

APPLICATION OF THE *LEX MERCATORIA* IN INTERNATIONAL COMMERCIAL ARBITRATION

by Michael Pryles¹

1. Introduction

1.1 Definition

The *lex mercatoria* conjures up romantic notions of ancient laws and practices adopted by merchants in medieval times as they traded from place to place. In recent decades it has been resurrected as a sort of international commercial law which may displace national laws in international transactions. As such it has great appeal. The idea of applying national laws, primarily directed at domestic transactions, to trans-national contracts has always been uncomfortable. The better, and more attractive approach, is to apply international commercial laws to international commercial transactions. The desirability of doing so seems readily apparent. Not only would an appropriate body of law developed for international transactions be applied but the complex process of selecting domestic laws, through conflict of laws rules or other approaches, would disappear. However all this presupposes that there is a body of international commercial law, that there is a *lex mercatoria*, which is developed and identifiable and capable of being applied to international transactions. It is here that the controversy arises. Proponents of the *lex mercatoria* maintain that it does exist, or can be sufficiently ascertained, to provide legal principles to govern international commercial transactions. Opponents are sceptical, deny its character as a law and question whether there are sufficiently developed principles which are capable of application to complex international transactions.

There is no international legislature which drafts international commercial laws. Nor is there an international commercial court which can develop a 'common law' for international commercial disputes. From where, therefore, does the *lex mercatoria* arise? Proponents of the *lex mercatoria* can point to some international legislation in the form of conventions and model laws drafted by bodies such as UNCITRAL. Moreover while there is no international commercial court there has developed an extensive system of international commercial arbitration and a number of arbitral awards are now published. Can these form the basis of a *lex mercatoria* and are they sufficient?

In his detailed and comprehensive book entitled '*The Creeping Codification of the Lex Mercatoria*'² Professor Berger describes the *lex mercatoria* as follows:

¹ Partner, Minter Ellison, Melbourne, Australia; President, Australia Centre for International Commercial Arbitration; Commissioner, United Nations Compensation Commission, Geneva.

² Berger, *The Creeping Codification of the Lex Mercatoria* (1999, Kluwer Law International)
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'Opinions about the terminology and the legal quality of the *lex mercatoria* diverge widely, especially with respect to its nature as a third legal system alongside domestic law and public international law. There is, however, a strong similarity in the starting points of all theories on transnational commercial law: the combined perspective of comparative law, usages, customs and practices of international commerce and trade leads to the evolution of transnational legal principles, rules and standards which are applied in practice in order to arrive at economically sensible solutions to transnational commercial disputes. The preference for substantive law solutions reflected in this transnational approach serves to avoid the uncertainties and unpredictable effects caused by the application of complicated conflict of laws-doctrines and of domestic substantive law rules, which are frequently inadequate to solve the manifold legal problems of contemporary international commercial law.'³

Lord Mustill who has written incisively and critically about the *lex mercatoria*, refers to the work of Professor Lando, and states that the supposed sources of the *lex mercatoria* are as follows:

- public international law
- uniform laws
- general principles of law
- the rules of international organisations
- customs and usages
- standard form contracts
- reporting of arbitral awards⁴

The spirited debate on the *lex mercatoria* raises the basic question of whether it suffices to constitute (1) an autonomous legal order and can therefore be classified as a 'law', (2) whether, if not a law, it comprises a sufficiently comprehensive body of rules to be capable of application to decide a dispute or: (3), whether it simply represents usage in international trade.⁵ Later in this paper I return to consider criticism of the *lex mercatoria* and its role and status as a body principles which is capable of being applied to resolve an international commercial dispute.

1.2 Related concepts

Sometimes, when contracting parties or arbitrators seek to subject a contract or decide a dispute via reference to non-national rules, they refer to terms other than the '*lex mercatoria*'. Examples include 'general principles of international commercial law', 'generally-recognised legal

³ Berger, at p.2

⁴ Mustill, '*The New Lex Mercatoria: the First Twenty-Five Years*' (1988) 4 *Arbitration International* 86 at 109

⁵ See Craig, Park, Paulson, *International Chamber of Commerce Arbitration* (3rd edition 2000) at pp 626-639; Berger, at pp39-41.

principles' and 'principles common to several legal systems'.⁶ Proponents of the *lex mercatoria* would recognise that general principles of law and common principles of law represent sources of the *lex mercatoria* and demonstrate an intention that the contract is not to be governed by the laws of a national legal system. Nonetheless, as some wise commentators have pointed out, arbitrators faced with such expressions must take care to exactly establish what the parties had in mind when they used a particular expression to describe the rules applicable to the dispute.⁷ Some writers have cautioned that the unification and harmonisation of laws is totally distinct from the concept of the *lex mercatoria* because it focuses on domestic laws and not transnational laws. Nonetheless to the extent that domestic laws are unified or harmonised they may be relevant in determining 'general principles of law' and trans-national standards. Sometimes contracting parties authorise an arbitrator to decide as *amiable compositeur* or *ex aequo et bono*. This frees the arbitrator from the obligation to decide according to law. It is said that this is an entirely different basis for determining a dispute to the application of the *lex mercatoria*.⁸ It is true that an obligation to apply the *lex mercatoria* is an obligation to apply international rules or law and not to decide free from any legal principles. But sometimes, an arbitrator who is empowered to decide as *amiable compositeur* or *ex aequo et bono* will, in the exercise of his or her discretion, resolve the dispute by applying the *lex mercatoria* or general principles of law.

2. Two Basic Approaches

Two basic approaches have been adopted to ascertain the *lex mercatoria*. The first is the identification of principles of the *lex mercatoria* and their collation or codification in a list. The second approach is the identification of a particular rule on an as needs basis as and when a question arises. Below each is briefly examined in turn.

2.1 Collation of rules

Various lists of rules or principles of the *lex mercatoria* have been prepared from time to time. These are discussed by Professor Berger.⁹ Lord Mustill has compiled a list of twenty principles which he describes as a rather modest haul for twenty five years of international arbitration. His list is as follows:

⁶ See Fouchard, Gaillard and Goldman, *International Commercial Arbitration* edited by Gaillard and Savage, (Kluwer Law 1999) at paragraph 1446; Rivkin 'Enforceability of Arbitral Awards based on Lex Mercatoria' (1993) 9 *Arbitration International* 67 at pp 68-70.

⁷ Fouchard, Gaillard and Goldman, at paragraph 1448.

⁸ Mustill, at p91.

⁹ Berger, at pp213-16.

1. A general principle that contract should *prima facie* be enforced according to their terms: *pacta sunt servanda*. The emphasis given to this maxim in the literature suggests that it is regarded, not so much as one of the rules of the *lex mercatoria*, but as the fundamental principle of the entire system.
2. The first general principle is qualified at least in respect of certain long-term contracts, by an exception akin to *rebus sic stantibus*. The interaction of the principle and the exception has yet to be fully worked out.
3. The first general principle may also be subject to the concept of *abus de droit*, and to a rule that unfair and unconscionable contracts and clauses should not be enforced.
4. There may be a doctrine of *culpa in contrahendo*.
5. A contract should be performed in good faith.
6. A contract obtained by bribes or other dishonest means is void, or at least unenforceable. So too if the contract creates a fictitious transaction designed to achieve an illegal object.
7. 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, or by asserting that the agreement is unenforceable for want of procedural formalities to which the entity is subject.
8. The controlling interest of a group of companies is regarded as contracting on behalf of all members of the group, at least so far as concerns an agreement to arbitrate.
9. If unforeseen difficulties intervene in the performance of a contract, the parties should negotiate in good faith to overcome them, even if the contract contains no revision clause.
10. 'Gold clause' agreements are valid and enforceable. Perhaps in some cases either a gold clause or a 'hardship' revision clause may be implied.
11. One party is entitled to treat itself as discharged from its obligations if the other has committed a breach, but only if the breach is substantial.
12. No party can be allowed by its own act to bring about a non-performance of a condition precedent to its own obligation.
13. A tribunal is not bound by the characterisation of the contract ascribed to it by the parties.
14. Damages for breach of contract are limited to the foreseeable consequences of the breach.
15. A party which has suffered a breach of contract must take reasonable steps to mitigate its loss.
16. Damages for non-delivery are calculated by reference to the market price of the goods and the price at which the buyer has purchased equivalent goods in replacement.
17. A party must act promptly to enforce its rights, on pain of losing them by waiver. This may be an instance of a more general rule, that each party must act in a diligent and practical manner to safeguard its own interests.
18. A debtor may in certain circumstances set off his own cross-claims to extinguish or diminish his liability to the creditor.
19. Contracts should be construed according to the principle *ut res magis valeat quam pereat*.
20. Failure by one party to respond to a letter written to it by the other is regarded as evidence of assent to terms.¹⁰

