmonization of International Trade Law, the non-national approach based on the new *lex mercatoria*: “Commercial self-regulation based on expansion of the businessman’s freedom to regulate his own affairs by contract is another avenue by which the laws affecting international business transactions could be harmonized.”<sup>501</sup> Thus, the states’ influence on the law of international trade would be limited. Practical needs of the merchant community instead of state interests and business policies would form the rules of international business. Merchants could easily avoid national laws by submitting their business relations to arbitration to be decided on the basis of the *lex mercatoria*. The national influence on the law of international trade would be limited to certain mandatory public policy rules and the concurrence of the arbitral awards with them. By engaging in international business, the states could also have an effect on the law merchant.

It is said, however, that given the power of states, a transnational system of law could only exist with their acceptance and support<sup>502</sup>. The application of transnational legal standards and the creation of arbitral tribunals have to be permitted and awards enforced.



### ***C. Allegations against lex mercatoria***

The arguments that the critics put forward against *lex mercatoria* are mainly of the same kind. It is said to lack legitimacy, completeness, precise contents, publicity and methodical rules.

Also, the opponents of the concept of transnational law and *lex mercatoria* are scholars, whereas the practitioners are more supportive of the concept<sup>503</sup>.

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<sup>501</sup> Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 323.

<sup>502</sup> Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 324.

<sup>503</sup> Langen, “Transnationales Handelsrecht”, Neue Juristische Wochenschrift (1969), 2229.

### 1. *Lex Mercatoria* is no legal order

Among the critics, there is a feeling that the *lex mercatoria* does not constitute a proper system or body of law. Goldman proposes the following definition of the term: ... *that a legal order is the body of specific rules, and the organs intended to apply them (if not necessarily to promulgate them, since custom is established spontaneously – even though it may at a further stage be reinforced by codification), that emerge from the formation and the activity of a specific social group.*<sup>504</sup>

Lagarde follows a different approach. For him, in order for the *lex mercatoria* to constitute an *ordre juridique*, there have to be certain norms and rules and these have to be a complete body of law or a system of rules<sup>505</sup>. Since he excludes every rule of state origin, or in the elaboration of which a state has participated, and focuses on the spontaneous character, only a few rules that are part of *lex mercatoria* are said to exist. The problem is whether these scattered rules are capable of resolving most if not all international trade disputes. This remains open to doubt, as Lagarde also excludes general principles of law from the law merchant's scope. He then asks if the community of international merchants is an institution capable of creating its own rules<sup>506</sup>. *Submitting a contract in its entirety to the application of the lex mercatoria seems to make very little sense, even if there is some precedent. Indeed, this would presuppose the existence of a legal system, and thus of a social organisation, which cannot be reasonably said to exist.*<sup>507</sup>

It is highly controversial whether or not a third legal system exists next to the national laws and Public International Law. It has been suggested that *lex mercatoria* does not have binding force because it is not state law. Consequently, some national law is always needed to support it<sup>508</sup>. Supposedly, *lex mercatoria*

<sup>504</sup> Goldman, "Lex Mercatoria", Forum Internationale (1983), 21.

<sup>505</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 128.

<sup>506</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 131.

<sup>507</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 139.

<sup>508</sup> Mann, "Internationale Schiedsgerichte und nationale Rechtsordnung", Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (1968), 101.

cannot constitute an autonomous legal order as the conditions for it are not given. First, it is said that no sources for an a-national law exist, as all the rules that are said to constitute the *lex mercatoria* are derived from national or Public International Law<sup>509</sup>. Their character cannot be altered by their application to international trade relations. International arbitration cannot be a proper source of the law merchant as arbitrators are never bound by precedents and there is no coherence. Whenever arbitrators base an award on *lex mercatoria* they are in reality deciding according to equitable considerations.

In order for the *lex mercatoria* to constitute a system of law, its rules have to be binding. There is no question about this for some elements of the *lex mercatoria*, such as general principles of law or the usages of international trade, for the former are common to every national law and even state judges have to take the latter ones into account when making a judgement as being part of the national law. Even national jurisdictions sometimes base their decisions on rules such as *bona fides*. Consequently, the relative vagueness of some rules of the *lex mercatoria* cannot be held against it<sup>510</sup>. This is different for standard form clauses and customs of a certain trade, for they need to be chosen explicitly by the parties to be part of the contract. Nevertheless, the more common they are and the more the parties expect their validity for a given contract, the closer these rules become to being law with binding force. In addition, the binding force of the *lex mercatoria* is not derived from its recognition by national laws but from its acceptance and constant observance by the merchant community and state authorities, such as courts when enforcing an arbitral award based on the *lex mercatoria*<sup>511</sup>.

Furthermore, the most important use of a system of law is to provide a set of rules to resolve a given conflict. This task of law can be accomplished by the *lex mercatoria* in the context of international commercial arbitration, since arbitrators often base their decision on the usages of international trade and general principles of law, and thereby leave aside national laws. The practitioners

<sup>509</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 131, 132.

<sup>510</sup> Dasser, Internationale Schiedsgerichte und *lex mercatoria*, Zurich (1989), 389.

<sup>511</sup> Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 ICLQ (1985), 752.

regard *lex mercatoria* as a third system of law that can be chosen by the parties and applied by the arbitrators instead of, or along with, national law and international public law<sup>512</sup>.

First, one argument against the allegation that *lex mercatoria* does not constitute a system of law must be put forward: there is a tendency towards a growing specialization of the general principles of law applied by the arbitrators. These general principles are an important element of the *lex mercatoria*. By becoming more and more specialized, these principles form, with some gaps, a consistent body of law. Thus it contains one of the most essential characteristics of an *ordre juridique*, going from general provisions to special ones<sup>513</sup>. One example is deriving special rules from the fundamental principle of the performance of the contract in good faith.

Another argument can be used against this allegation. The arbitral awards are rendered in accordance with Public International Law and the public policy of the country in which the enforcement of the award is likely to be requested. This means that the arbitrator is bound by certain rules and has to respect the parties' choices. The binding force of the *lex mercatoria* or any other law does not necessarily derive from the fact that it is being made and promulgated by a state, but from its being constantly observed and respected<sup>514</sup>.

However, it has also been suggested that *lex mercatoria* is not an autonomous body of rules because it is subordinated to the mandatory rules and public policy of national laws<sup>515</sup>. But it does not follow from its mere subordination to other rules that the *lex mercatoria* is not autonomous. Every rule of national law, every law regulating international trade and arbitration, every rule created by a court is subordinated to mandatory rules and public policy of that state and yet do not lose their quality as autonomous rules.

It is not obligatory that the rules of law chosen by the parties to govern their contract be structured in a certain way or have to be the law of a state. The

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<sup>512</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 394.

<sup>513</sup> Fouchard/Gaillard/Goldman, *Traité de l'arbitrage international*, Paris (1996), 820.

<sup>514</sup> Berman/Kaufman, "The Law of International Commercial Transactions (Lex Mercatoria)", 19 *Harv. Int'l. L. J.* (1978), 274.

<sup>515</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 33.

critics may argue that the arbitrator's decision has to be based on a national law. On the other hand, even these may be incomplete and, as long as the arbitrator bases his award on some set of rules (including *lex mercatoria*), he cannot be reproached for judging randomly. Furthermore, article 1496 of the French Code of Civil Procedure and other texts use the term "rules of law" and not "law"<sup>516</sup>.

Furthermore, there are certain methodical rules. Comparative law is a crucial element in elaborating the *lex mercatoria*. By comparing the laws of different states, principles common to all of them can be extracted and thus become part of the *lex mercatoria*. Comparative law advances the harmonization of the national laws because it inspires the national legislators who, before deciding about a given project of law, study other laws<sup>517</sup>.

## 2. Only rules made by a state are legitimate

According to this national approach, a state is the only entity capable of producing law. This approach is based on the classical theory of international law<sup>518</sup>.

Furthermore, *lex mercatoria* is said to lack democratic legitimacy, for it has been discovered by scholars and practitioners and not according to the procedural rules governing state law. The procedural rules of most national laws make provisions for numerous stages of discussion and readings of a law project. This verification of the democratic legitimacy and suitability of the rule's contents is not conspicuous for the *lex mercatoria*<sup>519</sup>.

This deficiency could be overcome firstly by the elaborations produced by the international formulating agencies, such as UNCITRAL and UNIDROIT, and secondly by the growing number of published awards of arbitral tribunals, contributing to the creation of an arbitral case law and a consistency among the awards.

<sup>516</sup> Fouchard/Gaillard/Goldman, *Traité de l'arbitrage international*, Paris (1996), 821.

<sup>517</sup> Berger, *Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 41.

<sup>518</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 *Boston Univ. Int'l. L. J.* (1984), 321.

<sup>519</sup> Berger, *Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 61.

Critics could argue that the formulating agencies themselves also lack democratic legitimacy. They could be said to be influenced by a great number of nations, multi-national enterprises, and different interests and consequently incapable of producing legitimate codifications. On the other hand, national legislation is very often influenced by lobbyists and political calculations as well. The practitioners play an important role in the work of the formulating agencies, thus taking into account the practical needs of the merchant community. Their work is also discussed with scholars. Furthermore, these elaborations and guidelines become part of the *lex mercatoria* only through their common acceptance and constant application by the merchant community. The subjects of International Trade Law create therefore the law governing their relations themselves<sup>520</sup>. This fact shows that there can be no doubt about the democratic legitimacy of the *lex mercatoria*. As formulated by Berger in 1998: ... *survey of recent arbitral case law reveals that the UNIDROIT Principles of International Commercial Contracts have furnished international arbitrators with a perfect and eminently practical tool for their comparative decision-making. ... A worldwide enquiry conducted in September 1996 has revealed that the Principles have met with increasing acceptance among the international contract and arbitration lawyers and academics. This success of 'privatised rulemaking' ...*<sup>521</sup>.

The publishing of arbitral awards constitutes one of the sources of the *lex mercatoria*<sup>522</sup>. A case law of arbitral awards is developing and a certain consistency has been achieved. Moreover, through the critical analysis of the rendered awards by practitioners, scholars and other arbitrators, the observance of rules and principles, and the legitimacy of the rule's procedure of emergence, are assured<sup>523</sup>.

Also, the elaboration of rules of the *lex mercatoria* through the methods of comparative law alleviates this assumption, because the national laws do not lack legitimacy. By deriving *lex mercatoria* from the principles common to the

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<sup>520</sup> Berger, *Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 66.

<sup>521</sup> Berger, "International Arbitral Practice and the UNIDROIT Principles of International Commercial Contracts", 46 *Am. J. Comp. L.* (1998), 149.

<sup>522</sup> See *supra*, Chapter 4, A, 7.

<sup>523</sup> Berger, *Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 72.

different national laws adapted to the needs of international trade, this legitimacy is passed on as national law is transformed into the law of international trade<sup>524</sup>.

Finally, the merchant community's usages in the area of International Trade Law have a law-creating force. One should not always associate the term "law" with a national state. *The law theoretician has to go beyond the archaic illusion of the correlation between state and law. Whenever social power is exercised, it takes on a legal/legitimated form, unless it disintegrates into anarchy or it is just a spontaneous dream. In both of these cases, there is no legitimacy but power is also absent. Consequently, one has to recognize the social power – and subsequently the particular form this legal system adopts – that one can find in the area of sport, economic relations, business activities of transnational enterprises, on the Euro-currency and Euro-obligations market ...*<sup>525</sup>

The critics focus on two points: first, national states have the law creating monopoly; second, national laws are said to be complete and therefore no other law is needed<sup>526</sup>. To deal with the first point, one only needs to look at the history of international trade.

Before modern states existed, there were also certain rules that were obeyed and some sort of private jurisdiction. Every organised community can create its own proper and binding law. "*Ubi societas ibi jus. Le droit est immanent à l'organisation sociale.*"<sup>527</sup> This law evolves from the constant observance of certain rules and no national legislation is necessary to change its nature. It has been suggested that the merchant community is not homogenous enough to create a set of rules. *The existence of a-national rules does not prove the existence of a mercantile legal system. Does experience not rather indicate that the progressive formation of this lex mercatoria (if indeed its existence becomes indisputable) has to go through the stages of a plurality of merchant societies, in the same way as the mystical jus mercatorum of the middle ages before it? The professional customs that are often used to ascertain the existence of the lex mercatoria are*

<sup>524</sup> Berger, Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts; Berlin, New York: de Gruyter (1996), 47.

<sup>525</sup> Rigaux, cited in: Berger, Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts; Berlin, New York: de Gruyter (1996), 98.

<sup>526</sup> Juenger, "Lex mercatoria und Eingriffsnormen", 233.

<sup>527</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 139.

*primarily the customs of a certain trade, or even of certain members of this trade.*<sup>528</sup>

And even more direct: *In summary, the milieu in which international trade develops is so extensive, diverse and closed off, that it is doubtful whether or not it can serve as a legal framework to a community that only has a minimum of organisation, following the example of other legal systems that have already been examined.*<sup>529</sup> Lagarde later concludes that “..., at the moment there seem to be only small islands of organisation which appear in international trade, but not a single umbrella organisation”<sup>530</sup>.

Admittedly, the international merchant community is not one homogenous group. Of course there are usages pertinent only to one sector of international trade. But, nevertheless, there are general principles common to all areas of international trade.

Consequently law can emerge from any community or organisation through the constant observance and respect of a given principle or rule. A state authority is not essential to give that rule a compulsory character. International organisations, such as the European Union, the FIFA, the UN or the Catholic Church are also capable of creating rules binding upon their members. The author need not be a state.

It has been argued that usage cannot be created in transnational trade law as it always has to be recognized by national laws<sup>531</sup>. Supposedly, the merchant community cannot create its own autonomous rules, as these always depend on being accepted by national law. Furthermore, the arbitral awards that make reference to these usages can only be enforced with the help of national courts.

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<sup>528</sup> Lagarde, “Approche critique de la *lex mercatoria*”, in: *Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman*, Paris (1987), 136.

<sup>529</sup> Lagarde, “Approche critique de la *lex mercatoria*”, in: *Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman*, Paris (1987), 138.

<sup>530</sup> Lagarde, “Approche critique de la *lex mercatoria*”, in: *Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman*, Paris (1987), 139.

<sup>531</sup> Triebel/Petzold, “Grenzen der *lex mercatoria* in der internationalen Schiedsgerichtsbarkeit”, *Recht der internationalen Wirtschaft* (1988), 246.

The binding force of usage does not necessarily depend on it being recognized by national laws<sup>532</sup>. As far as the usage consists of general principles common to the laws of the civilised nations, the problem does not arise, as it is recognized by national laws. Even in cases where the usage is not recognized by national laws, the arbitrator can make reference to it. If a usage is international, its validity and effectiveness cannot depend on its recognition through national laws. In addition to this, the national laws have empowered arbitral tribunals to qualify a certain behaviour as being a usage of international trade by allowing arbitration and by giving arbitrators the power to render binding decisions<sup>533</sup>.