Professor Berger has proposed his own technique and put forward his own list. His technique is described as that of 'creeping codification'. The essential point is that his list of the *lex*

¹⁰ Mustill, at pp 110-14
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mercatoria principles is not intended to be static and closed but is of an open-ended character which is to be updated and extended from time to time in his own words:

[This open-end character which requires the constant updating and extension of the list does not only meet the needs of the *lex mercatoria* as 'law in action'. It could also restrict the effectiveness and usefulness of the list. Practical problems will arise in those cases where an arbitrator or international practitioner is faced with a legal problem and finds no relevant rule or principle in the list. Similar to the UNIDROIT Principles however, the 'new' rule or 'new' legal principle that is necessary to solve the issue may be derived out of the material that is already contained in the list. It is the principal purpose of the list not only to look back and provide a picture of the status quo of the *lex mercatoria* but also to look forward and provide an incentive for the future evolution of transnational commercial law as an open legal system.]¹¹

Professor Berger's list is derived from many sources. He states:

'The list unifies the various sources that have fostered the evolution of a transnational commercial legal system into one single, open-end set of rules and principles: The reception of general principles of law, the codification of international trade law by 'formulating agencies', the case law of international arbitral tribunals, the law-making forces of international model contract forms and general conditions of trade, and finally the analysis of comparative legal science. Scientific research in this area of highly practical law is of particular relevance because many authors of case notes, articles and books on transnational commercial law are themselves active in the field of international commercial arbitration. It is therefore not necessary to advocate the acceptance and promotion of the efforts of international practice through legal doctrine. The often heard prejudice that the *lex mercatoria*-doctrine is purely theoretical is unjustified as long as the list does not only reflect comparative research but also the comprehensive case load of international arbitral tribunals which, in their function as 'social engineers', play a pivotal role in the evolution of transnational commercial law. It is this comprehensive coverage of all possible sources of the *lex mercatoria* which provides the necessary legitimacy and authority to the rules and principles contained in the list.'¹²

Professor Berger's list comprises seventy eight rules or principles as follows:

1. The parties are free to enter into contracts and to determine their contents (principle of party autonomy).
2. The parties must act in accordance with the standard of good faith and fair dealing in international trade.
3. A valid contract is binding upon the parties. It can only be modified or terminated by consent of the parties or if provided for by the law (*'pacta sunt servanda'*).
4. The parties always have to act according to what is reasonable in view of the particular nature of their contract and the circumstances involved, in particular the economic interests and expectations of the parties.
5. The parties are bound by any usages to which they have agreed and by any practice which they have established between themselves. Unless agreed otherwise, they are considered 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 contract of the type involved in the particular trade concerned.

¹¹ Berger, at p212.

¹² Berger, at pp210-11.

6. A valid contractual consent requires that the parties intend to be legally bound and that they have sufficiently identified the terms of the contract with respect to the parties and the subject matter.
7. Silence by the offeree does not in and of itself amount to acceptance unless the offeree begins with the performance of his contractual obligations or is required to reject the offer due to a long-standing business relationship with the offeror or is subject to a practice which the parties have established between themselves or a trade usage requiring rejection of the offer (*'qui tacet consentire videtur'*).
8. Contractual declarations are valid even when they are not evidenced in writing.
9. Contracts may not be concluded to the detriment of a third party (*'res inter alios acta alteri non nocet'*).
10. The construction of a contract has to determine the common intention of the parties or, if no such intention can be determined, the meaning that reasonable persons of the same kind as the parties (average diligent businessmen) would give to it in the same circumstances, taking into account, in particular, the nature and purpose of the contract, the conduct of the parties and the meaning commonly given to contract terms and expressions in the trade concerned.
11. Where there is doubt about the meaning of a contract term, an interpretation should be preferred that makes the contract lawful or effective (*'ut res magis valeat quam pereat'; 'effet utile'*).
12. Where there is doubt about the meaning of a contract term that has not been individually negotiated, an interpretation against the party who supplied it should be preferred (*'contra proferentum'*).
13. Contractual stipulations shall be interpreted taking into account the whole contract in which they appear.
14. In case the parties have used the wrong term but mean the same thing, their common intention prevails (*'falsa demonstratio non nocet'*).
15. If a party promises its 'best efforts' in the performance of its contractual duties, that party owes to the promisee all efforts which can be expected from a reasonable person of the same kind in the same circumstances, taking into account the particular nature of the contract and the interests of the parties.
16. Unless otherwise agreed by the parties or contrary to the intrinsic nature of the contract, time limits and other contractual stipulations as to the timely performance of the parties' obligations have to be strictly complied with (*'time is of the essence'*).
17. If a notice, letter or other communication cannot be delivered at the address of the addressee on the last day of a period set by law or contractual stipulation, because that day falls on an official holiday or non-business day at the place of business of the addressee, the period is extended until the first business day which follows.
18. A party who breaks off negotiations in bad faith (i.e. when the other party was justified in assuming that a contract would be concluded) is liable for the losses caused to the other party (*'culpa in contrahendo'*).
19. A contract that violates boni mores is void (*'fraus omnia corrumpit'*).
20. The invalidity of the main contract does not automatically extend to the arbitration clause contained therein (principle of separability).
21. Arbitration proceedings are not suspended if one of the parties goes bankrupt.
22. If a party is unjustifiably enriched at the expense of another, that party has to pay a sum of money equal to the value of the enrichment to be determined according to the contractually agreed price or market price, including full compensation for the use (usufruct) of the subject matter of the enrichment (*'nemo sine causa alterius jactura locupletari debet'; 'condictio indebiti'; 'unjust enrichment'*).
23. No one may reclaim what he has rendered to the other party while knowing the illegality of his performance (*'nemo turpitudinem suam allegans auditur'*).
24. If non-performance of a party is due to an impediment which is beyond the control of that party and could not have reasonably been foreseen by that party at the time of

- conclusion of the contract, such as war, civil war, strike, acts of governments, accidents, fire, explosions, natural disasters etc., and neither the impediment nor its consequences could have been avoided or overcome ('acts of God'; 'force majeure', 'hohere 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.
25. No one may derive an advantage from his own unlawful acts (*'nullus commodum capere potest de iniuria sua propria'*).
 26. Absent a choice of law by the parties, the contract is governed by the law with which the contract has the closest connection ('center of gravity test'; *'engster Zusammenhang'*; *'liens les plus etroits'*).
 27. If a contract has contacts to more than one jurisdiction and the parties have not agreed on the applicable law, it is in the presumed interest of the parties to apply the law, both as to form and to substance, that validates the contract (*'favor negotii'*, *'lex validitatis'*; 'rule of validation').
 28. The *lex causae* may not be changed.
 29. If an event of legal, economic, technical, political or financial nature occurs after the conclusion of the contract which could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract and which fundamentally alters the equilibrium of the contractual obligations, thereby rendering the performance of the contract excessively onerous for that party and if that party has not, through express stipulation or by the nature of the contract, assumed the risk of that event (*'Wegfall der Geschäftsgrundlage'*, *'clausula rebus sic stantibus'*, 'hardship', 'frustration of purpose'), that party may claim renegotiation of the contract. If the parties fail to reach agreement within reasonable time, either party may apply to a court or arbitral tribunal in order to have the contract adapted to the changed circumstances or terminated at a date and on terms to be determined by the court or arbitral tribunal.
 30. If the parties to a contract are required to render their respective performances simultaneously and have not agreed otherwise, each party may withhold performance until tender of performance by the other party (*'exceptio non adimpleti contractus'*).
 31. If a party's failure to perform its obligation amounts to a fundamental non-performance, the other party may terminate the contract. Both parties may then claim restitution, in re or in money, of whatever they have supplied to the other party. The *exceptio non adimpleti contractus* rule applies.
 32. If parties have mature and liquidated claims of an identical nature vis-à-vis each other, each party may declare the set-off of these claims. The parties may also agree on the set-off of these claims by contractual consent.
 33. Unless prohibited by the contract out of which the claim arises or by public policy, the creditor (assignor) may assign his claim by contract to the assignee.
 34. No one may transfer more rights than he actually has (*'nemo plus iure transferre potest quam ipse habet'*).
 35. No one may set himself in contradiction to his own previous conduct. (*'non concedit venire contra factum proprium'*; *'l'interdiction de se contredire au detriment d'autrui'*).
 36. A right that has been forfeited may not be raised.
 37. A party suffering damage or another prejudice may not raise claims arising out of this if it has consented to the act leading to the damage or prejudice (*'volenti non fit iniuria'*).
 38. A state or state controlled entity may not invoke its sovereignty or internal law to repudiate contractual consent.
 39. Unless otherwise agreed by the parties, payment may always be made in the currency of the place for payment.
 40. Conversion of the money of account into a different money of payment has to be made according to the exchange rate prevailing at the time when payment is due. If the debtor

- is in arrears, the creditor may require payment either at the rate when payment is due or at the rate of the time of actual payment.
41. Unless otherwise agreed by the parties, each party bears the risk of currency depreciation (nominal-value principle).
 42. Each party has a good faith obligation to renegotiate the contract if there is a need to adapt the contract to changed circumstances and the continuation of performance can reasonably be expected from the parties.
 43. Each party is under a good faith obligation to notify the other party of any problems that occur in the performance of the contract and to cooperate with the other party when such cooperation can reasonably be expected for the performance of that party's obligations.
 44. Notice of defects has to be given within two years of delivery of the goods.
 45. The distribution of the currency risk follows from Art. VIII (2)(b) IMF-Agreement.
 46. If the contract does not contain a provision fixing the price or a method for determining it, the parties are to be treated as having agreed to the price generally charged at the time of the conclusion of the contract for such performance in comparable circumstances in the trade concerned, or, if no such price is available, to a reasonable price.
 47. If the contract provides that the price is to be fixed or determined by a third party, and this determination is manifestly unreasonable, a party may apply to a court or arbitral tribunal to have a reasonable price fixed, notwithstanding any agreements to the contrary.
 48. Contractual claims are subject to limitation periods.
 49. Where an agent acts on behalf of a principal within the scope of his authority which has been granted to him expressly or can be implied from the circumstances, his acts bind the principal and the third party unless it follows from the circumstances of the case, for example by a reference to a contract of commission, that the agent undertakes to bind himself only.
 50. A corporate entity acting on behalf of a group of corporate entities binds all entities that belong to the group.
 51. The principal is not bound if an agent acts without or outside his authority (*falsus procurator*) unless he ratifies, expressly or impliedly through his conduct, the acts of the agent. In the latter case, the act produces the same effects as if it had initially been carried out with authority.
 52. Where the conduct of the principal causes the third party reasonable and in good faith to believe that the agent has authority to act on behalf of the principal and the agent is acting within the scope of that authority, the principal may not invoke against the third party the lack of authority of the agent ('agency by estoppel', 'Anscheinsvollmacht').
 53. Facts which the agent knows or ought to have known are attributable to the principal.
 54. There is a presumption for the professional competence of the parties to an international commercial contract. The parties may therefore not argue that they were not aware of the significance of the contractual obligations to which they have agreed.
 55. Specialised laws prevail over general laws ('*lex specialis derogat legi generali*').
 56. The burden of proof rests on the claimant viz. on the party who advances a proposition affirmatively ('*actori incumbit probatio*').
 57. A written contract may be proved through any means of modern telecommunication (Telex, Telefax, btx, EDI etc), if it provides a record of the information contained therein and can be reproduced in written form.
 58. Circumstantial evidence is permissible.
 59. When the contract contains a clause providing that a party who fails to perform is to pay a specified sum to the aggrieved party for such non-performance ('penalty clause'; 'clause penale'; 'Vertragsstrafeversprechen'), the aggrieved party is entitled to that sum irrespective of its actual loss. If the amount is grossly excessive in relation to the loss resulting from the non-performance, and the other circumstances, the specified sum

- may be reduced to a reasonable amount notwithstanding any agreements of the parties to the contrary.
60. The aggrieved party is entitled to damages for loss caused by the other party's non-performance of its contractual obligations.
 61. Claims for damages are limited to the loss which the non-performing party foresaw or could reasonably have foreseen at the time of the conclusion of the contract as being the likely result of its non-performance.
 62. Damages may not exceed the actual loss and are available only for loss which is proved by the claimant.
 63. A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If it fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated.
 64. A party is liable for damages if it solicits a legal opinion in the case according to the agreement of the parties and the other party, who has reasonably believed in the verity of the legal opinion, suffers damages because it has performed its obligation or has made other financial dispositions.
 65. If the parties have not agreed otherwise, the debtor, who does not pay a sum of money when it falls due has to pay to the creditor interest on that sum from the time when payment was due.
 66. The rate of interest is to be determined on the basis of the average bank short-term lending rate to commercial borrowers prevailing for the currency of payment at the place of payment.
 67. Compound interest may be charged on interest.
 68. The existence of foreign corporate entities is acknowledged.
 69. Principle of 'piercing the corporate veil' in international corporate law in case of clear under-capitalisation and a mingling of corporate and financial spheres, especially in case of total control of the parent company over the business and financial affairs of its subsidiary.
 70. In case of corporate de-facto succession liability continues.
 71. The founders are liable for debts incurred in the pre-incorporation phase.
 72. A state may not nationalise or expropriate foreign private investment except for a purpose which is in the public interest, not discriminatory, carried out under due process of law and against 'appropriate' compensation.
 73. 'Appropriate' compensation must be based on the 'fair market value' of the expropriated assets to be determined immediately before the time at which the taking occurred or the decision to take the asset became publicly known ('full compensation standard').
 74. Absent an agreement of the parties, if a going concern is expropriated, the amount of compensation is to be determined according to the 'going concern'-value, based on the discounted cash flow value of the enterprise ('discounted cash flow method'), 'DCF').
 75. Absent an agreement of the parties, if a non-profitable enterprise is expropriated, the amount of compensation is to be determined according to the liquidation value, i.e. the sum of the sale price of the individual assets under condition of liquidation.
 76. Absent an agreement of the parties, if other assets are expropriated, the amount of compensation is to be determined according to their replacement value, i.e. the cash amount required to replace the individual assets of the enterprise in their actual state as of the date of the taking or the book value, i.e. the balance of the enterprise's assets and liabilities as recorded on its financial statements or the amount at which the taken tangible assets appear on the balance sheet of the enterprise.
 77. The standard of compensation may be adjusted to the individual circumstances of the case.
 78. Payment of compensation shall include interest and has to be made 'effectively', i.e. in freely convertible currency on the basis of the market rate of exchange existing for that currency on the valuation date or in any other currency accepted by the investor, and

'prompt', i.e. without undue delay or, in case of established foreign exchange stringencies, by payment in installments within a period which will be as short as possible not exceeding five years from the time of the taking.'