Critics also argue that the *lex mercatoria* cannot be created by the merchant community, for the merchants are not even aware of its existence: *Commercial arbitration exists for one purpose only: to serve the commercial man. If it fails in this, it is unworthy of serious study. The commercial man is a conspicuous absentee from the writings on the lex mercatoria, and so indeed is his adviser.*<sup>534</sup>

Indeed, the concept of the *lex mercatoria* and its re-emergence is the product of scholars and not merchants. Nevertheless they only observed the usages and customs created by the merchants and did not create them themselves. The fact that the mercantile community is not aware of its law-creating power does not rule out its ability to do so.

### 3. *Lex Mercatoria* is incomplete

Because there is no consensus about the sources, elements and contents of *lex mercatoria*, it is said to be vague, incoherent and incomplete. As mentioned above, Lagarde defines *lex mercatoria* as being spontaneously created by the merchant community and thereby excludes all the rules and solutions created by

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<sup>532</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 34.

<sup>533</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 35.

<sup>534</sup> Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 86.

states<sup>535</sup>. Thus, what remains of the law merchant are some scattered rules unsuited to solve all the problems of international trade. “A bigger controversy concerns the question of whether one can conclude to the existence of a legal system that can solve all or at least most problems of international trade thanks to a smattering of rules.”<sup>536</sup>

Also, *lex mercatoria* is said to lack content, to be incomplete and fragmentary<sup>537</sup>. The rules of the *lex mercatoria* ... *may, on occasion, be useful to fill a gap but in essence they are too elementary, too obvious and even too platitudinous to permit detached evaluation of conflicting interests, the specifically legal appreciation of the implications of a given situation. In short, they are frequently apt to let discretion prevail over justice.*<sup>538</sup> Due to this incompleteness, application of *lex mercatoria* is said to lead necessarily to arbitrary and unpredictable results.

First, compared to national laws *lex mercatoria* is necessarily incomplete, as it only covers the area of international trade and thus ignores all other areas of law. It does not constitute a complete body of law but is only intended to serve the merchant community’s needs. Fields such as consumers’ rights or employment law are obviously left out of the scope. Due to the absence of an international legislator, these fields of law are to be regulated by the states<sup>539</sup>.

Lowenfeld argues as follows. For him, *lex mercatoria* does not constitute a complete and autonomous legal order. *My view is that lex mercatoria, derived from the law of many states and international conventions (in both senses of that word), is a useful tool for arbitrators (and I would add for judges) when faced with unsatisfying answers from their initial inquiries. It is, in other words, an additional option in the search for the applicable law, not an alternative to that*

<sup>535</sup> Lagarde, “Approche critique de la *lex mercatoria*”, in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 128.

<sup>536</sup> Lagarde, “Approche critique de la *lex mercatoria*”, in: Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Paris (1987), 130.

<sup>537</sup> Redfern/Hunter, Law and Practice of International Commercial Arbitration, London (1999), 2-62.

<sup>538</sup> Mann, “Reflections on a Commercial Law of Nations”, 33 British Yearbook of Int’l Law (1957), 38.

<sup>539</sup> Juenger, “Lex mercatoria und Eingriffsnormen”, 240.

*search*.<sup>540</sup> According to him, the rejection of national laws is never the arbitrator's first step and the law merchant only comes into play where rules are evidently not fit for international trade, the results are inconsistent with the needs and usages of international trade or when no state clearly has the most significant relation with the contract<sup>541</sup>.

To respond to these reproaches, one has to accept a broader concept of the *lex mercatoria*. The general principles of law are part of it. If one excludes every rule or solution in the elaboration of which a state has participated, the whole concept of *lex mercatoria* is useless and indeed incomplete. If, on the other hand, one accepts the notion put forward in the thesis (the general principles of law as those common to the laws of the commercial nations<sup>542</sup>), *lex mercatoria* is not an incomplete system of law. If in doubt, an arbitrator can fill the gaps by choosing the solution common to the laws of the trading nations or by referring to general principles of law. The arbitrator could also search for common principles in the laws connected with the contract.

Moreover, even national codifications are not systematically complete nor do they offer solutions to every problem that could possibly arise. Because of the complexity of international trade, a codification cannot foresee all the future problems and can therefore only be temporarily complete. National codifications, such as the German Civil Code and Commercial Code, are abstract and the solutions to a given problem have to be derived from a general rule or principle. Very modern or complex contracts are not part of the national codifications and are governed by the general conditions introduced into the contract by the parties and by interpretation and the application of general principles of law<sup>543</sup>.

Through the incorporation of general principles of law into the *lex mercatoria*, rules like *bona fides*, *pacta sunt servanda* and *clausula rebus sic stantibus* are also part of it. Basic principles such as performance of the contract

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<sup>540</sup> Lowenfeld, "Lex Mercatoria: An Arbitrator's View", 6 *Arbitration International* (1990), 145.

<sup>541</sup> Lowenfeld, "Lex Mercatoria: An Arbitrator's View", 6 *Arbitration International* (1990), 145.

<sup>542</sup> Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 *ICLQ* (1985), 749.

<sup>543</sup> Berger, *Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 90.

in good faith and fair dealing cover the whole area of International Trade Law and every dispute could be solved by applying this rule. All the rules can be derived from a few general principles.

In addition to this, the gaps in the *lex mercatoria* can be overcome through a growing number of published awards. Contrary to national laws, *lex mercatoria* is even more complete in some specialized areas of trade law, for specialists and practitioners are part of the arbitral tribunals and create very sophisticated rules especially adapted to the branch in question. But one should not focus on arbitral awards only as this would lead to a certain incompleteness of the *lex mercatoria*. In a recent publication, Loquin writes that the idea that *lex mercatoria* is lacking in content is the most unjustified prejudice against it<sup>544</sup>. Its content is constantly growing through contractual practices and comparative law.

Finally, many international trade contracts are very precise and complete. In these cases the arbitral tribunal does not need to fill possible gaps of the *lex mercatoria*. The tribunal only has to decide on the merits or interpret a certain clause of the contract.

Even those who are of the opinion that *lex mercatoria* is incomplete admit that it is not ineffective to choose it as the applicable law. The arbitrator can apply *lex mercatoria* as far as it is complete<sup>545</sup>. It is for him to decide whether or not there is a gap, and he can use general principles and the contractual stipulations to fill it before having to have recourse to a national law.

Goldman, Lando and other authors consider *lex mercatoria* to be incomplete. Therefore the arbitrators have to refer to national law<sup>546</sup>. *Lex mercatoria* can still be a valid choice of the law to be applied to the dispute. The gaps are to be filled with the non-obligatory rules of the otherwise applicable national law. The mandatory rules of the latter have to be respected in any case.

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<sup>544</sup> Loquin, "Où en est la *Lex Mercatoria*", in: *Souveraineté étatique et marchés internationaux à la fin du 20<sup>ème</sup> siècle. Mélanges en l'honneur de Philippe Kahn*, (2000), 28.

<sup>545</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 33.

<sup>546</sup> Goldman, "The applicable law: general principles of law – the *lex mercatoria*", in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 116; Lando, "The *lex mercatoria* in International Commercial Arbitration", 34 *ICLQ* (1985), 748.

It should be admitted that there are certain areas governed in the national laws that are not contained in the *lex mercatoria*. Well-known examples are questions of pure delict, consent, fraud, incapacity to conclude a contract, majority and the like. But the reason why these questions are not part of the *lex mercatoria* is that they are hardly ever involved in international commercial arbitration. These problems are traditionally resolved by national laws. On the other hand, no arbitrator would ignore a violation of these mandatory rules as he wishes to render a reasonable award. The arbitrator has to do everything in his power to ensure that the award is recognized and enforceable. These minor gaps do not interfere with the *lex mercatoria*'s suitability for resolving international trade disputes.

Self-regulatory contracts are ones created by the parties that anticipate all future events in order to be independent of national laws. They reflect the parties' special needs and constitute a set of rules outside of national law and are, especially as standardized self-regulatory contracts, an important source of the *lex mercatoria*. Nevertheless, even these contracts have some points of contact with national laws. Thus, the help of national courts is necessary whenever the enforcement of an arbitral award is sought against a recalcitrant party. Furthermore, questions concerning capacity, formality and validity are usually not treated in (standardized) self-regulatory contracts and arbitrators have to refer to national laws to find answers to these basic problems<sup>547</sup>.

Lando has described the application of the *lex mercatoria* in spite of its incompleteness as an invention: *An arbitrator applying the lex mercatoria will act as an inventor more often than one who applies national law. Faced with the restricted legal material which the law merchant offers, he must often seek guidance elsewhere. His main source is the various legal systems. When they conflict, he must make a choice or find a new solution. The lex mercatoria often becomes a creative process by this means.*<sup>548</sup>

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<sup>547</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", 2 Boston Univ. Int'l. L. J. (1984), 329.

<sup>548</sup> Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 ICLQ (1985), 753.

It has been pointed out above that one of the advantages of the *lex mercatoria* over national laws is its flexibility. It can easily adapt to the rapidly changing circumstances in international trade relations. If the *lex mercatoria* were a very detailed and absolutely complete set of rules, this adaptability to different situations would be impossible. *In any case, an overly systematized and detailed New Lex Mercatoria will never be useful to the international business community. The business community is subject to constantly changing circumstances and goals. Specific rules, initially providing certainty, soon become obsolete. A New Lex Mercatoria must achieve clarity and coherence without sacrificing adaptability. These goals are best reconciled by applying clearly defined fundamental principles which, though broad, take on the greater specificity of a rule when applied to a particular factual situation.*<sup>549</sup>

A very detailed set of rules that provides precise and binding answers to any question resulting from an international trade dispute would prevent the arbitrator from always finding an equitable solution to the problem. What is just in one case, might be completely unfair in a different one due to changed circumstances or peculiarities of international trade. “The arbitrator combines broad legal and equitable principles implied by non-national law clauses with the perceived needs and actual practices of international commerce.”<sup>550</sup> Focussing on general principles and then deriving precise rules from them for the specific dispute can lead to better and more flexible results and fill any gaps that might exist.

#### 4. *Lex Mercatoria* favours the rich

Sometimes the law merchant is said to privilege the economically or socially stronger party<sup>551</sup>. Especially in north-south relations, the less developed nations are allegedly victimized. Third World countries have little influence on the elaboration of trade usages and customs because of their insignificant part in

<sup>549</sup> Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 338.

<sup>550</sup> Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 332.

<sup>551</sup> Mann, “Schiedsrichter und Recht”, in: Festschrift Flume (1978), 595.

international trade. Therefore they do not participate in the creation of the *lex mercatoria* and their special needs as underdeveloped countries are neglected. If two merchants spontaneously create the rules that are to govern their contract, the stronger party is said to have more influence<sup>552</sup>. Lagarde writes on this point: *How often have the practitioners of international trade and their counsel tried to cast off the yoke of national legislations in order to submit themselves to more adapted rules which they “spontaneously” create themselves and how many times, in return, has this attempt been struck by the suspicion of concealment of a “rule of the stronger party” imposed on the weaker party by the more powerful enterprise.*<sup>553</sup>

It should be admitted that the *lex mercatoria* cannot prevent the stronger party from dictating its terms and forcing the weaker one to consent. Nor can it prevent the richer party from imposing standard form contracts according to its needs. On the other hand, there is no proof that national law can ensure perfect equality between the parties. No matter which set of rules governs the contract, the party which has a greater interest in concluding the contract is more likely to comply with the other's opinions concerning the rules governing the contract or the use of the other party's standard forms. In addition, national laws can ensure the protection of the weaker party only where they are applicable, that is to say in the area in which the law is operative<sup>554</sup>. Also, transnational law is never completely independent of national laws. Most national laws are very liberal about the parties' freedom to formulate the contract's clauses and reluctant to interfere whenever international trading activities are concerned. This fact excludes effective protection in the area of international business. Through the incorporation of general principles of law in the scope of the *lex mercatoria*, the latter can provide better protection in the area of international trade.

It is also argued that due to the importance of *pacta sunt servanda*, *lex mercatoria* puts the contract above the law. Since the stronger party is supposed to influence the contract's contents more strongly, this criticism means the same as

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<sup>552</sup> Fouchard/Gaillard/Goldman, *Traité de l'arbitrage international*, Paris (1996), 821.

<sup>553</sup> Lagarde, “Approche critique de la *lex mercatoria*”, in: *Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman*, Paris (1987), 126.

<sup>554</sup> Stein, *Lex mercatoria: Realität und Theorie*, 249.

favouring the rich. First, the *pacta sunt servanda* rule is not applied strictly, for there are some exceptions. Thus, the performance of the contract in good faith and fair dealing means that the contract is not always put above the law<sup>555</sup>. The contract is only valid and thus to be performed if certain basic rules have been respected. Consequently, the weaker party cannot be forced to consent to a contract against its will.

Furthermore, the application of *lex mercatoria* by arbitrators is pertinent only to international business relations, which means only amongst professional traders. They do not need the same amount of protection that national laws provide for consumers through their mandatory rules. The central role is attributed to the principle of good faith and fair dealing allows effective protection of the weaker party<sup>556</sup>. In addition to this, in cases where a national law is chosen to govern the conflict, the parties have to decide which national law they are going to apply. It is in these cases that the more powerful or wealthier one can impose its own national law or a law that is advantageous to it. However, when *lex mercatoria* is chosen by the parties as the applicable law, the stronger one does not have the advantage of having the contract governed by the national law of its choice.

Finally, arbitral tribunals are only tolerated by the national states, for the latter have the jurisdictional monopoly. The states only tolerate arbitral tribunals if certain basic conditions concerning fairness, justice and fundamental rights are respected and the states thus protect such individuals from an award dictated by the stronger party<sup>557</sup>. The most fundamental rule that is common to all the national laws is that nobody can be forced to insert an arbitral clause into the contract. Every individual has the right to appeal to the national courts to defend his rights. Only by consenting to arbitration does he voluntarily renounce national courts. The national courts only supervise the arbitrators. This supervision is limited to very few principles in order not to interfere with the international merchant community's needs and destroy the advantages of arbitration. First, an arbitral award can be contested if the tribunal did not respect the parties' choices

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<sup>555</sup> Fouchar/Gaillard/Goldman, *Traité de l'arbitrage international*, Paris (1996), 832.

<sup>556</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 401.

<sup>557</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 268.

or if there was an excess of power. According to Article 34 of the UNCITRAL Model Law on International Commercial Arbitration, awards can only be set aside if a party was under some incapacity, the agreement is not valid according to the law of the state the parties are subjected to, a party was not given proper notice or was unable to present its case, the composition or procedure of the arbitral tribunal was not according to the parties' agreement, the subject matter of the dispute is not susceptible to settlement by arbitration under the law of this state or the award is in conflict with the public policy of this state. *The permanent Court of Arbitration ... decided that 'the excess of power may consist not only in deciding a question not submitted to the Arbitrators, but also misinterpreting the express provisions of the Agreement governing the manner in which they are to reach their decision, notably with regard to the statutes or principles of law to be applied.'* Excess of power can take the form of the failure of the arbitrator to apply the rules set forth in the arbitration agreement or in the application of other rules.<sup>558</sup>



##### 5. The contents are not precisely defined

The actual rules of the *lex mercatoria* are said to be unclear and indefinable, to the amount that the arbitrators seem to redefine and change it with every application. Compared to a national law, *lex mercatoria* seems to be vague and incomplete<sup>559</sup>. But the reasons for this and for the increased unpredictability compared to state tribunals lie in the nature of arbitration itself and not in the application of the *lex mercatoria*. The state tribunals are permanent and therefore more homogenous in their awards. Arbitral tribunals are, however, often spontaneously created and not organised hierarchically. The hierarchy of the state tribunals ensures a homogeneous interpretation of the rules of law applied. Consequently, it is very doubtful that arbitral awards, if the arbitrators did not apply *lex mercatoria* but only state law, would be more predictable or coherent<sup>560</sup>. Furthermore, there seems to be incoherence in the motivations rather than in the

<sup>558</sup> YCA vol. XI (1986), 167.