2.2 Ad hoc determination

Professor Gaillard, while not denying the use of lists of principles, maintains that the *lex mercatoria* is not so much a list but a method for determining the appropriate rule or principle.

In his own words:

'The other approach to defining the contents of transnational law is to view transnational law as a method of decision-making, rather than as a list. This approach consists, in any given case, of deriving the substantive solution to the legal issue at hand not from a particular law selected by a traditional choice-of-law process, but from a comparative law analysis which will enable the arbitrators to apply the rule which is the most widely accepted, as opposed to a rule which may be peculiar to a legal system or less widely recognized. This comparative law analysis is greatly assisted today not only by the extremely comprehensive compilations of principles previously discussed, but also by the existence of a number of international treaties which, whether in force or not, reflect a broad consensus, by the increasingly large number of published awards providing as large a number of precedents to international arbitrators and by the availability of extensive comparative law resources such as monographs on a large number of specific issues.'¹³

Professor Gaillard goes on to explain how his method would work in practice:

'The transnational law method should thus, in our opinion, be conducted in the following three steps. First, the utmost attention should be given to the parties' intentions. They may have suggested a methodology themselves, for instance in limiting the comparative law analysis to two legal systems or to those of a region. They may have used clumsy terminology which arbitrators need to interpret in order to give effect to the parties' true intent. In all of these instances, the first task of the arbitrators will be to implement the parties instructions. Second, the arbitrators will determine, on the basis of the comparative law sources mentioned above, whether the contentions made by the parties are supported by a widely accepted rule, or whether they merely reflect the idiosyncrasies of one legal system, in which case they should be rejected. This will be the case, for instance, of the French rule pursuant to which a subcontract will be void if certain conditions including the placing of a bond in favour of the subcontractor are not met, of the English rule denying the validity of agreements to agree, or of the Algerian rule prohibiting agents, all of which are fairly peculiar to the legal system in which they are found. Third, in determining whether the acceptance of a given rule is sufficiently wide for that rule to qualify as a general principle of law, the unanimous acceptance in all legal systems is by no means required.'¹⁴

Gaillard maintains that his method has a distinct advantage over the list approach because it eliminates the criticism based on the alleged paucity of the list. Professor Berger himself

¹³ Gaillard 'Transnational Law: A legal system or a method of decision-making?' (2000) 17 *Arbitration International* 59 at 62-63.

¹⁴ Gaillard, at p63.
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criticises Gaillard's approach on two bases. The first is that it underestimates the considerable problems that are related to the determination of the contents of the *lex mercatoria*. The second is that the approach of codifying the *lex mercatoria* is not necessarily inconsistent with the functional comparative methodology. This latter point is acknowledged by Professor Gaillard who states that under his method use can be made of available lists.¹⁵

There is much to be said for the Gaillard methodology. While Professor Berger's list is considerably longer than predecessors produced by other authors, it is still modest. The multitude of questions which can arise in international commercial arbitrations could not all be conceivably answered by reference to the lists produced to date. It is here that that Gaillard approach offers a workable method and therefore a possible solution. But as Professor Gaillard himself acknowledges, lists are not irrelevant. They may be used in the course of his functional approach, to establish the relevant rule or principle.

3. Criticism and Support

The *lex mercatoria* has been subject to trenchant criticism, particularly in common law countries. The classic case against the *lex mercatoria* has been put forward by Lord Mustill in his thoughtful and incisive article.¹⁶ Lord Mustill, employing careful, meticulous and critical analysis, so typical of common lawyers, has presented a strong case against the *lex mercatoria*. His arguments may be classified under two principal headings, namely practical objections and philosophical or conceptual objections. Turning first to the practical objections Lord Mustill notes that while the *lex mercatoria* is detached from national law, some of its rules are to be ascertained by a process of distilling several national laws. Today the international business community is immeasurably enlarged and he asks 'how could the arbitrators or the advocates who appear before them, amass the necessary materials on the laws of, say, Brazil, China, the Soviet Union, Australia, Nigeria and Iraq?'¹⁷ Lord Mustill then proceeds to point out that some proponents, evidently oppressed by these difficulties, had suggested that the *lex mercatoria* may be one which is 'common to all or most of the states engaged in international trade'. In his view this fatally compromises the appeal of the *lex mercatoria* as a *lex universalis*. Another approach which he terms the '*micro lex mercatoria*' is that an arbitrator should confine his investigation to those legal systems which are connected with the subject matter of the dispute. This makes the arbitrator's task more practicable but, questions Lord Mustill, what is the nature of this law? He

¹⁵ Gaillard, at p62.

¹⁶ Mustill, *supra*. The arguments against the *lex mercatoria* have been meticulously collated by Berger, at pp43-110.

¹⁷ Mustill, at p92.

proceeds to ask whether there exists a constellation of para-laws, Franco-Belgium, Anglo-Dutch, Italo-Hispano-Korean and so on?

Lord Mustill raises further questions concerning the sources of the *lex mercatoria*. Insofar as reference can be had to standard form contracts, he notes that there is no guarantee of homogeneity even within a single trade. But standard form contracts between trades may also vary significantly. Other practical objections raised concern the paucity of rules of the *lex mercatoria* and the process of ascertaining it. Lord Mustill postulates that an advisor will face two distinct problems. One is how to discover the substandard content of the *lex mercatoria*. The second is how to predict, in a case where the relevant rule has not yet been firmly established by a consensus of opinion or by one or more arbitral awards, what sources a tribunal will deploy when addressing the new issue of principle, and what conclusion it will reach.¹⁸

Apart from practical difficulties concerning sources, ascertainment and predictability there are also philosophical objections to the *lex mercatoria*. A basic question is whether it can properly be classified as a 'law'. From where does it derive its authority, does it have the organisation, conceptual framework and detailed rules which would be expected of a legal system? These are searching questions which have been posed by critics of the *lex mercatoria* with some vigour.

3.1 Support

The *lex mercatoria* has its proponents as well as its critics. Early advocats were eminent lawyers such as Professor Goldman and Professor Schmitthoff. More recently the *lex mercatoria* has found support from Professor Berger, Professor Lando and Professor Gaillard.

Professor Lowenfeld¹⁹ has taken issue with Lord Mustill. Professor Lowenfeld says:

'Together with Goldman, Lando, and most of its other proponents, I do not view *lex mercatoria* as some arcane mystery, open only to anointed guardians of an ambiguous flame. It is perfectly appropriate, in my view, for counsel to submit argument to the tribunal about the content of the *lex mercatoria*, as well as about the usages of the particular trade and the circumstances on which the parties had, or fairly could have, relied. In fact, in my experience, counsel nearly always do present such evidence and argument, in one guise or another.'²⁰

¹⁸ Mustill, at p114.

¹⁹ Lowenfeld, '*Lex Mercatoria: An Arbitrator's View*' (1990) 6 *Arbitration International* 133.

²⁰ Lowenfeld, at p140.

Fouchard, Gaillard and Goldman contend that 'it is by no means evident that to be the object of a valid choice of governing law the rules chosen must necessarily be organised in a distinct legal order'²¹.