<sup>559</sup> Mann, "Schiedsrichter und Recht", in: Festschrift Flume (1978), 595.

<sup>560</sup> Fouchard/Gaillard/Goldman, *Traité de l'arbitrage international*, Paris (1996), 824.

solutions<sup>561</sup>. Also, the application of the general principles of law as part of the *lex mercatoria* offers as much certainty and predictability as national laws, especially in cases in which these were not chosen by the parties<sup>562</sup>.

Another supposedly weak point of the *lex mercatoria* that is being put forward is the lack of publicity. There are arguments that can be held against this assumption. First, the list-making proves the existence of certain rules and provides arbitrators as well as merchants with a set of written rules. In addition to this, the principles published by UNIDROIT or the principles published by the Commission on European Contract Law also contribute to a growing awareness of the *lex mercatoria*. This is also true of the growing number of published arbitral awards. Thus the ICC publishes its awards regularly in the *Journal du Droit International* and in the Yearbook of Commercial Arbitration. These publications have reached a significant volume and therefore play an important role in the awareness of the *lex mercatoria* and the concord amongst the awards based on it<sup>563</sup>.



Further, to require an arbitrator to apply *lex mercatoria* is said to be asking too much of him. With the clear indications provided by national laws, he can easily find a solution to a dispute. Transnational law, however, allegedly does not provide a set of pre-established and formulated rules that are fit to be applied to the substance. But, admittedly, there seems to be a lesser degree of predictability about the rules of law (and their origin) that the solution will be based on when ousting the application of national law. On the other hand, one must not ignore the greater degree of security concerning the outcome of the dispute. When applying transnational law, the arbitrator is forced to take every aspect of the international trade relation into consideration, because he cannot rush to judgement by applying a national law rule. It is thus more likely that an equitable solution taking the

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<sup>561</sup> Fouchard/Gaillard/Goldman, *Traité de l'arbitrage international*, Paris (1996), 824.

<sup>562</sup> Lowenfeld, "Lex Mercatoria: An Arbitrator's View", 6 *Arbitration International* (1990), 137.

<sup>563</sup> Berger, *Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 61.

contract's particularities and its international character into account will be rendered<sup>564</sup>.

#### 6. *Lex Mercatoria* is contradictory

It has been suggested that the *lex mercatoria* is contradictory. It is said to contain principles or to lead to different solutions to similar problems because of its often contradictory elements. Thus, the general principle that contracts are to be enforced or *pacta sunt servanda* contradicts the *clausula rebus sic stantibus*, hardship, *force majeure* principles as well as the exception that enforcement cannot be enforced for a contract obtained through bribery or other dishonest means.

If one were to take this approach seriously, one would have to consider every national law as being contradictory as well. Every national law has certain rules concerning the capacity to conclude a contract and rules that are aimed to protect weak and inexperienced parties. Also, all the trading nations' laws contain rules similar to the *lex mercatoria*'s hardship and *force majeure* principles. The sanctity of the contract principle is enshrined in every national law and is the basis of domestic and international trade. However, no national law, no judge or arbitrator considers this principle to be absolute and allow of no exceptions. If one does not consider those national laws that contain these exceptions to the *pacta sunt servanda* principle to be contradictory, why should this be held against the *lex mercatoria*<sup>565</sup>?

#### 7. Every contract is based on some national law

Hightet, among others, expresses his views on whether or not a contract can be stateless. *A state-free contract presents the paradox of the contrat sans loi – un marteau sans maître – which is, for this observer at least, a logical impossibility and an intellectual solecism. ... In brief, it is hard to conceive rationally of a contract in vacuo, as it were; a form of test-tube baby with no mother and no*

<sup>564</sup> Langen, "Transnationales Handelsrecht", *Neue Juristische Wochenschrift* (1969), 2230.

<sup>565</sup> Gaillard, "Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit", *Journal du Droit International* (1995), 12.

*father*.<sup>566</sup> He concludes that “If the contract is stateless, it is not a contract and cannot be enforced.”<sup>567</sup> To further illustrate his point of view, he adds that one of his partners thinks that *lex mercatoria* was a once-famed linebacker for the Chicago Bears<sup>568</sup>. The English House of Lords shares this view: “Contracts are incapable of existing in a legal vacuum. They are mere pieces of paper devoid of all legal effects unless made by reference to some system of private law”.<sup>569</sup>

This theory is obviously wrong and untenable. First, there is a difference between a state-free contract and a law-free contract. One must not confuse the two notions, for a state-free contract is not necessarily law-free, because the contract could still be governed by some sort of a-national law. A state-free contract is only *contrat sans loi* if no rules are applicable and the stipulations of the contract are superior to any law or rule, that is to say if the contract has absolute validity. The trade relations governed by *lex mercatoria*, however, are not lawless, for certain mandatory rules the parties cannot deviate from do exist<sup>570</sup>. It follows from the principle of party autonomy that they are free to create a contract that is governed neither by national nor by transnational law. These contracts are self-regulatory and the law applied is the *lex contractus*<sup>571</sup>.

Furthermore, there is no doubt about the existence of numerous state-free contracts, such as the employment contracts of UN or EU employees or contracts concluded according to Canon Law. As was shown in the historical background, rules have always been made without the interference of a sovereign or a state. Customs and usage have always played a very important role in the elaboration of laws and were often regarded as being as binding as “proper” law. The constant application of certain rules and customs created a law common to the *societas mercatorum*. The *lex mercatoria* is older than the modern nation-states. The opinion that law can only be made by sovereigns appeared quite late, for until the national laws began to be codified in the 19<sup>th</sup> century, the states rarely used their

<sup>566</sup> Hightet, “The Enigma of the Lex Mercatoria”, 63 Tul. L. R. (1989), 614.

<sup>567</sup> Hightet, “The Enigma of the Lex Mercatoria”, 63 Tul. L. R. (1989), 615.

<sup>568</sup> Hightet, “The Enigma of the Lex Mercatoria”, 63 Tul. L. R. (1989), 617, footnote 4.

<sup>569</sup> *Amin Rashed Shipping Corporation v. Kuwait Insurance Co.*, Weekly Law Reports (1983), 249.

<sup>570</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 21.

<sup>571</sup> CENTRAL-List No. IV.1.1, available at: <http://www.tldb.de/>; Cremades/Plehn, “The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions”, 2 Boston Univ. Int’l. L. J. (1984), 328.

power to create law. More exactly, European states used the Canon or Roman law or, as in England, let the judicative create law<sup>572</sup>. “If it is assumed that law can only be made by nation-states, then, of course, it ‘follows’ that law cannot be made by communities that transcend nation-states”.<sup>573</sup>

National law is not a crucial element of international trade relations: ... *let us have no illusions: the lawyer’s idea which aspires to submit international trade, in every case, to one or more national systems of law is nothing but bluff. The practical men have largely freed themselves from it, by means of standard contracts and arbitration, and states will be abandoning neither sovereignty nor prerogatives if they open their eyes to reality and lend themselves to the reconstruction of international law.*<sup>574</sup>

One cannot equate a state-free contract with a law-free contract, because every contractual relationship is governed by some sort of law. The proponents of the *lex mercatoria* do not claim the existence of law-free contracts. According to them, international trade relations can be governed by a different, state-free system of law which excludes the existence of contracts in a legal vacuum.

The so-called self-regulatory contracts also need to be mentioned here. A self-regulatory contract is a contract in which the parties have foreseen every possible problem and provided a solution to avoid the application of national law. Party autonomy and freedom of contract are general principles of law recognized by the civilized nations and the basis of a free economy. From these principles follows the existence of self-regulatory contracts. If the parties to an international contract are free to provide detailed contractual stipulations or have recourse to pre-formulated self-regulatory contracts that anticipate any future event, the impact of national law is minimized. A self-regulatory contract constitutes a complete set of rules created by the parties themselves and therefore perfectly adapted to their individual needs. Also, it is independent of national law.

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<sup>572</sup> Juenger, “Lex mercatoria und Eingriffsnormen”, 233.

<sup>573</sup> Berman, “The Law of International Commercial Transactions”, 2 *Emory J. of Int’l Dispute Resolution* (1988), 235.

<sup>574</sup> David, “The International Unification of Private Law”, in: *International Encyclopedia of Comparative Law*, II, (1971), 212, cited in: Juenger, “Lex mercatoria und Eingriffsnormen”, 237.

Even without having recourse to self-regulatory contracts, one can argue against the theory that every contract is based on a national law. To prove the existence of contracts that are free of national law, one only needs to apply the *pacta sunt servanda* principle in a strict and consequent manner<sup>575</sup>. By making this principle the key principle, every contract becomes self-regulatory, even if the parties have not considered every eventuality in their stipulations. However, the sanctity of the contracts can never be in contradiction to the mandatory rules of public policy in the countries that the contract is connected with. Other exceptions to the principle, such as hardship, no contract can be obtained through bribery, *force majeure*, *abus de droit* and the like have been presented above.

In addition to this and following these principles, the parties can choose any national law to govern their contract. If the legislators admit the freedoms to conclude contracts, determine their contents and designate the applicable national law, they consequently admit that the parties regulate all the problems that could possibly arise in the contract itself and thereby oust the application of national law<sup>576</sup>. As the existence of these contracts is admitted, one also admits the existence of a contract that exists outside national law, since the parties' stipulations are the law (the *lex contractus*) that governs their relation. Even without explicitly substituting the national law for the contractual terms, the parties can oust the application of national law by providing a complete set of rules<sup>577</sup>. The same goes for general conditions and standard form contracts. They are usually self-regulatory and therefore independent of national law, apart from mandatory rules.

## 8. Every arbitration is national

It has been pointed out that the nationalization of international commercial arbitration has many disadvantages and tends to obliterate many of its advantages. There is a tendency towards internationalization and delocalization, to respect the

<sup>575</sup> Gaillard, "Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit", *Journal du Droit International* (1995), 10.

<sup>576</sup> Schmitthoff, "Das neue Recht des Welthandels", *28 Rabels Zeitschrift für ausländisches und internationales Privatrecht* (1964), 69.

<sup>577</sup> Stein, *Lex mercatoria: Realität und Theorie*, 42.

principle of party autonomy. This takes place through the support, acceptance or at least non-hindrance of a-national arbitration by the national legislator, jurisdiction and scholars<sup>578</sup>. According to the traditional point of view, there is no international arbitration independent of any national law. But the emergence of a-national arbitration has been observed: ... *for many practitioners would readily acknowledge that in the small minority of cases where it makes a difference what law is applied to the substance of the dispute (for most disputes turn on the facts and on the words of the contract), the arbitrators frequently abstain from referring themselves explicitly to the conflict rules of the country in which they happen to be sitting, but rather proceed to an intuitive choice of the proper law.*<sup>579</sup>

Naturally there still remains a certain dependence on the national laws and courts concerning the recognition and enforcement of the arbitral awards. This international commercial arbitration is different from domestic arbitration, as the latter provides an alternative to the existing national jurisdiction, whereas there is no jurisdiction for international trade<sup>580</sup>.

There are important differences between foreign, domestic and national arbitration. First, domestic arbitration deals with purely domestic matters and is governed exclusively by the domestic national law<sup>581</sup>. Thus, it constitutes an alternative to the existing national courts. Foreign arbitration, on the other hand, involves cases with elements connecting them to one foreign state and is governed by that state's national law<sup>582</sup>. Finally, international arbitration involves cases with elements connecting them to more than one state.

According to authors such as Smit it is nevertheless governed by the national law of one state only. Smit states that the *lex loci arbitri* is generally the law of the tribunal's seat<sup>583</sup>. The seat of the tribunal is said to determine the nationality of the award and thereby the law that is applied to all elements of the arbitration. Only the state in which the tribunal is situated can control and

<sup>578</sup> Stein, *Lex mercatoria: Realität und Theorie*, 77.

<sup>579</sup> Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 90.

<sup>580</sup> Stein, *Lex mercatoria: Realität und Theorie*, 78.

<sup>581</sup> Smit, "A-national Arbitration", 63 *Tul. L. R.* (1989), 629.

<sup>582</sup> Smit, "A-national Arbitration", 63 *Tul. L. R.* (1989), 629.

<sup>583</sup> Smit, "A-national Arbitration", 63 *Tul. L. R.* (1989), 630.

supervise the arbitrator<sup>584</sup>. For Smit, a-national arbitration does not exist, as every arbitral tribunal must rely on some national law and cannot exist in a legal vacuum. Institutional rules can never be a body of law providing rules of procedure and the rules of substantive law. Without reference to a national law, agreements to arbitrate can never be effective and awards never recognised or enforced<sup>585</sup>. Mann describes the same phenomenon. According to him, and contrary to widespread opinion, the merchant community expects predictable solutions to their problems in order to adapt their behaviour and do not desire emancipation from national law<sup>586</sup>. Only national law is said to be predictable and able to avoid arbitrariness, protect the weaker party and promote justice<sup>587</sup>.

However, national law cannot satisfactorily regulate international commercial arbitration. National laws are not harmonized, flexible, and adaptive, but are connected to the needs and policies of their states. Even reforms of the national laws and their efforts to include international commercial arbitration and its special needs in their scopes, has failed to stop the growing importance of transnational law, because the competition between the national rules of conflict and the tendency of laws to declare themselves applicable remains. The practitioners want their choice-of-law clause to be respected, even if they choose *lex mercatoria*. If the national law does not allow the choice of an a-national standard or declares its own rules of conflict to settle the question of the applicable law, the parties' stipulations might not be respected. To remedy this situation, one has to avoid the application of national law and use rules of conflict which do not necessarily indicate national law<sup>588</sup>.

Proponents of the theory of a-national arbitration criticize the arbitrariness and the unsuitability of the *lex arbitri* and the seat of the tribunal theory and the forced connection of a dispute to a national law. Typically enough, in some 20 % of arbitral procedures, the seat of the tribunal is not determined by the parties but by the arbitral tribunal according to geographical or other practical

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<sup>584</sup> Mann, "Internationale Schiedsgerichte und nationale Rechtsordnung", *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht* (1968), 101.

<sup>585</sup> Smit, "A-national Arbitration", 63 *Tul. L. R.* (1989), 631.

<sup>586</sup> Mann, "Schiedsrichter und Recht", in: *Festschrift Flume* (1978), 594.

<sup>587</sup> Mann, "Schiedsrichter und Recht", in: *Festschrift Flume* (1978), 595.

<sup>588</sup> Stein, *Lex mercatoria: Realität und Theorie*, 84.

considerations<sup>589</sup>. An arbitrator is not a national judge and does not necessarily have to apply national law. A-national arbitration is generally accepted and there is no doubt about the recognition and the enforcement of awards rendered by a-national arbitral tribunals<sup>590</sup>. Most of the time, an arbitrator will not occupy a position of authority in, or have close connections with, the state where the tribunal is situated<sup>591</sup>.

None of the attempts to nationalize international commercial arbitration is convincing. How can one determine the nationality of an arbitral tribunal? As criteria have been proposed: the seat of the tribunal, nationality or residence of the arbitrator, law of the contract, the procedural rules that are being applied and the law of the state whose tribunals would be competent had an arbitral clause not been inserted into the contract<sup>592</sup>.

The denial of a-national arbitration restricts the autonomy of the parties. They cannot choose *lex mercatoria* to govern the conflict. For Mann, the principle of party autonomy is respected. By indicating an arbitral tribunal, they are aware of the seat. Therefore, they are choosing the *lex arbitri* as well. Just as a given national court would apply its own law, the choice of an arbitrator also includes designating the law of the tribunal's seat as the law governing the conflict<sup>593</sup>.

To approach Mann's theory, the following needs to be considered. The arbitrator is appointed by the parties and not by a state. His ability to render a binding decision is derived from the parties' authorization and not from a national regulation made by a state. There is not necessarily a connection between the arbitrator and the law of the seat and there is no reason why he should be forced to disrespect the parties' choice by applying the arbitral *lex fori*<sup>594</sup>. To the extent that

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<sup>589</sup> Triebel/Petzold, "Grenzen der *lex mercatoria* in der internationalen Schiedsgerichtsbarkeit", *Recht der internationalen Wirtschaft* (1988), 248.

<sup>590</sup> Stein, *Lex mercatoria: Realität und Theorie*, 87.

<sup>591</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 25.

<sup>592</sup> Mann, "Internationale Schiedsgerichte und nationale Rechtsordnung", *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht* (1968), 107, 108; Stein, *Lex mercatoria: Realität und Theorie*, 72.

<sup>593</sup> Mann, "Internationale Schiedsgerichte und nationale Rechtsordnung", *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht* (1968), 108.

<sup>594</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 29.

the parties authorized the arbitrator to act outside of national law and that enforcement is not sought from a national court, there is no link between the law of the arbitration and any national law, because: "... what the arbitrators do is authoritative for the arbitration simply because the parties have, through their agreement, set in motion a process in which at least one of them is still prepared to participate."<sup>595</sup>

One also has to consider the idea of partial a-nationality. It seems to be more realistic to admit that there are always minor points of contact at one stage or another. Arbitrators will never completely disregard national law, as the mandatory or public policy rules always need to be respected. In addition to this, parties might not wish to exclude all the provisions of national law, especially to ensure the help of national tribunals in the event of one party's non-compliance with the award.

By following the theory that a-national arbitration exists, the parties are not faced with and surprised by a national law that they are not familiar with and the application of which they did not expect or choose. The fact that no national law is preferred or automatically applied assures that all (national) laws are on the same level and the arbitrator is free to apply the one that the parties designated or that he considers appropriate. The contract, the arbitral agreement, the conflict of law rules, the procedural rules and the rules applicable to the substance are not interpreted and regulated according to a national law determined by the seat of the arbitral tribunal<sup>596</sup>. The arbitrator determines the applicable law according to his own method, which should concur with the parties' wishes.

One should not forget that the arbitrator's duty is to do everything to ensure recognition and enforcement of the award<sup>597</sup>. Even an a-national tribunal will therefore not render an award for which this is not assured or that is based on rules not respected in the countries to which the contract is connected. *To the*

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<sup>595</sup> Von Mehren, "To what Extent Is International Commercial Arbitration Autonomous?", in: *Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman, Litec*: Paris (1987), 222.

<sup>596</sup> Stein, *Lex mercatoria: Realität und Theorie*, 95.

<sup>597</sup> Lando, „The lex mercatoria in International Commercial Arbitration“, 34 *ICLQ* (1985), 765; Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 109; Osman, *Les Principes Généraux de la Lex Mercatoria*, Paris (1992), 395; Weise, *Lex Mercatoria*, 135.

*extent that national laws limit the ability of national courts to interfere with arbitral awards, the arbitrators are in practice able to disregard any theoretical limitations on the way they reach their decisions and the law they apply. Even so, arbitral tribunals have a moral, as well as legal, obligation to act in a disciplined fashion and according to settled principles unless they are dispensed from such obligation by the agreement of the parties. So the fact that the control exercised over their functions is relatively light is not a ground for treating the legal basis for their decisions as unimportant.*<sup>598</sup>

The classical theory of international private law argues that every contract or dispute is necessarily governed by a national law. Its opponents demand a de-nationalization of international trade relations and also that international commercial arbitration be governed by an a-national legal standard to take the differences to domestic trade relations into consideration. However, how can one speak of a “de-nationalization” of a trade relation that has never been national in the first place? If there is no choice-of-law clause designating a national law in an international contract, the arbitrator has to honour the fact that it is a trade relation outside the domestic scope and can only apply a particular national law if there are indications leading him to that conclusion<sup>599</sup>.

To summarise, it is clear that not every arbitration is national. The merchant’s freedom to choose the law governing his business relation and even to oust all national law is a fact. As David put it: *... let us have no illusions: the lawyer’s idea which aspires to submit international trade, in every case, to one or more national systems of law is nothing but bluff. The practical men have largely freed themselves from it, by means of standard contracts and arbitration, and states will be abandoning neither sovereignty nor prerogatives if they open their eyes to reality and lend themselves to the reconstruction of international law.*<sup>600</sup>

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<sup>598</sup> Goode, “Usage and its Reception in Transnational Commercial Law”, in: Ziegel (ed.), “New Developments in International Commercial and Consumer Law”, Oxford (1998), 9.

<sup>599</sup> Langen, “Transnationales Handelsrecht”, *Neue Juristische Wochenschrift* (1969), 2231.

<sup>600</sup> David, “The International Unification of Private Law”, in: *International Encyclopedia of Comparative Law*, II (1971), 212. cited in: Juenger, “Lex mercatoria und Eingriffsnormen”, 237.

## 9. Decisions based on *lex mercatoria* are arbitrary

Some critics argue that the outcome of a conflict that is to be decided according to transnational law is not predictable<sup>601</sup>. By choosing *lex mercatoria* as the law governing the conflict, the parties explicitly wish to have these rules applied. They may reflect their own interests and the requirements of their trade, and thus the "... vagaries of different national laws ..." are ruled out<sup>602</sup>. Certain rules have to be discovered by comparing national laws and by observing the practices and usages of the international merchant community. This fact is said to make the outcome of the dispute and the choice of the rules that are applied in the matter insecure and arbitrary compared to strict and rigid national law. The technical rules of national laws do not exist in arbitration cases involving *lex mercatoria*. Due to these facts and the wide discretion with which the arbitrator decides, the latter might be inclined to find his decision based on his personal impression of the facts, which would, indeed, make the outcome arbitrary. The arbitrary and vague jurisprudence based on general principles and the like could be used to evade the normally applicable law and to abuse one's power and influence<sup>603</sup>. The arbitrator could decide in equity rather than based on rules.

Firstly, an arbitral award will only be enforced by a national court if it is based on some rule. Thus, the Vienna Oberlandesgericht cancelled an arbitral award that was based only on the transnational rule of good faith. According to the court, by founding his decision on this rule only, the arbitrator declares that he has found a just and equitable solution to the dispute. Nevertheless, a judge has to base a decision on law and not on his personal convictions<sup>604</sup>.

Secondly, sometimes national courts also have great freedom to interpret the law or the facts according to good faith and the like. *Lex mercatoria*, like national laws, contains principles and rules that are binding on the parties and the arbitrator. In cases where norms of the *lex mercatoria* apply, the arbitrator cannot

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<sup>601</sup> Mann, "Schiedsrichter und Recht", in: Festschrift Flume (1978), 595.

<sup>602</sup> Redfern/Hunter, *Law and Practice of International Commercial Arbitration*, 3<sup>rd</sup> ed., London (1999), 2-60.

<sup>603</sup> Berger, *Formalisierte oder "schleichende" Kodifizierung des transnationalen Wirtschaftsrechts*; Berlin, New York: de Gruyter (1996), 51.

<sup>604</sup> OLG Wien (26.01.1982), *Norsolor v. Pabalk Ticaret, Die Aktiengesellschaft* (1982), 166.

deviate from them and impose his own opinions<sup>605</sup>. If, on the other hand, there is room for interpretation, the arbitrator can impose his own ideas just like a national judge. There is a difference between amiable composition and *lex mercatoria*. The latter is a law and a set of rules, the first is a decision based on equity for an individual case. This elementary difference is not very clear in many awards. Nevertheless, whenever an arbitrator is called to decide a dispute according to *lex mercatoria*, he cannot deviate from its rules and base his award on equity. If the law merchant provides a rule for the question of law that needs to be decided the arbitrator cannot disregard that rule, even if the result does not correspond with his personal views<sup>606</sup>.

Dispute resolution in international trade according to International Private Law and its rules of conflict also seems arbitrary. Whenever a dispute arises out of a trade relation, the rules of conflict indicate a national law to be the law governing the conflict. The parties might not be familiar with that particular law and the solutions it provides for the given cases. This method does not seem to provide greater security for the parties than the application of transnational law. First, the national law is foreign to at least one of the parties. Second, in certain cases the application of *lex mercatoria* leads to more predictable results. Unlike national laws with many mandatory rules, the latter only rarely changes the contents of a contract. When national law is applied, one has to expect that some provisions of the contract can be changed or adapted because that law considers them to be illegal<sup>607</sup>.

It remains to be shown that applying national law leads to more predictable and less arbitrary results than applying the *lex mercatoria*. If the law merchant were vague and lead to insecurity, the community of international traders would long have abandoned the whole concept<sup>608</sup>. Also, when basing awards on general principles of law recognised by the trading nations, results are predictable, as these principles can be found in all the national laws according to the methods of

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<sup>605</sup> Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 103.

<sup>606</sup> Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 103.

<sup>607</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 399.

<sup>608</sup> Juenger, "Lex mercatoria und Eingriffsnormen", 239.

comparative law. “*La règle transnationale est par nature prévisible. Elle doit répondre à l’attente prévisible des deux parties.*”<sup>609</sup>



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<sup>609</sup> Loquin, “Où en est la *Lex Mercatoria*”, in: Souveraineté étatique et marchés internationaux à la fin du 20<sup>ème</sup> siècle. Mélanges en l’honneur de Philippe Kahn, (2000), 38.

## Chapter 6

### Application of the *lex mercatoria*

It is also highly controversial under which circumstances an arbitrator can apply *lex mercatoria* to resolve a conflict. It needs to be discussed if it constitutes a standing body of legal rules that is automatically applied to all the international business transactions unless specifically ousted by the parties, or, on the contrary, if it consists of rules that have to be expressly chosen in cases where the parties have excluded the application of national law.

Since *lex mercatoria* represents general principles of law common to all the civilized nations, there seems to be no reason to deny its applicability as the law governing the contract. This approach has been confirmed by case law<sup>610</sup>. Does the parties' choice have to designate *lex mercatoria* explicitly as the applicable law? Are the arbitrators obliged to obey the parties' designation of *lex mercatoria*?



Unlike a national judge, an arbitrator is generally not bound to follow the rules of a certain country. The arbitrator is not forced to apply the *lex fori*, the law of the seat of the arbitral tribunal. There are numerous reasons for this.

According to a traditional theory, the conflict of law rules used by the arbitrator should be the ones of the arbitral seat. Thus, the arbitrator applies the same rules a national court would apply. This might facilitate supervision, intervention and enforcement<sup>611</sup>.

On the other hand, this law often has no connection whatsoever with the contract and therefore it is not convenient to oblige the arbitrator to apply it. Another argument against this theory is that the seat of the arbitral tribunal is often difficult to determine. There might be arbitrators from different countries who meet at different places. Also, they might render the award at a location different from the one where the meetings were held or the agreement was

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<sup>610</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 30.

<sup>611</sup> Mann, *Schiedsrichter und Recht*, 598-601.

signed<sup>612</sup>. In addition, the seat of the arbitral tribunal is often arbitrary, and deriving the applicable law from the seat would eliminate some of arbitration's advantages over national courts, such as flexibility as to what conflict of law rules are to be used. Furthermore, Article VII (1) of the European International Commercial Arbitration Convention can be held against that theory:

The parties shall be free to determine, by agreement, the law to be applied by the arbitrators to the substance of the dispute. Failing any indication by the parties as to the applicable law, the arbitrators shall apply the proper law under the rule of conflict that the arbitrators deem applicable. In both cases the arbitrators shall take account of the terms of the contract and trade usages.

In the same sense, Article 17 of the ICC Rules of Arbitration reads as follows:

(1) The parties shall be free to agree upon the rules of law to be applied by the Arbitral Tribunal to the merits of the dispute. In the absence of any such agreement, the Arbitral Tribunal shall apply the rules of law which it determines to be appropriate.

(2) In all cases the Arbitral Tribunal shall take account of the provisions of the contract and the relevant trade usages.

(3) ...

“It is legitimate to think that this formula opens the way to a form of arbitration more or less unbound, in the future, from legalistic constraints.”<sup>613</sup> Consequently, the solution proposed in the thesis is not to bind the arbitrator by the conflict of law rules or the law of the seat of the arbitral tribunal. The arbitrator is not even obliged to apply any national law, since most modern national laws use the term “rules of law” instead of “law”. Because no system of

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<sup>612</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 94.

<sup>613</sup> Triebel/Petzold, “Grenzen der lex mercatoria in der internationalen Schiedsgerichtsbarkeit”, *Recht der internationalen Wirtschaft* (1988), 245.

conflict of laws is immediately applicable, arbitrators are free to choose one, as long as their choice complies with the parties' instructions<sup>614</sup>. Approaches focusing exclusively on the nationalities or residences of the parties or the arbitrators can be neglected for the reasons presented above.

Since the arbitrator is not bound by the conflict of law rules of a certain state, he must act according to the common intention of the parties. One must differentiate between the conflict of laws situation before a national court and an arbitral tribunal. From the absence of a *forum* for the arbitrator, De Ly, among others, concludes the following: *1) international commercial arbitrators are under no obligation to apply a national system of conflict of laws or national conflict rules; 2) problems of qualification should not be solved by the law of the arbitral seat; 3) international commercial arbitrators are under no obligation to review whether the applicable rules conflict with the public order of any national state or to apply mandatory laws of any national state; or 4) international commercial arbitrators cannot sanction fraude à la loi since no national law may pretend that it should be applied by international commercial arbitrators.*<sup>615</sup>



In international contracts, parties often include a choice of law clause to designate the law that is to govern the contract and to exclude other national laws that might also be connected with their business relation. There are different theories about the parties' choice of law. One theory, known as the subjective theory, regards the will of the parties as expressed in the choice of law of the contract as an exclusive indicator as to which law should be applied. This theory is dominant<sup>616</sup>. The parties' choice is always respected and becomes the only criterion when determining the applicable law. The objective theory, on the other hand, regards the will of the parties as an important, but not exclusive, indicator. According to this approach, the arbitrator has to take other elements into account, which means that he could disregard the parties' explicit choice and that some real connection between the contract and the chosen law could be necessary<sup>617</sup>.