In truth the argument whether the *lex mercatoria* qualifies as a system of law is academic in cases where the parties have expressly chosen it, or a version of it, to govern their contract; or in cases where the arbitrator is empowered to decide a dispute by reference to 'rules of law' as opposed to a 'law' system. This matter is discussed below.

The practical difficulties identified with the *lex mercatoria* are of more serious concern. Identifying the relevant principles, and indeed predicting what they may be, are difficult. It is here that the critics of the *lex mercatoria* make a telling point. But the concerns of lawyers, theoretical or practical, and often pedantic, must be weighed against the needs of the international system. Where parties choose to govern their relationship by the *lex mercatoria*, or a version of it, or where an arbitral tribunal deems it appropriate to depart from a domestic national law and apply the *lex mercatoria*, a transnational or international standard is selected. The parties may have good reason for doing so. In particular, they may not wish to subject their relationship to the laws of any particular state. Likewise an arbitrator, when given sufficient freedom to determine the applicable rule, may conclude that the relevant rules found in the laws of the states connected to the dispute are not appropriate, or work an injustice, on the international plane. It is here that an international or transnational solution may be sought. It is going too far to say that there is a sophisticated and comprehensive body of international and commercial law. But it is by no means impossible to identify an international standard which may be appropriate. This international standard may be founded on general principles of law, principles enshrined in widely adopted international conventions or in trade usages. It will be for the parties, who will each have an opportunity to submit on the relevant standard, to persuade the arbitrators what it is. The functional method, advocated by Professor Gaillard, will enable an appropriate international standard to be identified and therefore applied in the particular case. In appropriate cases this will meet the needs of justice and international commerce.

4. Validity

Can an arbitral award be challenged on the basis that the arbitral tribunal purported to decide the dispute by applying the *lex mercatoria*, or some specie of it? The question could arise in two ways. In the first place an application may be made to the courts of the seat of the arbitration to

²¹ Fouchard, Gaillard and Goldman, at p809.
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set aside the award. Alternatively enforcement of the award in another state may be resisted. In either case the relevant court will have to determine whether the arbitral tribunal's resort to the *lex mercatoria* has affected the validity of the award.

In the English case of *Deutsche Schachtbau-und Tiefbohrergesellschaft v Ras Al Khaimah National Oil Co.*²² enforcement of a foreign award was resisted on the ground that the tribunal had chosen as the governing law a common denominator of principles underlying the laws of the various nations governing contractual relations. The court decided that this did not affect the enforceability of the award in England. As far as arbitrations held in England are concerned the Arbitration Act 1996 contains relevant provisions. It provides:

'46 (1) The arbitral 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.
- (2) For this purpose the choice of the laws of a country shall be understood to refer to the substantive laws of that country and not its conflict of laws rules.
- (3) If or to the extent that there is no such choice or agreement, the tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.'

Whether or not the *lex mercatoria* is a 'law' it therefore falls within paragraph (a), it would clearly be caught by paragraph (b).

Some national laws, and some arbitration rules, use the term 'rules of law' in connection with the selection of the governing law. The reference to the term 'rules of law' as opposed to 'law' is said to encompass the selection of a non-national system of law such as *the lex mercatoria*. The position is stated thus by Fouchard, Gaillard and Goldman:

'This terminology was first used by the 1981 French decree on international arbitration, which provided in Article 1496 of the New Code of Civil Procedure that the parties (and, in the absence of a choice by them, the arbitrators) were free to select the 'rules of law' applicable to their dispute. Commentators were unanimous in recognizing the implicit reference to transnational rules in the text and the courts have never questioned that interpretation. Several other legal systems have used the same expression with the same meaning. When Article 1054 of the Netherlands Code of Civil Procedure was presented to the legislature in 1986, the Dutch government emphasized in an explanatory memorandum that the expression 'rules of law' encompassed not only national rules of law but also *lex mercatoria*. Likewise, Article 187 of the 1987 Swiss Private International Law Statute provides that '[t]he arbitral tribunal shall decide the

²² [1987] 3 WLR 1027, reversed on other grounds, [1990] 1 AC 295.
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case according to the rules of law chosen by the parties,' thus giving the parties the option of applying *lex mercatoria*, in one form or another. A large number of laws, including those of Italy, Egypt, Mexico and Germany followed suit. This is largely due to the fact that, in 1985, the UNCITRAL Model Law embraced the trend by providing in its Article 28 that '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.' Some authors have argued, rather curiously, that the expression 'rules of law' found in the UNCITRAL Model Law covers certain transnational rules, such as international conventions, but that it is not intended to enable the parties to submit their dispute to general principles of law or to *lex mercatoria*. However, neither the terminology employed, nor the Model Law's *travaux préparatoires* justify such a restrictive interpretation.²³

5. Application

5.1 General

I now turn to consider instances where arbitral tribunals have decided a case by reference to the *lex mercatoria* or some species thereof such as general principles of law or common principles of law. Until 1986 application of the *lex mercatoria* was rare, at least in ICC awards²⁴. It cannot be said that application of the *lex mercatoria* is common today but there are a number of awards where arbitrators have decided to apply the *lex mercatoria* or some other variety of transnational or international rules or principles. The ability to determine the exact resort to the *lex mercatoria* is limited by the number of awards published. However the available publications, such as the ICC International Court of Arbitration Bulletin, Mealey's International Arbitration Report and the Journal du Droit International contain extracts of various awards wherein the tribunal purported to apply trans-national rules. Two recent articles in the ICC International Court of Arbitration Bulletin are particularly useful in collating references to the use, or rejection, of transnational rules. The first is an article by Fabrizio, Marella and Gelinas entitled '*The Unidroit Principles of International Commercial Contracts in ICC Arbitration*'.²⁵ This reviews ICC cases up to the end of 1988 in which the Unidroit Principles were referred to. In many of these cases the tribunal also referred to the *lex mercatoria* or other general principles of law. The authors collate the cases under three heads. The first are cases where the Unidroit principles were applied as the governing law. The second are cases where the Unidroit principles were referred to as a means of supplementing and interpreting applicable domestic law and the third are cases where the Unidroit principles were resorted to as a means of supplementing and interpreting international conventions. The authors also list cases where application of the Unidroit principles was considered but rejected.

²³ Fouchard, Gaillard Goldman, pp802-803. As the French court decreases upholding awards were transnational rules were applied see Fouchard, Gaillard & Goldman at pp. 879-80

²⁴ Craig-Park, and Paulsson, at p625, n11 referring to comments of Mr Sigvard Jarvin the then General Counsel of the ICC International Court of Arbitration.

²⁵ 1999 ICC International Court of Arbitration Bulletin Vol. 10, No. 2 at p26.

The second article which is particularly helpful is a follow-up article by Marella entitled *'The Unidroit Principles of International Commercial Contracts in ICC Arbitration, 1999-2001'*²⁶

There reference is made to a further fifteen cases where the Unidroit principles were either applied as the governing law, as a means of supplementing an international convention or as a means of interpreting or supplementing applicable national law.

My survey of the relevant cases below does not purport to be an exhaustive survey of all awards referring to the *lex mercatoria* or other transnational principles or rules. It simply provides illustration of the acceptance and application, or rejection, of such principles.

5.2 Lex Mercatoria

Professor Bortolotti²⁷ cites the *Norsolor* case of 1979, ICC Case No. 3131, where the *lex mercatoria* was applied to a commercial agency contract. According to Professor Bortolotti, the case concerned an agency contract between a French principal and a Turkish agent. The agent claimed damages for termination of the agreement which he was entitled to under French law but not under Turkish law. The arbitrators decided to apply neither of these domestic laws and, reasoning that the contract was international, held that it should be governed by the *lex mercatoria*.