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<sup>614</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 169.

<sup>615</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 92.

<sup>616</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 64.

<sup>617</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 71.

There are different approaches concerning the conflict of law systems used by arbitrators. First, there is the theory according to which the applicable law is determined by the national rules of conflict of the arbitral seat. The differences between a procedure before a national court and arbitration are not that significant because the same national rules of conflict are applied<sup>618</sup>.

On the other hand there is the theory about an autonomous conflict of law system for international commercial arbitration. The advocates of this theory want to free the arbitrator from the boundaries of national rules of conflict and enable him to apply the law that he considers adequate or that has been designated by the parties, regardless of which law the national rules of conflict indicate. In order for the *lex mercatoria* to be applied, no national rule of conflict can be used. National rules of conflict will in most cases designate a national law to be the applicable law. Even if the application of a transnational system of rules is authorized, *lex mercatoria* would be nationalized to a certain extent<sup>619</sup>.

When discussing the application of the *lex mercatoria*, one should first remember the fact that the parties' choice is always respected by the arbitrators. The application of the law designated by them has never been denied for reasons such as unsuitability or incompleteness and the like<sup>620</sup>. This follows from the principle of the parties' autonomy regarding this question, because basically all the national laws respect the parties' choice. Thus, "In the field of contract, it is possible to speak, to a large extent, of a common or universal private law, at least whenever the question is that of the law governing the contract when there is an expressed choice by the parties."<sup>621</sup>

The parties' autonomy plays a very important role in international commercial arbitration. They are free to decide which national law should be applied, to exclude all national laws and to authorize the arbitrators to base their

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<sup>618</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 274.

<sup>619</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 276.

<sup>620</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 170; Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 29.

<sup>621</sup> ICC Award No. 1512/1971, YCA vol. I (1976), 129.

decision on *lex mercatoria*, transnational law, general principles of law and the like, or to act as *amiable compositeur*.

However, it should be noted, that the problems described below only arise on few occasions. There are no difficulties determining the applicable national or non-national law in cases where the contract's stipulations, the *lex contractus*, solve the dispute sufficiently. This follows from *the pacta sunt servanda* principle and the parties' autonomy. Furthermore, if all the laws that could be applicable provide the same solution to the dispute in question, there is no need to decide which one should govern the conflict. These two possibilities should be pertinent to most disputes in International Trade Law and solve the question about the parties' designation of an applicable law or the absence thereof<sup>622</sup>.

Another fact that should be recalled is that one must always differentiate between the applicable procedural rules and the laws applied to the substance of the dispute: *The present authors believe that the significant distinction is the one to be perceived between the law of the arbitration, that is to say the law (or laws) which determines the binding effect of the actions of the parties or the arbitrator (in agreeing to arbitrate, in choosing rules of procedure or the applicable substantive law, in determining jurisdiction or arbitrability, in issuing an award) and the law under which the merits of the dispute are decided. The latter is foremost in the minds of the parties when addressing the arbitral tribunal, because it establishes the nature and extent of their obligations; the former comes into play when facing national judges, because it determines what effect is to be given to an agreement to arbitrate, or to an arbitral award.*<sup>623</sup>

#### **A. Choice of the *lex mercatoria* by the parties**

The practitioners of international trade more and more frequently choose *lex mercatoria* to be the law governing the contract<sup>624</sup>. However, when merchants introduce an arbitration clause into their contracts and wish to avoid the

<sup>622</sup> Kappus, *Lex mercatoria in Europa und Wiener UN-Kaufrechtskonvention 1980*, Frankfurt am Main (1990), 165.

<sup>623</sup> Craig, Park, Paulsson, „ICC Arbitration“, New York (2000), 626.

<sup>624</sup> Lando, “The law applicable to the merits of the dispute”, in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 104.

application of national law in case of dispute, they rarely use the term *lex mercatoria*. More often, they refer to the general principles of law, the usages of international trade, transnational law and the like. By wording their contract this way they authorize the arbitral tribunal to apply *lex mercatoria*<sup>625</sup>. It follows from the flexible character of the *lex mercatoria*, its many different sources, elements and concepts that it is rarely called by its name<sup>626</sup>. This choice of law can also be made after the dispute has arisen. A very important award concerning the re-emergence of the *lex mercatoria* was *Petroleum Development Ltd. v. Sheik of Abu Dhabi*<sup>627</sup>. The clause used by the parties did not indicate explicitly that a-national law should be applied: “17: The Ruler and the Company both declare that they intend to execute this Agreement in a spirit of good intentions and integrity, and to interpret it in a reasonable manner.” The arbitrator did not find the law of Abu Dhabi apt to resolve the conflict. Thus, he concluded the following: *On the contrary, Clause 17 of the Agreement, cited above, repels the notion that the municipal Law of any country, as such, could be appropriate. The terms of that Clause invite, indeed prescribe, the application of principles rooted in the good sense and common practice of the generality of civilized nations – a sort of modern law of nature.*

The possibility for the arbitrator to apply a-national law becomes quite clear in the following award: *The parties have not indicated the national law that they want to be applied to their relations or disputes in their agreements or correspondence. By doing that, they implicitly empowered the arbitrator to apply the rules of law and, in their absence, commercial customs relating to the interpretation of their obligations.*<sup>628</sup>

It also follows from the principle of party autonomy, that the explicit choice of *lex mercatoria* as governing law needs to be respected by the arbitrators. “When the parties actually express the desire that their rights and obligations be

<sup>625</sup> Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 137.

<sup>626</sup> Rivkin, “Enforceability of Arbitral Awards Based on *Lex Mercatoria*”, 9 *Arbitration International* (1993), 68.

<sup>627</sup> ICLQ (1952), 247.

<sup>628</sup> ICC Award No. 1641/1969, *Journal du Droit International* (1974), 888.

determined in accordance with the customs, practices and standards of international commerce, arbitrators are obliged to respect that desire.”<sup>629</sup>

Some opponents of the *lex mercatoria* argue that it does not constitute an autonomous legal system and only has a very limited number of sources and rules and many gaps<sup>630</sup>. If the parties wish to have to their contract governed by the *lex mercatoria* and their disputes resolved according to its rules, they include an explicit choice of law clause into their contracts. De Ly, who denies the existence of an autonomous *lex mercatoria*, proposes a solution in order to respect the parties’ choice as much as possible – the tribunal should apply transnational rules as far as possible as if they were incorporated contract rules, as long as they do not contradict the national law connected with the contract<sup>631</sup>. Yet the existence of *lex mercatoria* cannot be denied, as it is used by arbitrators to solve conflicts and referred to by merchants. “Let me just note that in Europe the *lex mercatoria* is a fact. Arbitrators apply it and those courts which have faced awards applying it have accepted its application.”<sup>632</sup>



On the other hand, there is no clear consensus about the signification of an *amiable compositeur* clause. As in the cases where *lex mercatoria* is applied, the arbitrators always have to respect the parties’ choice. Thus Article 33 (II) of the UNCITRAL Arbitration Rules prohibits arbitrators from acting as *amiable compositeur* if not explicitly authorized to do so by the parties:

The arbitral tribunal shall decide as *amiable compositeur* or *ex aequo et bono* only if the parties have expressly authorized the arbitral tribunal to do so and if the law applicable to the arbitral procedure permits such arbitration.

The same rule is fixed in Article 28 (III) of the UNCITRAL Model Law on International Commercial Arbitration and in Article 17 (3) of the ICC Rules of Arbitration. There is a difference between *lex mercatoria* and *amiable*

<sup>629</sup> Lew, “Applicable Law in International Commercial Arbitration”, New York (1978), 117.

<sup>630</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 286.

<sup>631</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 289.

<sup>632</sup> Lando, “The law applicable to the merits of the dispute”, in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 104.

composition. By choosing *lex mercatoria* to be the law governing the conflict, the arbitrator is obliged to observe the mandatory rules. By choosing amiable composition, the arbitrator can base his decision on equitable principles and is freed from any law. Nevertheless, there are numerous awards in which the arbitrators who are called on to act as *amiables compositeurs* apply the *lex mercatoria*: *But it seems that the parties have clearly expressed their intention to give amiable composition an extremely wide definition and to exclude the application of all national laws to their dispute. ... After having stated that the concept of such a contract and its localisation excludes a mandatory application of Belgian and English law, the arbitrators proclaimed their use of the lex mercatoria to exercise their powers as amiables compositeurs for the above reasons.*<sup>633</sup>

The arbitrators applied the a-national law merchant without an explicit authorization by the parties. This also becomes clear in the following award: *Additionally, when the authority is granted to it to act as amiable compositeur, as specified in the Contract and in the Terms of Reference, the Arbitral Tribunal need not decide which specific law governs the contractual relationship between parties. On the basis of the foregoing, in making its determination on the issues involved in the present proceedings, the Arbitral Tribunal will apply the widely accepted general principle governing commercial international law with no specific reference to a particular system of law.*<sup>634</sup>

In the following case the parties had authorized the arbitrators to act as *amiables compositeurs*: *Considering that in the present case the arbitral tribunal holds that it has been given by the parties' intent a discretionary power as to the choice of the applicable law, ... in practice, one of the methods used by international arbitrators is that of the 'direct approach' (voie directe), either by the direct determination of an applicable national law chosen in view of the circumstances of the contract and of the dispute, or by basing themselves uniquely on the contract and the general and common legal principles; That the arbitral tribunal, upon careful consideration, holds that this latter principle, that is, the application of the 'lex mercatoria', should be used here, within the limits and*

<sup>633</sup> Paris, Revue de l'arbitrage (1980), 560.

<sup>634</sup> ICC Award No. 3267/1979, YCA vol. VII (1982), 98.

*framework to be set out hereafter; Considering that this seems in reality the implicit choice of the parties, ...*<sup>635</sup>.

In summary, the insertion of an amiable composition clause into a contract gives the arbitrator great freedom. He can base his decision on his personal convictions and considerations. Consequently, if he considers transnational law or the a-national *lex mercatoria* to be applicable to the dispute, or to serve the parties' interests best, he is free to apply it. Therefore the insertion of an amiable composition clause into a contract logically empowers the arbitrator to apply *lex mercatoria*. If, on the other hand, the parties have explicitly chosen *lex mercatoria* to be the law governing the conflict, the arbitrator is not free to act as *amiable compositeur*.

For Goldman and other authors who describe *lex mercatoria* as incomplete, its applicability can result either from the insertion of a clause in an international contract or from the direct application by the arbitral tribunal<sup>636</sup>. In the first case, the parties have stipulated that the contract be governed exclusively by the law merchant. As these authors consider it to be incomplete, the arbitrators have to refer to national law. *In reality, such clauses cannot prevent the arbitrator (and possibly the judge) from referring, in some instances, to a municipal law: for example, where the validity of the consent to the contract or the personal capacity of one of the parties is challenged.*<sup>637</sup> They propose the application of the *lex mercatoria* when chosen by the parties. The gaps are to be filled with the otherwise applicable national law.

### ***B. Application of the lex mercatoria in the absence of choice***

It is quite common for parties to an international trade contract to omit to indicate a law governing the contract<sup>638</sup>. There is no consensus about the

<sup>635</sup> YCA vol. VII (1982), 129.

<sup>636</sup> Goldman, "The applicable law: general principles of law – the *lex mercatoria*", in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 116.

<sup>637</sup> Goldman, "The applicable law: general principles of law – the *lex mercatoria*", in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 116.

<sup>638</sup> Lowenfeld, "Lex Mercatoria: An Arbitrator's View", 6 *Arbitration International* (1990), 146.

application of the *lex mercatoria* if it has not been chosen by the parties as the law governing the contract. Trade usages as one element of the *lex mercatoria* are always applicable. Arbitrators apply trade usages, and these inspire their awards, without making a special reference to them and without having to legitimize the application of an element that is not part of the national law<sup>639</sup>. According to one point of view, whenever a choice-of-law clause is not included in the contract, the arbitrators will apply a-national rules of law and commercial usages<sup>640</sup>. This has also been confirmed by arbitral awards: *The defendant declared that a clause concerning the applicable law was deliberately not inserted into the contract: as an international organisation he does not consider that his contracts should be submitted to any national legal system. He deems that the contract should be governed exclusively by generally accepted principles. The plaintiffs further declared that they had not envisaged a possible choice of law. Consequently, the undersigned (the arbitrator) does not consider it necessary to choose a particular national law to be applied to the contract submitted.*<sup>641</sup>

On the other hand, the application of *lex mercatoria* is said to be possible only if the parties have agreed on the point<sup>642</sup>. In the absence of such a choice the arbitral tribunal should determine an applicable national law consistent with the rules of conflict. National law can only be excluded if there is a clear indication that *lex mercatoria* or usages of international trade should be applied.

Another argument against the application of *lex mercatoria* in cases where the parties have not stipulated the applicable law is the wording of Article 28 (2) of the UNCITRAL Model Law on International Commercial Arbitration. In Article 28 (1), which deals with the law chosen by the parties, the term “rules of law” is used. This clearly indicates the possibility of having the dispute governed by an a-national legal order. By contrast, Article 28 (2), which deals with the law to be applied when the parties omitted to choose a law to govern the contract, refers to “law”. This obvious difference could oust the applicability of *lex*

<sup>639</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 263.

<sup>640</sup> Goldman, “The applicable law: general principles of law – the *lex mercatoria*”, in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 117.

<sup>641</sup> ICC Award No. 2152/1972, cited in: *Journal du Droit International* (1974), 889.

<sup>642</sup> Freeman, “*Lex Mercatoria: A Legal Basis for the Resolution of International Disputes*”, in: Zylva, Harrison, Jordan (ed.), *International Commercial Arbitration*, Bristol (2000), 127.

*mercatoria* by arbitrators when the parties have not stipulated a law<sup>643</sup>. On the other hand, Article 17 (1) of the ICC Rules reads as follows:

The parties shall be free to agree upon the rules of law to be applied by the Arbitral Tribunal to the merits of the dispute. In the absence of any such agreement, the Arbitral Tribunal shall apply the rules of law which it determines to be appropriate.

Some more modern national laws, such as the French NCPC (New Code of Civil Procedure) or Dutch and Swiss law, permit the application of *lex mercatoria*<sup>644</sup>. It is true that arbitrators dispose of great discretionary powers if the parties have not chosen the law governing the conflict. But they will in most cases be driven to render an award that is enforceable and recognizable. They will be influenced by the same considerations when basing their award on general principles of law or usages of international trade as their colleagues who apply national law, and attempt to render a reasonable award. In addition, if no choice has been made by the parties, it might lead to arbitrary and unpredictable results to oblige the arbitrators not to apply *lex mercatoria* but to choose one of the national laws connected with the contract<sup>645</sup>. This is especially true in cases where the contract is equally connected to two or more national laws.

Therefore, it cannot be deduced from the absence of a chosen law that the parties have impliedly chosen *lex mercatoria* to be the law governing the conflict. There could be numerous reasons for the absence of a choice-of-law clause. The parties could have simply forgotten it or not considered it to be of any importance. They could have also thought it to be obvious which (national) law should be applied. Furthermore, they might not have wished to have an argument about the applicable law endanger the whole contract. On the other hand, one could argue that the parties explicitly omitted to designate a law. By so doing, they empower the arbitrator to apply a law that he considers appropriate. If that law happens to

<sup>643</sup> Gaillard, “Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit”, *Journal du Droit International* (1995), 19.