Professor Berger refers to an award rendered in 1966 in ICC Case No. 8365 where the arbitral tribunal applied the *lex mercatoria* and espoused eight principles which, in its view, formed part of the *lex mercatoria*.²⁸

In ICC Case No. 9875 an arbitral tribunal, in its partial award of January 1999, decided to apply the *lex mercatoria*.²⁹ The claimant was a French company which was given an exclusive license to manufacture, sell and distribute the respondent's products in Europe. It appears that the respondent was a Japanese corporation. In 1996 the respondent entered into another licensing agreement with a third company which covered Asia. The claimant contended that this agreement infringed its exclusivity in Europe. The contract did not contain a choice of law clause and the arbitral tribunal considered that no national law applied. It dismissed the

²⁶ 2001 ICC International Court of Arbitration Bulletin Vol. 12, No. 2 at p49.

²⁷ Bortolotti, *'International Commercial Agency Agreements and ICC Arbitration'* 2001 ICC International Court of Arbitration Bulletin Vol. 12, No. 1, 48 at p51.

²⁸ Berger, op cited, at p215; Clunet 1997, at 1078, 1079.

²⁹ The case is reproduced in 2001 ICC International Court of Arbitration Bulletin Vol. 12, No. 2 95. It is discussed by Marella, op cited at p52.

arguments that the law of one of the parties should apply namely French law or Japanese law or the law of the place of the arbitration, Belgium:

'According to article 17(1) of the ICC Rules, in the absence of an agreement between the parties upon the rules to be applied to the merits of the case, '...the Arbitral Tribunal shall apply the rules of law which it determines to be appropriate'. Article 17(2) adds: 'In all cases the Arbitral Tribunal shall take into account the provisions of the contract and the relevant trade usages.'

The provisions of the contract are not decisive. It contains references to France and other European and non-European countries as well as to Japan. The Sales Territory described in Exhibit II covers 'All countries of the world, other than Canada, USA, Mexico and Asian countries east of Iran, except French Territories'. The licence is granted for patents held by Japanese companies (Exhibit III). Technical assistance will be provided by the Defendant at the Claimant's factory in France (art. 4) or at the Defendant's offices and production facilities in Japan (art. 5). The Claimant has agreed to pay royalties in Japanese currency (art. 6). An important provision, much at the centre of this dispute, deals with improvements invented by the Claimant, normally in its premises in France (art. 9).

The tribunal does not consider the neutral choice of Brussels as the seat of the arbitration to imply a choice of Belgian law as the law applicable to the contract.

In licence agreements, the appropriate law is sometimes considered to be that of the country where the licensor is located (in this case, Japan), assuming the most characteristic performance of such contracts would be that of the licensor. However this is not an absolute rule. For example, the law of the licensee is sometimes preferred. The Rome Conventions of 1980 also provides that the link to the characteristic performance can be discarded when such characteristic performance cannot be determined or when circumstances indicate that the contract is more closely connected with another country (art. 4) (cf. J.M. Mousseron, J. Raynard, R. Fabre and J.L. Pierre, *Droit du commerce international*, 1997, no.136 et seq.).

In this case, part of the issues deal with the way the Defendant handles technical improvements invented and transferred to the former by the Claimant, casting doubts on a solution that would exclusively consider the licensor's transfer of technology to the licensee as the most characteristic performance of the contract. Insofar as the licensee's own performance can be considered as characteristic of the contract, this would lead to the application of French law. Another significant factor consists in the geographical scope of the rights licensed to the Claimant, which do not exclusively lead to French law, but would eliminate Japanese law. The arbitral tribunal considers that the difficulties to find decisive factors qualifying either Japanese or French law as applicable to the contract reveal the inadequacy of the choice of a domestic legal system to govern a case like this. A contract concluded between Japanese and French companies concerning a licence to manufacture products and to sell them in various parts of the world is not appropriately governed by the national law of one of the parties, failing agreement on such a choice.³⁰

The arbitral tribunal then decided to apply the *lex mercatoria*:

'The most appropriate 'rules of law' to be applied to the merits of this case are those of the *lex mercatoria*, that is the rules of law and usages of international trade which have been gradually elaborated by different sources such as the operators of international trade themselves, their associations, the decisions of international arbitral tribunals and some institutions like Unidroit and its recently published Principles of International Commercial Contracts.

³⁰ (2001) ICC International Court of Arbitration Bulletin Vol. 12, No. 2 95 at pp96-97.
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Nevertheless the tribunal will take into account any relevant national laws concerning intellectual property rights issues raised during this procedure.³¹

There have been cases in which an arbitral tribunal has expressly considered and rejected application of the *lex mercatoria*. In ICC Case No. 9419³² an agreement was made between the parties relating to the exportation of Bulgarian goods obtained by the respondent, a Lichtenstein exporter, for counter-trade purposes to cover supplies to be made in Bulgaria by a company belonging to the same group as the Claimant, a Swiss counter-trade management company. There was no express choice of the law to govern the contract. The arbitrator dismissed an argument that he should apply the *lex mercatoria* as follows:

'The arbitration clause does not specify the substantive law that the arbitrator has to apply. It is therefore up to the arbitrator to determine this, as stated, moreover, in point D10 of the Terms of Reference.

The Claimant has covered this question in its Brief and, more specifically, has argued that, in absence of any reference to a specific national law, the demands are based on the universally acknowledged principles of international commerce, allowing the arbitrator to pronounce his decision in the light of the so-called '*lex mercatoria*', a kind of codification of which can be found in the principles of international commercial contracts drawn up by Unidroit. Otherwise, in the event that reference needs to be made to a national law, French law has to be applied, given that the Agreement between X and Y has become an integral part of the Accord and the application of French law is explicitly provided in said Agreement...

The undersigned arbitrator is not convinced of the applicability of the so-called *lex mercatoria*. While acknowledging the authoritative nature of the school of thought that has posited the existence of such an unwritten and supranational law, based on principles and usages generally accepted by players in international commerce (the so-called *mercatores*), and although aware that there have even been awards in international commercial arbitration where explicit reference is made to *lex mercatoria*, the undersigned arbitrator sides with the other school of thought that does not believe in the existence of *lex mercatoria* and which firmly believes that the search for a law that can be applied to a contractual relationship must necessarily lead to the identification of a national law. This is all the more so since, in accordance with the provisions of Article 13.3 of the ICC Rules (consistent with the provisions of Article VII of the Geneva Convention of 1961), the arbitrator, barring any indication by the parties is required to apply the law that is applicable on the basis of the rules of conflict that he considers to be appropriate.³³

The arbitrator also rejected application of the *lex mercatoria* although he noted that the ICC rules require him to take account of relevant trade usages:

'Notwithstanding this, the arbitrator must in all events take account not only of the contractual stipulations, but also of trade usages (as provided for in Article 13.5 of the ICC Rules). In other words, precisely due to their general acceptance by the *mercatores* community, trade usages can be considered to be tacitly acknowledged by the parties in their contractual relationship. Such

³¹ id at p97.

³² (1999) ICC International Court of Arbitration Bulletin Vol. 10, No. 2 104.

³³ Id at p105.

usages incorporate the contractual regulation of the relationship, though without excluding the need to identify the relevant legislative framework.

With regard to the Principles drawn up by Unidroit, it is quite true that these may be considered as a kind of codification of the *lex mercatoria*, but once again these are the results of highly commendable work of academic research and comparison, as well as the reflection of an increasingly eager aspiration to arrive, as it were, at a globalization of legal thinking, though without attributing any binding value to such Principles.^(*)

(*) The Introduction to the Principles states that: '...the Governing Council is fully conscious of the fact that the Principles, which do not involve the endorsement of Governments, are not a binding instrument'.