<sup>644</sup> Article 1496 (1) of the French Code of Civil Procedure; Berger, *Internationale Wirtschaftsschiedsgerichtsbarkeit*, 386.

<sup>645</sup> Gaillard, “Trente ans de Lex Mercatoria. Pour une application sélective de la méthode des principes généraux du droit”, *Journal du Droit International* (1995), 20.

be *lex mercatoria*, the award should not be set aside because of the absence of the parties' choice.

On the other hand, however, application of or reference to the *lex mercatoria* has been made without a clause designating it as the law governing the contract. *Lex mercatoria* was even employed in a case without a formal written contract<sup>646</sup>.

In the following ICC award, the parties instructed the arbitrators to find out according to which national law or general principles of law, usages and customs their dispute should be resolved. The arbitrators stated the following: *Considering that one must acknowledge the autonomy of the international merchant community, which follows its own rules in the course of its interactions; for example that the law of the international enterprises escapes the influence of national law.*<sup>647</sup> This is a very radical point of view, for the arbitrators consider that all law governing international trade is independent from national law.

One of the most famous awards concerning the *lex mercatoria* is the *Pabalk v. Norsolor* award from 1979. Having to decide between the application of either French or Turkish law, the arbitrators decided as follows: *Faced with the difficulty of choosing a national law, the application of which is sufficiently compelling, the Tribunal considered that it was appropriate, given the international nature of the agreement, to leave aside any compelling reference to a specific legislation, be it Turkish or French, and to apply the international lex mercatoria.*<sup>648</sup>

This is also a very radical point of view. First of all, *lex mercatoria* is applicable only as a subsidiary law in cases where no national law has been chosen and seems apt. The arbitrators' approach obliterates one of the advantages of the *lex mercatoria*. As shown above, one of the disadvantages of the application of national law to international trade relations is the uncertainty about which national law will be applied and the arbitrariness of the unavoidable

<sup>646</sup> ICC Award No. 2291/1975, *Journal du Droit International* (1976), 989: *Les parties n'ayant pas pris la précaution de rédiger un contrat formel, il convient d'interpréter leurs volontés et leurs engagements à partir de leurs écrits, et en fonction des principes généraux du droit et de l'équité qui doivent régir les transactions commerciales internationales.*

<sup>647</sup> ICC Award No. 2375/1975, *Journal du Droit International* (1976), 974.

<sup>648</sup> ICC Award No. 3131/1979, *YCA* vol. IX (1984), 110.

decision. If *lex mercatoria* is used in the way the arbitrators did in this case, the results become unpredictable as well and the parties are not aware of the fact that transnational law will govern their conflict, for they have not explicitly chosen *lex mercatoria*. As in the case cited before, the internationality of the trade relation is said to provide an explanation for the application of transnational law and the exclusion of national laws.

In ICC award no. 1512/1971, the parties had chosen Indian law as the applicable law to the substance of the dispute. This choice was respected by the arbitrator: “The arbitrator has no power to substitute his own choice to that of the parties, as soon as there is an expressed, clear and unambiguous choice, and no sufficient reason has been put forward to refuse effects to such a choice.”<sup>649</sup> However, as to the applicable procedural law, the arbitrator set aside the designation of a national law and resolved the dispute according to the principles of the *lex mercatoria*: *As a result of the above, the various references made by the parties to a Pakistani or Indian Code of procedure, or to the juridical decisions of one or the other of these countries, were held irrelevant and could not be taken into account by the arbitrator.*<sup>650</sup>

The absence of a choice of law clause indicating a national law does not implicate the choice of one of the parties’ national law to be the law governing the contract. Especially in trade relations involving states, the absence of such a clause does not necessarily mean that they wish to have their disputes resolved by a national law only. Hence the application of *lex mercatoria* could be more adequate to the parties’ intentions<sup>651</sup>.

What’s more, one cannot conclude the desire to have transnational law applied from the fact that arbitration is the mode of dispute resolution chosen by the parties. Nevertheless, the choice of a certain arbitral tribunal or a body of rules that allows the application of transnational law can be an indication of the parties’ preference for *lex mercatoria* over national laws. It has been argued that if the parties choose a model law that allows the application of transnational rules to

<sup>649</sup> ICC Award No. 1512/1971, YCA vol. I (1976), 130.

<sup>650</sup> ICC Award No. 1512/1971, YCA vol. I (1976), 128.

<sup>651</sup> Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 141.

govern the conflict, they implicitly choose *lex mercatoria*<sup>652</sup>. In the same way, the inclusion of usages of international trade into the contract has been identified as authorization to apply an a-national legal system<sup>653</sup>. The choice of a certain arbitral tribunal, the seat of the arbitration and the nationality of the arbitrators has also been used as an indicator to designate an applicable national law. Whenever non-national arbitral tribunals are involved, these indicators cannot be useful criteria, as the arbitrator has no *lex fori*. There is no reason to apply the national law of the arbitrator or of the place where the award is rendered, for this would be random and not necessarily in harmony with the parties' intentions. They often choose the a-national arbitral tribunal in order to avoid the application of national law.

To connect the dispute to the law of the country where the arbitration takes place would lead to arbitrary results, as there is often more than one place connected to the procedure and parts of the procedure might take place in a different country. *Instead of applying the law of the casual seat of the tribunal, it is an appropriate way out of the difficulty to apply the lex mercatoria. Also, if in a case where the law applicable to the contract has not been selected by the parties one of them pleads the application of the lex mercatoria, a non-national arbitral tribunal should be permitted to comply with his request.*<sup>654</sup>

One could also argue that the parties to an international trade contract who omit to designate a national law to regulate their business relation have consented to having it governed by a non-national set of rules such as the *lex mercatoria*. To support this statement one could put forward the point of view that the parties are fully aware of the fact that they did not choose a national law and that the law merchant might be applied by the arbitral tribunal. The trade relation might be more connected to the rules and usages of international trade than to a particular national law.

This theory goes too far. As noted above, one cannot conclude the choice of *lex mercatoria* from the fact that there is no choice of applicable law at all.

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<sup>652</sup> Stein, *Lex mercatoria: Realität und Theorie*, 138.

<sup>653</sup> Stein, *Lex mercatoria: Realität und Theorie*, 138.

<sup>654</sup> Lando, "The law applicable to the merits of the dispute", in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 110.

Furthermore, one can always connect a contract to some national law, even if this may create the difficulties presented before, such as arbitrariness of the designation of one national law, inequality of the parties, etc. Problems may also arise out of situations where the contract is equally connected to two or more national laws. But even in such cases, it would go too far to automatically oust the application of any of them. Maybe the parties omitted the designation of a national law because they thought it would be obvious and not worth mentioning which national law should govern the contract. Maybe the parties never thought about the problem or wanted the arbitrator to choose one of the possibly applicable national laws<sup>655</sup>.

It has also been suggested that the choice of arbitration as the mode of dispute resolution can be interpreted as choosing *lex mercatoria* as the applicable law. *Furthermore, the mere insertion of an international arbitration clause is frequently considered as an internationalization instrument of the contract, and consequently, an implicit reference to the general principles and usages of international trade, even where the same is not expressly stipulated.*<sup>656</sup>

This point of view is too radical. Arbitration is the most commonly used mode of dispute resolution in international trade but even an ardent supporter of the *lex mercatoria* would hesitate to state that over 90 % of the practitioners implicitly wish to have their contracts governed by it.

Mustill proposes the following: *In the absence of express consent, it is generally held that the arbitrator should proceed by three stages, asking himself whether the application of any national system of law is appropriate; then, if not, whether he should proceed by amiable composition or by the application of a-national rules; and finally, if the latter, what a-national rules exist and are relevant to the dispute.*<sup>657</sup>

In the absence of an explicit choice of the *lex mercatoria* by the parties as the law governing the contract, arbitrators should take the *lex mercatoria*'s

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<sup>655</sup> Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 101.

<sup>656</sup> Goldman, "The applicable law: general principles of law – the *lex mercatoria*", in: Lew (ed.), *Contemporary Problems in International Arbitration*, (1987), 117.

<sup>657</sup> Mustill, "The New Lex Mercatoria: The First Twenty-five Years", 4 *Arbitration International* (1988), 99.

principles and rules into consideration to evaluate the contract's special needs and stipulations, due to its internationality. If no law has been chosen by the parties, arbitrators will usually designate the applicable law with the help of the conflict of law rules of the *lex fori* or with the help of the "centre of gravity" or "closest connection" rule. One problem in these cases is the tendency of judges or arbitrators to apply their own law and to disregard the hypothetical will of the parties<sup>658</sup>. In most of the cases in which no law has been chosen by the parties, a national law was applied and *lex mercatoria* only had an indirect influence on the awards.

To conclude, *lex mercatoria* should only be the law governing the conflict if it has been explicitly chosen by the parties. One cannot automatically conclude the choice of *lex mercatoria* from the mere fact that the parties did not designate a national law to govern the conflict. Even the most ardent supporter of the *lex mercatoria* has to admit that any other solution would also lead to arbitrary and unpredictable results.



### ***C. Application of the lex mercatoria against the parties' will***

Another problem presents itself in cases where the parties have explicitly chosen a national law and excluded the application of transnational law. *It is probably true to say that even the most impassioned proponents of lex mercatoria would agree that if a contract expressly stipulates a choice of governing law and the arbitrator is not amiable compositeur, then he cannot properly apply lex mercatoria in preference to the chosen law.*<sup>659</sup>

It is not admissible to allow the application of the *lex mercatoria* in these cases, for the parties' autonomy would be evidently disrespected and the award would surely not be enforced by national courts or respected by the parties. As mentioned above, the parties' wish has always been accepted, thus law merchant cannot be applied if national laws have been designated. Even in cases where the parties only implicitly ousted the application of the *lex mercatoria*, arbitrators are

<sup>658</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 74.

<sup>659</sup> Freeman, "*Lex Mercatoria: A Legal Basis for the Resolution of International Disputes*", in: Zylva, Harrison, Jordan (ed.), *International Commercial Arbitration*, Bristol (2000), 127.

reluctant to refer to it: *This poses the question which rules of law are appropriate. It is argued in literature that international arbitrators should, to the extent possible, apply the lex mercatoria. Leaving aside that its contents are not easy to determine, neither party has argued that a lex mercatoria should be applied. Rather, each party strenuously argued on the basis of a national law, i.e. Syrian and Ghanaian/English law respectively. Accordingly, the Arbitrator shall follow the implied desire of the parties to apply a national law.*<sup>660</sup>

However, there is one exception to that principle. In cases where the designation of a national law or the application of a rule thereof is absolutely impossible or contradicts a mandatory rule of international law, the application of the *lex mercatoria* or the general principles of international trade seems to be justified in order to find a solution to the dispute<sup>661</sup>. Similarly, whenever a rule of the law merchant represents the *ordre public international* it needs to be respected even if not stipulated by the parties. Grigera Naón goes even further by observing the following: *Moreover, even if it is no longer expressly incorporated into specific contracts or specifically validated by national laws, in the long run general international custom and principles of law as recognized by the international merchant community will become mandatory rules of lex mercatoria with direct application and thus ex officio applicable by international arbitrators against the will of the parties, even if the latter did not allege it or prove its existence. This would confer external regulatory functions on lex mercatoria in the field of international commercial transactions, similar to those currently exclusively ascribed to national legal orders.*<sup>662</sup>

The setting aside and the refusal of recognition and enforcement of an arbitral award where *lex mercatoria* was applied to the dispute against the parties' will is possible according to Articles 34 and 36 of the UNCITRAL Model Law and national laws because of excess of power. Article IX of the European Convention on International Commercial Arbitration of 1961 and Article V of the

<sup>660</sup> ICC Award No. 4237/84, YCA vol. X (1985), 55.

<sup>661</sup> Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 137.

<sup>662</sup> Grigera Naón, *Choice-of law problems in International Commercial Arbitration*, J.C.B. Mohr: Tübingen (1992), 27.

New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards provide the same solution.

Arbitrators would disregard the parties' choice and abuse their power if they applied *lex mercatoria* against the expressed will. An arbitrator cannot substitute his personal preferences for the law chosen by the parties, as it would clearly contradict the principle of party autonomy and the mandatory rules of most national laws on arbitration. Lowenfeld names an exception to that principle: *Even then, however, lex mercatoria intelligently used, can, I submit, be useful. Faced with an unclear statute or judicial precedent, an arbitral tribunal would be justified, I believe, in interpreting the national source so as to be consistent, and not inconsistent, with generally accepted international understanding and usage, or so as to be applicable only to internal commerce.*<sup>663</sup>

#### ***D. Awards inspired by the lex mercatoria***

*Lex mercatoria* also has an impact on cases where national laws have been applied. In such cases, the arbitrator often has to take usages of international trade into account to find a solution or to interpret the facts, the contract and the parties' behaviour. To further illustrate the well-founding of a solution, judges often refer to general principles of law and other sources of the *lex mercatoria*. In the *Liamco v. Libya* award, the choice of law clause was formulated as followed: *'This concession shall be governed by and interpreted in accordance with the principles of law of Libya common to the principles of international law, and in the absence of such common principles then by and in accordance with the general principles of law as may have been applied by international tribunals.'* The arbitrator analyzed this clause as follows: *The proper law ... is in the first place the law of Libya when consistent with international law, and subsidiarily the general principles of law. Hence the principal proper law of the contract in said Concessions is Libyan domestic law. But it is specified in the Agreements that this covers only 'the principles of law of Libya common to the principles of*

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<sup>663</sup> Lowenfeld, "Lex Mercatoria: An Arbitrator's View", 6 *Arbitration International* (1990), 147.

*international law'. Thus it excludes any part of Libyan law which is in conflict with the principles of international law.*<sup>664</sup>

In a contract involving an Italian and a Syrian enterprise the parties chose a state law as the law governing the contract but only insofar as this law was in accordance with the general principles of law. In addition, the parties chose the general principles of law as applied by international arbitral tribunals and not by other international courts. Therefore the arbitrators applied *lex mercatoria*.<sup>665</sup>

The choice of law clause in the contract that led to ICC awards no. 4761/84 and 87 ran as follows: ... 2. *Dans l'hypothèse où le droit libyen n'aurait pas été prouvé conformément à l'article 8 de l'acte de mission, le Tribunal appliquera la lex mercatoria, soit les principes généraux du droit.* 3. *La lex mercatoria s'appliquera également si le droit libyen tel qu'il a été établi par l'une ou l'autre des parties était manifestement lacunaire ou incomplet sur un ou plusieurs aspect du litige.*<sup>666</sup> This clause is one of the rare ones in which the parties and not the arbitrators in their award use the term *lex mercatoria*<sup>667</sup>. In this case they wanted the *lex mercatoria* to be employed only if the national law did not provide a satisfactory solution and only if the rule provided by the *lex mercatoria* is in concordance with the general principles of law. In the end the arbitrators applied Libyan law to resolve dispute, but not without indicating that other national laws and the *lex mercatoria* would have led to the same solution<sup>668</sup>.