This means that the Unidroit Principles could certainly be used for reference by the parties involved for the voluntary regulation of their contractual relationship, in addition to helping the arbitrator in confirming the existence of particular trade usages, but they cannot constitute a normative body in themselves that can be considered as an applicable supranational law to replace a national law, at least as long as the arbitrator is required to identify applicable law by choosing the rule of conflict that he considers most appropriate, in accordance with the provisions laid down by the international conventions and as provided for in the rules of arbitration within the scope of which he operates.^(**)

(**) The Preamble to the Principles states that: 'Parties who wish to adopt the Principles as the rules applicable to their contract would however be well advised to combine the reference to the Principles with an arbitration agreement.'³⁴

Finally the arbitrator considered that he had to choose the governing law by applying a relevant conflict of laws rule:

'Whereas, on the one hand, the parties maintain their freedom of choice regarding the legal regulation of their relationship, on the other hand, failing the expression of such choice, the power of the arbitrator is not to choose the applicable law in a direct way, but is limited to identifying the rule of conflict that he considers to be the most appropriate and on the basis of which, in an indirect way, the determination of the applicable law will be made. This means that, by proceeding in this manner (as is his precise duty), the arbitrator necessarily arrives at the designation of a specific national legal system.'³⁵

He concluded that the governing law was the law of France and as part of the law of France he had to apply the Vienna Sales Convention.

In relation to this case it should be noted that the arbitrator applied an earlier version of the ICC Rules, namely the 1998 rules, which required the arbitrator to apply 'the law designated as the proper law by the rule of conflict which he deems appropriate'³⁶. The present ICC Rules of

³⁴ Id at pp105-106.

³⁵ Id at p105.

³⁶ ICC Rules of Arbitration in effect as from 1 January 1988, article 13(3).

Arbitration, in force as from 1 January 1998, directs the arbitral tribunal to apply the 'rules law which it determines to be appropriate'³⁷

5.3 Other transnational principles

Sometimes cases are decided by reference to rules which are transnational or international in character but are not described as the *lex mercatoria*. Examples include a direction to decide in accordance with general 'principles of law' or principles common to various legal systems. These transnational principles may purport to be universal or they may be confined to two or more countries. Indeed parties have shown considerable creativity and originality in drafting choice of law clauses for their contracts. David Rivkin has collated a number of interesting examples.³⁸ Among others, Rivkin lists the following examples:

'Principles rooted in the good sense and common practice of the generality of civilised nations'

'The Law governing the substantive issues between the parties shall be determined by the Tribunal, having regard to the quality of the Parties, the transnational character of their relations, and the principles of law and practice prevailing in the modern world'.

'[The agreement] must be interpreted and applied, in conformity with the principles common to the laws of Kuwait and the state of New York, USA, and in the absence of such common principles, then in conformity with the principles of law normally recognised by civilised states in general, including those which have been applied by international tribunals.'

'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.'

In the Channel Tunnel case the concession agreement provided that the contract would be governed by:

'The principles common to both English law and French law, and in the absence of such common principles by such general principles of international trade law as have been applied by national and international tribunals'.³⁹

Another example of a choice of principles common to the countries connected with the contract is found in concession agreements made by the National Iranian Oil Company which provided:

'In view of the diverse nationalities of the parties to this Agreement, it shall be governed by and interpreted and applied in accordance with the principles of law common to Iran and the several

³⁷ Article 17(1).

³⁸ Rivkin, at pp68-72.

³⁹ *Channel Tunnel Group Ltd v Balfour Beatty Construction Ltd* [1993] AC 334.

nations in which the other parties to this Agreement are incorporated, and in the absence of such common principles then by and in accordance with principles of law recognised by civilised nations in general, including such of those principles as may have been applied by international tribunals.⁴⁰

As in the case of application of the *lex mercatoria*, reference to other transnational principles not only arises as a result of the choice of law clause selected by the parties but, in the absence of the choice of law clause, by a decision of the arbitral tribunal. In ICC Case No. 7375 the arbitral tribunal was faced with a contract made between an Islamic state and an American entity. It did not contain a choice of law clause. The tribunal found that the failure to include a choice of law clause reflected an implied intent to avoid the other party's national law. The tribunal therefore decided to apply:

'The general principles of law applicable to international contractual obligations having earned a wide international consensus, including notions said to form part of the *lex mercatoria* as well as the UNIDROIT principles, as far as they can be considered to reflect generally accepted notions and principles'.⁴¹

In ICC Case No. 9474 the parties agreed, on the suggestion of the arbitral tribunal, to the application of 'the general standards and rules of international contracts' and in ICC Case No. 9479 the arbitral tribunal construed a choice of New York law as relating only to the validity of the contract and subjected other issues to the contractual provisions and international trade usages including the UNIDROIT principles.⁴²

5.4 UNIDROIT Principles

In 1994 the International Institute for the Unification of Private Law ('UNIDROIT') published its 'Principles of International Commercial Contracts' ('UNIDROIT Principles'). These compose a preamble and 119 articles divided into seven chapters comprising general principles, formation, validity, interpretation, content, performance and non-performance. The Unidroit Principles are intended to set out general rules for international commercial contracts and have been described as a 'modern expression of what is commonly called *lex mercatoria*'.⁴³

⁴⁰ See Redfern and Hunter, *Law and Practice of International Commercial Arbitration* (3rd edition 1999) at p107.

⁴¹ Fabrizio, Marella and Gelinis, at p30; Redfern and Hunter, at pp 126-127.

⁴² Marella, at p51.

⁴³ Berger at pp3-4 citing Bonnel in *Rabels Z* 56 (1992) at 275, 287. See also Baron, 'Do the UNIDROIT Principles of International Commercial Contracts Form a New *Lex Mercatoria*?' (1999) *Arbitration International* Vol. 15, No. 2, 115; And see 'Unidroit Principles of International Commercial Contracts, Reflections on their Use in International commercial Arbitration' Special Supplement - ICC International Court of Arbitration Bulletin, 2002.

In the introduction to the Unidroit Principles the Governing Council of Unidroit states that the Unidroit Principles, for the most part, reflect concepts to be found in many, if not all, legal systems. However since the principles are intended to provide a system of rules especially tailored to the needs of international commercial transactions, they also embody what are perceived to be the best solutions, even if still not yet generally adopted. The Governing Council goes on to state that the objective of the Unidroit Principles is to establish a balanced set of rules designed for use throughout the world irrespective of the legal traditions and the economic and political conditions of the countries in which they may be applied.

The preamble to the Unidroit Principles sets out the purpose of the principles but also defines how and when they can be utilised. The preamble states as follows:

'These Principles set forth general rules for international commercial contracts. They shall be applied when the parties have agreed that their contract be governed by them. 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. They may provide a solution to an issue raised when it proves impossible to establish the relevant rule of the applicable law. They may be used to interpret or supplement international uniform law instruments. They may serve as a model for national and international legislators.'

Another transnational, although less universal, study was prepared under the leadership of Professor Ole Lando for the Commission on European Contract Law. Their 'Principles of European Contract Law' were published in 1998.

In their study, Fabrizio, Marella and Gelinas conclude that the Unidroit principles have been used as the governing law in eight ICC cases. In his follow up study, Marella has identified three additional cases where the Unidroit principles were applied as the governing law. ICC Case No. 7110 is a good example.⁴⁴ The case concerned a number of contracts entered into between a State and an English private contractor for the sale, supply, modification, maintenance and operation of equipment and support services relating thereto. The contracts were terminated and disputes arose in connection with the amounts claimed by the parties from each other. Each contract contained an arbitration agreement, one providing for ICC arbitration in the Hague and others for ICC arbitration in Paris. Some contracts provided for arbitration but not in accordance with the ICC rules. However the parties agreed to submit all disputes to arbitration under the ICC rules and for the tribunal to sit at the Hague. A number of the contracts provided for the disputes to be finally settled 'according to natural justice'. There was no choice of law clause in the contracts.