Finally, in the award *Saudi Arabia v. Aramco* the arbitrators referred to the *lex mercatoria* to remedy the gaps of Saudi Arabian law: *In conclusion, this analysis shows that, in Saudi Arabian law as in the laws of Western Countries, ... Because of this fundamental similarity, the Tribunal will be led, in the case of gaps in the law of Saudi Arabia, of which the Concession Agreement is a part, to ascertain the applicable principles by resorting to the world custom and practice in the oil business and industry; failing such custom and practice, the Tribunal*

<sup>664</sup> *Liamco v. Libya*, YCA vol. VI (1981), 93.

<sup>665</sup> YCA vol. VII (1982), 118.

<sup>666</sup> Coll. Vol II, (1984) 299, (1987) 302, 519.

<sup>667</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 237.

<sup>668</sup> Coll. Vol II, (1984) 299, (1987) 302, 519: *Ce faisant, le droit libyen, à l'image d'autres droits nationaux tels le droit allemand et le droit suisse ou encore de la lex mercatoria, donne effet à la théorie de l'imprévision qui procède du principe que la règle 'pacta sunt servanda' trouve sa limite dans le principe supérieur de la bonne foi ...*

will be influenced by the solutions recognized by world case law and doctrine and by pure jurisprudence.<sup>669</sup>

### ***E. Application of the lex mercatoria by national courts***

A completely different problem is the application of *lex mercatoria* by national courts. Will a national court apply it as law in compliance with the parties' choice or even as the proper law of conflict if no choice has been made?

National courts are bound above all by their national laws and have to apply their rules. National courts will always use their proper rules of conflict to determine the applicable law. Opponents of the *lex mercatoria* deny the national judge the possibility of applying it, even in cases where it was chosen by the parties as the law governing the contract.<sup>670</sup>

According to the supporters of the *lex mercatoria*, it can be applied by virtue of a rule of conflict of the *lex fori*. The *lex fori* of the national court will thus define the extent and limits of the application of transnational law. This system of limited application of the *lex mercatoria* by national courts will not contribute to a uniformity of the law of international trade because it will not be the same in every country<sup>671</sup>.

On the other hand, a national court will not completely ignore a choice of law clause that stipulates *lex mercatoria* be applied in case of conflict. It follows from the parties' autonomy and from the freedom of contract principle that they have the possibility of choosing a transnational standard of law or merely some national rules without being forced to submit their dispute to arbitration. A

<sup>669</sup> *Saudi Arabia v. Aramco*, 27 Int'l. L. Rep. (1963), 171.

<sup>670</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: *Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman*, Paris (1987), 146: *Si la volonté des parties est une condition nécessaire de l'application de la lex mercatoria par le juge étatique, elle n'est pas une condition suffisante. Le juge ne peut accepter l'incorporation par les parties dans leur contrat de normes de la lex mercatoria que lorsqu'elles existent. Dans l'hypothèse, peu fréquente il est vrai, où un contrat international se réfère expressément à la lex mercatoria ou aux 'principes généraux du droit' serait soumis à un juge étatique, il nous semble que ce juge, faute par les parties d'établir des règles précises et constantes de la lex mercatoria, devrait éviter de se lancer dans la périlleuse entreprise de déduire des solutions concrètes de principes aussi vagues que la règle pacta sunt servanda ou le principe de bonne foi, mais plutôt constater que la référence des parties conduit à un vide juridique et combler ce vide par un appel au droit étatique désigné par son système de conflit de lois*

<sup>671</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 272.

national judge will respect the parties' stipulations and apply rules of the *lex mercatoria* if they have been chosen. In addition, many national laws oblige the judge to take usages into account. This is another possibility for a rule of the *lex mercatoria* to be applied by a national judge. He can also apply a foreign law if his own rules of conflict so indicate. However, unlike an arbitrator, a national judge cannot apply *lex mercatoria* if the merchants have not expressly designated it as the governing law: "... *que la volonté des parties est une condition nécessaire, encore que non suffisante, de l'application de la lex mercatoria par une autorité étatique.*"<sup>672</sup> Contrary to an arbitrator, a national judge can apply *lex mercatoria* only insofar as the parties included concrete rules in their contract or where there is no doubt about the existence of a certain rule. He can never act as an inventor or creator. If in doubt, he should apply the rules of the national law designated by his own rules of conflict and disregard the parties' will. Before national courts, international merchants cannot completely oust the application of national law. Rather, there is co-existence between national law and *lex mercatoria*. The connection that can safely be supposed to exist, is the case where enforcement of an arbitral award is being sought before a national court. Apart from that, the interaction between *lex mercatoria* and national courts, or the national courts' application of the law merchant, is rare or non-existent. *In short, it is evident that those involved in international trade tend to adopt norms developed without the participation of national organizations and tend for the most part to prefer not to bring their disputes to national courts, relying exceptionally upon governmental assistance in the enforcement of arbitral tribunal decisions.*<sup>673</sup>

But, even in cases where *lex mercatoria* was not chosen by the parties, a national court might be obliged to seek inspiration from it in order to overcome gaps in its national law or to avoid rules unfit for international trade. When interpreting the contract and the facts of the dispute, the judge has to consider the international trader's special situation and problems and therefore cannot leave *lex*

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<sup>672</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: *Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman*, Paris (1987), 144.

<sup>673</sup> Blaurock, "The Law of Transnational Commerce", in: Ferrari (ed.), *The Unification of International Commercial Law*, (1998), 17.

*mercatoria* aside. This problem can be even more significant in cases where the judge has to apply a foreign law.



## Chapter 7

### Enforcement of an award based on *lex mercatoria*

National courts have the jurisdictional monopoly. Arbitral tribunals can only exist and resolve disputes because this is tolerated by the national states. Naturally, arbitration would be ineffective and worthless if national courts refused categorically to enforce arbitral awards. As noted above, critics argue that an award based on a-national law such as *lex mercatoria* will not be enforced by a national court. According to this classical doctrine, only national law exists. Relations between private parties are said to be always governed by national law and the applicable law is determined by the national rules of conflict<sup>674</sup>. As the Permanent Court of International Justice put it: “Any contract which is not a contract between States in their capacity as subjects of international law is based on the municipal law of some country.”<sup>675</sup>

More modern arbitration or rules of conflicts laws however use the term “rules of law”, and not only “law”<sup>676</sup>. This includes *lex mercatoria*. There is no clear consensus on the question as to whether or not state courts have the possibility or even the duty to apply the law merchant when faced with an international trade dispute. National courts are said to not have the capacity to apply or to refer to an a-national law, they can only apply the foreign law indicated by their national rules of conflict<sup>677</sup>. Evidently, it would be desirable that national courts take the special needs and usages of international merchants into consideration. Nevertheless, the application of the *lex mercatoria* might not be necessary to achieve that aim. Instead, national judges could interpret the

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<sup>674</sup> Kegel/Schurig, Internationales Privatrecht, 9.

<sup>675</sup> PCIJ, Ser. A, no. 20, at 41, cited in: Berger, Formalisierte oder “schleichende” Kodifizierung des transnationalen Wirtschaftsrechts; Berlin, New York: de Gruyter (1996), 39.

<sup>676</sup> Art. 1496 of the French NCPC; Art. 28 (I) UNCITRAL Model Law on International Commercial Arbitration: The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Any designation of the law or legal system of a given State shall be construed, unless otherwise expressed, as directly referring to the substantive law of that State and not to its conflict of laws rules.

<sup>677</sup> Stein, *Lex mercatoria: Realität und Theorie*, 18.

contract according to its internationality and take customs and usages into account while they are applying national law.

It has been argued that the application of the law merchant by national judges would not contribute to its growing popularity and use. National judges are bound by their laws, are not as free and inventive as arbitrators, and they lack experience in international trade matters<sup>678</sup>. The *lex mercatoria* should therefore be developed and promulgated by arbitral tribunals only. The interaction between national courts and the law merchant is limited to the recognition and enforcement of arbitral awards based on it. Through this, rules of the *lex mercatoria* are incorporated into national law and applied by national courts. *The lex mercatoria is created outside of national legal systems but has to be connected with them in order to be enforced by the national courts. This means that there is no strict boundary between national legal systems and the lex mercatoria. The lex mercatoria uses the coercive authority of the lex contractus and the one recognised by states concerning arbitral awards.*<sup>679</sup>

It has been argued that *lex mercatoria* derives its qualification as a legal order only through the national laws' recognition. However, law is inherent to any form of organisation<sup>680</sup>. For a long time, national states let individuals or organisations create rules governing areas of law that the states had no interest in governing. Thus, marriage and family law was regulated by rules edicted by the Catholic Church. Problems arise if the state decides to create a law governing the same field. According to Lagarde, in International Trade Law, merchants can regulate their own affairs only insofar as the national laws allow them to do so. Rules of *lex mercatoria* can be applied because national laws permit arbitration and respect the freedom of contract and party autonomy principles<sup>681</sup>.

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<sup>678</sup> Stein, *Lex mercatoria: Realität und Theorie*, 247.

<sup>679</sup> Loquin, "Où en est la *Lex Mercatoria*", in: *Souveraineté étatique et marchés internationaux à la fin du 20<sup>ème</sup> siècle. Mélanges en l'honneur de Philippe Kahn*, (2000), 41.

<sup>680</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: *Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman*, Paris (1987), 139.

<sup>681</sup> Lagarde, "Approche critique de la *lex mercatoria*", in: *Le Droit des relations économiques internationales. Etudes offertes à Berthold Goldman*, Paris (1987), 140.

If the parties to an international commercial contract wish to have a dispute governed by *lex mercatoria*, they cannot be sure if national courts will enforce the agreement or an award based on this agreement. This problem arises naturally only if one of the parties is reluctant to abide by the award. It is rare that the parties do not comply with arbitral awards, for between 90 and 95 % of awards are respected by them<sup>682</sup>. The *societas mercatorum* has certain practices that help to make sure that arbitral awards are respected by the parties. First, a party that does not comply with the arbitrator's decision could be put on a blacklist, suffer a great loss of reputation, and can also be excluded from economic associations<sup>683</sup>. Some arbitration institutions even have the right to publish the names of the recalcitrant parties. If a recalcitrant merchant should later ask another party to appear before an arbitral tribunal, it can be refused to appear before the arbitrator because of the former non-compliance<sup>684</sup>.

As noted before, the finality of an arbitral award is one of the main attractions of arbitration, as no time and money are wasted on appeals. In order to respect the principle of finality, national laws are reluctant to interfere with arbitral awards "... even if they appear to be erroneous in fact or law, with the result that it is inherently more difficult to upset an award than it is to reverse a judge on appeal."<sup>685</sup> In addition, there seems to be no particular reason to set an award based on *lex mercatoria* aside if the parties have inserted this as applicable law in their arbitral clause. The award is still valid even if it is based on usage without reference to a particular national law. Arbitrators are not bound to apply any national law or even rules of conflict. The reluctance to set arbitral awards aside reinforces this statement<sup>686</sup>.

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<sup>682</sup> Draetta, Lake, Nanda, *Breach and Adaptation of International Contracts*, Butterworth (1992), 20.

<sup>683</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", (1984) Boston Univ. Int'l. L. J., 325.

<sup>684</sup> Cremades/Plehn, "The New *Lex Mercatoria* and the Harmonization of the Laws of International Commercial Transactions", (1984) Boston Univ. Int'l. L. J., 325, note 39.

<sup>685</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 9.

<sup>686</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 32.

The American and Continental view was long opposed to the traditional English view. The latter did not consider the *lex mercatoria* a law and was reticent about freeing arbitral awards from judicial control. The other view however, focussed on the finality of an arbitral award and tended to respect the parties' choice of arbitration as mode of dispute resolution and law merchant as the law governing the contract. Review of an arbitral award was limited to excess of power by the arbitrators or violations of mandatory rules of public policy<sup>687</sup>. The national attitudes concerning the recognition and the enforcement of an award based on *lex mercatoria* do not differ much anymore. It is almost uniformly accepted that awards based on *lex mercatoria* are recognized and enforced<sup>688</sup>. Even those laws, such as English law, that were traditionally not in favour of applying the *lex mercatoria* to disputes now admit the validity of the parties' choice of transnational rules: "... the battle in England is giving ground to the validity of Lex Mercatoria and other a-national standards."<sup>689</sup> The English view was traditionally hostile to the concept of an a-national *lex mercatoria* and its application by arbitrators. However, the 1996 Arbitration Act grants greater freedom to the parties and arbitrators. Thus, according to Section 1 (b) of the Arbitration Act "... the parties should be free to agree how their disputes are resolved, subject only to such safeguards as are necessary in the public interest". As to the applicable substantive law, section 46 needs to be consulted:

- (1) The tribunal shall decide the dispute:
    - (a) in accordance with the law chosen by the parties as applicable to the substance of the dispute; or
    - (b) if the parties so agree, in accordance with such other considerations as are agreed by them or determined by the tribunal.
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<sup>687</sup> Lowenfeld, "Lex Mercatoria: An Arbitrator's View", 6 *Arbitration International* (1990), 134.

<sup>688</sup> Rivkin, "Enforceability of Arbitral Awards Based on *Lex Mercatoria*", 9 *Arbitration International* (1993), 74.

<sup>689</sup> Rivkin, "Enforceability of Arbitral Awards Based on *Lex Mercatoria*", 9 *Arbitration International* (1993), 19.

- (2) If or to the extent that there is no such such choice or agreement, the tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

As stated by Freeman, ... *section 34 (l) allows the tribunal to decide all procedural and evidential matters, subject to the agreement of the parties. Finally, section 46 safeguards the parties' ability to choose the law to apply to the substance of their dispute. Importantly, it goes on to provide that they may also agree to have the dispute 'decided in accordance with such other considerations as are agreed by them or determined by the tribunal'*.<sup>690</sup> The object of the English 1996 Arbitration Act is to assure London's popularity as the world's leading centre for arbitration and to strengthen the parties' autonomy<sup>691</sup>. It follows from the foregoing and especially from the provisions of Section 46 of the Arbitration Act 1996 that the tribunal will apply the law chosen by the parties, even if they have chosen *lex mercatoria*, the general principles of law, customs and usages of international trade or the like.

Problems can arise if a national law does not allow the choice of an extra-legal standard to govern a conflict, which is not the case for most legal systems. This can be explained with the controversy about its classification. If certain national courts do not consider *lex mercatoria* to be an autonomous legal system they are reluctant to enforce an award based on it or to even apply it directly themselves. Consequently, parties and arbitrators are not completely free to choose the law governing the dispute, for their choice is influenced to a certain degree by the national laws of the states the award or the parties are connected with. Most national laws today honour an award based on the law merchant, and comparative analysis has shown that recognition and enforcement is denied by hardly any national law<sup>692</sup>. The relationship and the interaction between national and transnational laws and conflict of law rules need to be examined.

<sup>690</sup> Freeman, "*Lex Mercatoria: A Legal Basis for the Resolution of International Disputes*", in: Zylva, Harrison, Jordan (ed.), *International Commercial Arbitration*, Bristol (2000), 137.

<sup>691</sup> Carr, *Principles of International Trade Law*, 2<sup>nd</sup> ed. London (1999), 322.

<sup>692</sup> Stein, *Lex mercatoria: Realität und Theorie*, 243.

It needs to be discussed if application of the *lex mercatoria* by arbitrators is accepted by the different national laws. As mentioned before, French law permits the application of a-national legal rules in Article 1496 NCPC. This article was introduced into the Code of Civil Procedure in 1981 and largely influenced by the French proponents of the *lex mercatoria*. Influenced by the French legislation, the Dutch Arbitration Act from 1986 introduced Article 1054 into the Dutch Code of Civil Procedure. That article had the same content as Article 1496 NCPC and in the explanatory report the application of the *lex mercatoria* by the arbitrator was explicitly permitted, if in compliance with the parties' choice<sup>693</sup>.

According to Article VII (1) of the European International Commercial Arbitration Convention, Article 33 (1) of the UNCITRAL Arbitration Rules and Article 13 (3) of the ICC Arbitration Rules, national courts may review arbitral awards if the conflict of law rules or the law chosen by the parties has not been applied by the arbitrator.

According to Article 28 of the UNCITRAL Model Law a review is possible to decide whether or not the arbitrators have applied the conflict of law rules or the law designated by the parties. According to Article 34 of that law, awards can be reviewed and enforcement denied if the parties' choice was ignored. If no law has been chosen by the parties, no review as to the rules applied by the arbitrators is admitted<sup>694</sup>. Also, in cases where the arbitrators acted as *amiables compositeurs* without the parties' authorization or otherwise exceeded their powers the award can be reviewed and enforcement denied, even if the applicable law permits amiable composition<sup>695</sup>.

Two important problems thus need to be discussed. First, will a national court enforce an (arbitral) award based upon *lex mercatoria*, if chosen as the law governing the contract by the parties? Secondly, will a national court apply *lex*

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<sup>693</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 250.

<sup>694</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 111.

<sup>695</sup> De Ly, *International Business Law and Lex Mercatoria*, (1992), 122.

*mercatoria* in compliance with the parties' choice or even as the proper law of the contract, if no law has been chosen by the parties<sup>696</sup>?

Before, one exception should be recalled. Unsurprisingly, there is no national law that denies enforcement of an arbitral award simply because it is based on *lex mercatoria*<sup>697</sup>. It is clear that when asked to enforce an award a national court cannot review it and substitute its own law for the law that was applied to the case, be it another national law or *lex mercatoria*. As noted above, the court might employ the exception of public order.

As mentioned before, arbitration can only exist as long as it is tolerated by the national laws. The less arbitral awards contradict mandatory rules of the national laws concerned and the public policy of these states, the less this state's courts will interfere with arbitration and regulate its rules. Therefore and out of an interest in keeping the states from interfering, arbitrators respect these provisions of the national laws<sup>698</sup>. One of the arbitrator's main duties is to do everything to assure the validity and enforceability of his award. Therefore "... the principles applied by the arbitrator must be such that they will be recognized by courts as founding a valid award, for an unenforceable award is not an instrument of law or of commerce."<sup>699</sup>

The enforcement of an arbitral award is not the arbitrator's business. An arbitral tribunal cannot force the parties to abide by its solution and accept all the consequences. Thus, the arbitrator is not obliged to take any national laws into consideration. But as explained above, he cannot totally ignore the public policy of the countries where the award is likely to be enforced. To ensure a certain efficiency of the award, the mandatory rules of the national laws of these states have to be respected. As noted above, most arbitral awards are respected by the parties without having to seek enforcement by a national court. If one of the parties is recalcitrant about accepting the arbitral award, the other party has to

<sup>696</sup> Redfern/Hunter, *Law and Practice of International Commercial Arbitration*, 3<sup>rd</sup> ed., London (1999), 2-63.

<sup>697</sup> Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 168.

<sup>698</sup> Lando, „The *lex mercatoria* in International Commercial Arbitration“, 34 *ICLQ* (1985), 767.

<sup>699</sup> Mustill, „The New *Lex Mercatoria*: The First Twenty-five Years“, 4 *Arbitration International* (1988), 96.

appear before a national court to engage the recognition and enforcement procedure.

As noted above, national courts are reluctant to interfere in arbitral awards and to deny enforcement, even in cases where the award is based on *lex mercatoria*<sup>700</sup>. In 1992, the International Law Association adopted a resolution concerning the enforceability of awards based on *lex mercatoria*<sup>701</sup>:

The fact that an international arbitrator has based an award on transnational rules (general principles of law, principles common to several jurisdictions, international law, usage of trade, etc.) rather than on one law of a particular State should not itself affect the validity or enforceability of the award:

- (1) where the parties have agreed that the arbitrator may apply transnational rules; or
- (2) where the parties have remained silent concerning the applicable law.

Arbitration would be meaningless if national courts refused to enforce arbitral awards. In international commercial arbitration, the parties are of different nationalities and enforcement might be sought in different countries. A very important text concerning the problem of the enforceability of arbitral awards is the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). This convention has been ratified by 133 states. Through this wide acceptance the convention's principles and rules concerning enforceability and recognition of foreign awards have become standard setting in the areas concerned. These reasons concur with the reasons for which an award can be set aside according to Article 34, or recognition or enforcement can be denied according to Article 36 of the UNCITRAL Model Law on International Commercial Arbitration. Article IX (1) of the European Convention on International Commercial Arbitration gives a list of similar reasons for which an arbitral award can be set aside:

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<sup>700</sup> Goode, "Usage and its Reception in Transnational Commercial Law", in: Ziegel (ed.), "New Developments in International Commercial and Consumer Law", Oxford (1998), 33.

<sup>701</sup> Paul Bowden, "L'interdiction de se contredire au détriment d'autrui (estoppel) as a Substantive Transnational Rule in International Commercial Arbitration", in: Gaillard (ed.), Transnational Rules in International Commercial Arbitration, ICC Publication No. 480/4, Paris (1993), 247.

#### Article IX - Setting Aside of the Arbitral Award

1. The setting aside in a Contracting State of an arbitral award covered by this Convention shall only constitute a ground for the refusal of recognition or enforcement in another Contracting State where such setting aside took place in a State in which, or under the law of which, the award has been made and for one of the following reasons:

- (a) the parties to the arbitration agreement were under the law applicable to them, under some incapacity or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made, or
- (b) the party requesting the setting aside of the award was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or
- (c) the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration need not be set aside;
- d) the composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or failing such agreement, with the provisions of Article IV of this Convention.

Likewise, according to Article 5 of the New York Convention enforcement can be denied if a party was under some incapacity, the agreement is not valid according to the law of the state the parties subjected to, a party was not given proper notice or was not able to present its case, the composition or procedure of the arbitral tribunal was not according to the parties' agreement, the subject matter of the dispute is not capable of settlement by arbitration under the law of this state or was not transferred to the arbitral tribunal by the parties, the award is in conflict with the public policy of this state or the award has not yet become binding or has been set aside or suspended by a competent authority. Article 5 provides an exhaustive list of these reasons. The actual award and the (national) law it is based

on cannot be revised by the national courts<sup>702</sup>. The setting aside of the award in the state of origin thus automatically affects its enforcement. This is different whenever the European Convention on International Commercial Arbitration is applicable. According to Article IX (2) :

In relations between Contracting States that are also parties to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10th June 1958, paragraph 1 of this Article limits the application of Article V (1) (e) of the New York Convention solely to the cases of setting aside set out under paragraph 1 above.

Of all the reasons for not recognising or enforcing an arbitral award, only three could theoretically be pertinent to awards based on *lex mercatoria*, according to Booysen<sup>703</sup>. Firstly, the arbitral clause might not be valid under the law of the arbitral seat or under the law chosen by the parties, as a court or the applicable national law might not hold *lex mercatoria* to be capable of governing a contract. Secondly, if the parties did not designate *lex mercatoria* to be the law governing the contract and arbitrators nevertheless apply it because of its close connection with the international business relation. In this case, a court could refuse to recognize the arbitral award because of excess of power because it does not comply with the terms of the agreement to arbitrate. Thirdly, if a country considered that the recognition of an arbitral award was contrary to its public policy, a court might deny the award's recognition and enforcement<sup>704</sup>.

Finally, one comment has to be made about the enforcement of an award based on *lex mercatoria*. If a given national law enables the parties to let an arbitrator act as *amiable compositeur*, then the courts of that country cannot deny the enforcement of an award for the reason that it is based on transnational law. In cases where arbitrators act as *amiable compositeur*, they are completely free to decide *ex aequo et bono* and are not bound by any national rules. In cases where

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<sup>702</sup> Dasser, *Internationale Schiedsgerichte und lex mercatoria*, Zurich (1989), 357.

<sup>703</sup> Booysen, "Principles of International Trade Law as a monistic system", Pretoria (2003), 814.

<sup>704</sup> Booysen, "Principles of International Trade Law as a monistic system", Pretoria (2003), 815.

arbitrators are to decide according to *lex mercatoria*, they are bound by its rules and principles. Thus, in the latter cases, the arbitrator has less freedom. Consequently, national laws that admit amiable composition should even more readily admit the choice of *lex mercatoria* as the law governing the dispute (*argumentum a maiore ad minus*)<sup>705</sup>. It is clear that *lex mercatoria* cannot be equated with equity or a decision made *ex aequo et bono*<sup>706</sup>. The law merchant is a law and its mandatory rules have to be respected. However, the arbitrator can apply *lex mercatoria* when told to decide *ex aequo et bono* for it seems to be the best-adapted body of rules concerning matters of international trade.

The capacity of national courts to revise an arbitral award also depends upon the nationality of the arbitral tribunal, meaning whether the award has been rendered by a foreign, domestic or international tribunal<sup>707</sup>. Sometimes it is difficult to determine the nationality of the tribunal. One could establish the seat of the arbitral tribunal to be the determining factor, i.e. the country in which the arbitrators will mainly be active. On the other hand, one could let the procedural rules that are being applied indicate the nationality of the award. Finally, there is a theory about delocalized arbitration<sup>708</sup>. According to this approach, there is a procedural *lex mercatoria* and the therefore truly a-national and autonomous arbitration. The problem that arises from delocalized awards and this theory is the absence of national authority. Can these awards be treated like foreign awards and revised in the same way or are they not enforceable by a national court at all<sup>709</sup>?

Whenever national courts are asked to enforce a foreign arbitral award, they dispose of fewer competencies to control and revise the award. This can be explained with the desire to make international arbitration more effective and to

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<sup>705</sup> Weise, *Lex Mercatoria*, Frankfurt/Main 1990, 151; Triebel/Petzold, "Grenzen der *lex mercatoria* in der internationalen Schiedsgerichtsbarkeit", *Recht der internationalen Wirtschaft* (1988), 250.

<sup>706</sup> Kappus, *Lex mercatoria in Europa und Wiener UN-Kaufrechtskonvention 1980*, Frankfurt am Main (1990), 70; Lando, "The *lex mercatoria* in International Commercial Arbitration", 34 *ICLQ* (1985), 754.

<sup>707</sup> Weise, *Lex Mercatoria*, Frankfurt/Main 1990, 149.

<sup>708</sup> Paulsson, "Arbitration Unbound: Award Detached from the Law of its Country of Origin", 30 *ICLQ* (1981), 358.

<sup>709</sup> Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 150.

allow international business to function better. Therefore the national courts can only deny enforcement of a foreign award on the grounds that it is contrary to its own fundamental principles of law or public policy<sup>710</sup>.

Also, the awards are to a great extent not controlled according to national law but to international rules, such as the New York Convention. Article V of the convention gives the aforementioned list of grounds for denying enforcement of an award. There exists a transnational public policy that is different from the national public policies. *The national jurisdictions in charge of revising the awards within the context of an invalidation or enforcement action have to judge the conformity of the award with the conception of international public order of the state that instituted them. These concepts are certainly not to be confused with those that concern the public order as defined by the internal law of the State in question, but they undisputedly constitute a public order with a national source. The New York Convention from 1958 explicitly acknowledges this by evoking the control of the award's conformity with the public order of the state in which the recognition or the enforcement is being sought.*<sup>711</sup>

Naturally this is different for arbitral tribunals. Whenever they are faced with a non-conformity between national and international public policy, especially in the case of discrimination for racist or religious reasons, the arbitrator should opt for the latter and decide according to his moral convictions. The legitimacy of these transnational rules that might not correspond with certain national laws is clear<sup>712</sup>.

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<sup>710</sup> Weise, *Lex Mercatoria*, Frankfurt/Main (1990), 166.

<sup>711</sup> Gaillard, "Trente ans de *Lex Mercatoria*. Pour une application sélective de la méthode des principes généraux du droit", *Journal du Droit International* (1995), 20.

<sup>712</sup> Gaillard, "Trente ans de *Lex Mercatoria*. Pour une application sélective de la méthode des principes généraux du droit", *Journal du Droit International* (1995), 21.

## Chapter 8

### Conclusion

In conclusion, one can state that *lex mercatoria* constitutes an effective and viable system of law for dispute resolution in international trade. It is applied more and more by arbitrators, its rules are predictable and adapted to the needs of international commerce. It is composed of usages of the international merchant community and therefore flexible and always up-to-date. In addition to customs and usages, other sources have been discovered. These are public international law, international conventions, general principles of law, codes of conduct, standard form contracts, the reporting of arbitral awards, the public policy of the countries that are likely to be concerned by the award and the compilations of the rules of *lex mercatoria* published by comparative lawyers.

The new law merchant can be compared to its medieval predecessor because there was a universally accepted body of rules in the Middle Ages, based on mercantile needs, derived from the usages and customs governing the business transactions of the travelling merchants and applied by their special courts.

International merchants undoubtedly have the right to include an arbitral clause in their contract and to stipulate that *lex mercatoria* be the law governing the conflict. Arbitrators have to respect this choice and apply the law merchant to resolve the dispute. This follows from the principle of party autonomy and the sanctity of the contract. Recourse to national laws is only necessary in cases where the law merchant does not provide an adequate answer, as some minor gaps do exist. However, these gaps almost exclusively concern matters that are not pertinent to international trade affairs and the arbitrator can seek guidance in the national laws in these cases.

Contrary to some allegations, *lex mercatoria* does not lead to arbitrary results, for it is a law and the arbitrator cannot substitute his private preferences for the parties' stipulations or the law merchant's binding rules. In addition to that, good faith and fair dealing is of paramount importance. Also, not only rules made by national states are legitimate because other entities are and have always been capable of creating binding rules.

Today it is undoubtedly true that a-national arbitration does exist, i.e. arbitral courts that are not especially linked to one country but composed of arbitrators of different nationalities and settling a truly international dispute. Thus, it is convenient to submit to the new law merchant as it is truly international and adapted to the peculiarities of international trade. By applying *lex mercatoria*, the parties avoid the difficult choice of one of their national laws to be the law governing the conflict, for this leads to arbitrary results and privileges one party which is usually the economically stronger one.

In future, *lex mercatoria*'s acceptance by the merchant community and its application by arbitral tribunals could be further promoted by a growing number of published awards. In the same manner, an increasing number of lists will also provide international traders and arbitrators with a useful survey of the law merchant's contents and therefore contribute to its popularity. With these developments allegations against the *lex mercatoria* such as the said lack of predictable results could be refuted in an even more convincing way.



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