⁴⁴ The case is reported in 1999 ICC International Court of Arbitration Bulletin Vol. 10, No. 2, p39.
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In its first partial Award on the applicable law, the arbitral tribunal held that the reference to 'natural justice' in six out of the nine contracts was not a reference to procedural rules but to substantive justice. In the sense of justice other than that which would be obtained by applying a national law:

'Common to such expressions found in six out of nine Contracts...is precisely, the word 'justice', which undoubtedly is the predominant element to be taken into account for assessing their meaning and scope. In international commercial arbitration, though it is imaginable that the term 'justice' may be utilised only in the sense of procedural justice, i.e. due process and fair trial, it is commonly understood as referring to arbitral justice in a more comprehensive sense, including not only arbitral procedural fairness but also the type of solution regarding the merits - not necessarily the same that would be obtained from national courts - that should be expected by the parties by the very fact of having chosen international commercial arbitration for resolving their contractual disputes. Thus, it is not infrequently stated that often the parties resort to arbitration in order to have access to a 'justice' other than that which would be obtained by applying a 'national law', particularly when, on account of the discrete circumstances of the case, a national law would not be adapted to the solution of the dispute at stake...An obvious confirmation that notions of justice in international commercial arbitration are not merely procedural but are also substantive is that the majority of national statutes dealing with international arbitration, international conventions regarding arbitration not just concerned with the recognition and enforcement of arbitral agreements and awards, and international arbitration rules contain procedural provisions and choice-of-law provisions, i.e. provisions pointing to choice-of-law solutions only becoming relevant because the dispute has been submitted to international commercial arbitration and which may well differ from those that would have been otherwise obtained had the decisions of the case been left to municipal courts and their private international law systems.'⁴⁵

The arbitral tribunal also concluded that the failure of the parties to designate a national law to govern their transaction led to a negative choice that they did not want a national law to apply however, although the parties excluded the application of any national law to the contracts, it did not follow that they failed to imply the application of any other substantive rules or principles. The tribunal stated that the parties decision to international arbitration under the ICC Rules was clear evidence and confirmation that the parties favoured the de-localisation of the dispute resolution system. The arbitral tribunal also noted that one of the parties to the contracts was a State and considered that 'the parties and the arbitrators enjoy larger autonomy for de-localising the contract and determining the applicable laws or rules when disputes arising out of the State contract are submitted to international arbitration than otherwise...'⁴⁶ The arbitral tribunal continued:

'In the present case, such equilibrium was an integral part of the substantive and dispute resolution justice framework the parties had in mind when entering into the state contracts binding on them. Therefore, references to 'natural justice' and 'laws' or 'rules' of 'natural justice' found in

⁴⁵ 1999 ICC International Court of Arbitration Bulletin Vol. 10, no.2, 39 at pp44-45.

⁴⁶ *id* at 47.

the majority of the Contracts should be consistently and uniformly interpreted as referring not only to procedural justice but to the special type of substantive justice the parties had in mind, based on the neutrality of the applicable law to the merits and of the means of dispute resolution mechanisms selected by the parties to effectuate substantive neutrality, this latter aspect further confirmed by the ulterior comprehensive submission by the parties of their disputes arising out of the Contracts to ICC international arbitration.⁴⁷

The tribunal then concluded:

'Being international and commercial state contracts, reference in the Contracts to natural justice or the like, together with the absence of reference to any national law, can then be only reasonably construed as pointing to the application of such substantive legal rules and principles adapted to the Contracts and the facts and circumstances surrounding them, which, by not belonging to any discrete national legal system, satisfy the parties' concerns as to the neutrality of the applicable proper law. Substantive rules and principles fulfilling such requirements may only be general legal rules and principles regarding international contractual obligations and enjoying wide international consensus.

...the Tribunal concludes that the reasonable intention of the parties regarding the substantive law applicable to the Contracts was to have all of them governed by general legal rules and principles in matter of international contractual obligations such as those arising out of the Contracts, which, though not necessarily enshrined in any specific national legal system, are specially adapted to the needs of international transactions like the Contracts and enjoy wide international consensus.

In addition, this Tribunal estimates that its mandate...requires that, to the extent possible at this stage, some precisions be given as to the substance of such legal rules and principles. It should be noted that both Claimant and Defendant, at different stages of their successive argumentations, have expressed their concern either about the vagueness of general principles of law or the possibility (at least with respect to English courts) that an award rendered on the basis of such principles might not be enforceable before national courts.

Taking into account such circumstances, the discussions held in such connections with the parties...and also the requirement that arbitrators '...should do no less than is required to exercise their authority completely...' (Institute of International Law, Santiago de Compostela Resolution cited above, art. 1, 63-II *International Law Institute Yearbook* 326 (1990)), this Tribunal finds that general legal rules and principles enjoying wide international consensus, applicable to international contractual obligations and relevant to the Contracts, are primarily reflected by the Principles of International Commercial Contracts adopted by Unidroit (the 'Unidroit Principles') in 1994...In consequence, without prejudice to taking into account the provisions of the Contracts and relevant trade usages, this Tribunal finds that the Contracts are governed by, and shall be interpreted in accordance [with], the Unidroit Principles with respect to all matters falling within the scope of such Principles, and for all other matters, by such other general legal rules and principles applicable to international contractual obligations enjoying wide international consensus, which would be found relevant for deciding controverted issues falling under the present arbitration.⁴⁸

The tribunal went on to state why it considered the Unidroit Principles to be the central component of the general rules and principles regarding international contractual obligations. In

⁴⁷ id at p48.

⁴⁸ id at pp48-49.

the first place the Unidroit Principles are a re-statement of international legal principles applicable to international commercial contracts made by a distinguished group of international experts coming from all prevailing legal systems of the world. Secondly, the Unidroit Principles were inspired by an international uniform-law text already enjoying wide international recognition, namely the 1980 Vienna Convention on the International Sale of Goods. Thirdly, the Unidroit Principles are specifically adapted to contracts being the subject of the arbitration at hand since they covered both international sale of goods and supply of services. Fourthly, the Unidroit Principles were specifically conceived to apply to international contracts in instances in which, as in the present case, it has been found that the parties have agreed that their transactions shall be governed shall be governed by general legal rules and principles. Finally, rather than vague principles or general guidelines, the Unidroit Principles are mostly constituted by clearly enunciated and specific rules coherently organised in a systematic way.

The final reason advanced by the arbitral tribunal for referring to the Unidroit Principles are of particular note. The Unidroit Principles provide a degree of detail often thought to be lacking in the *lex mercatoria* when considered as an amorphous mass.

There have also been cases where the Unidroit Principles have been applied to supplement national law. In the preamble to the Unidroit Principles this is stated to be appropriate wherever it proves extremely difficult, if not impossible, to establish the relevant rule of the particular domestic law with respect to a specific issue and a solution can be found in the principles. However, of the case listed by Marrella, under this head, most appeared to concern instances where the Unidroit principles were referred to on other bases. In one group reference is made to the Unidroit Principles to establish that the provision in a national law is reasonable because both it and the Unidroit Principles would lead to the same result in the given case. A second instance is where a choice of law clause referred to a national law and together with other considerations such as 'justice, equity and good conscience'.⁴⁹ A third instance is where the Unidroit Principles are relied upon to define trade usages which are relevant under Article 17 (2) of the ICC Rules of Arbitration.⁵⁰

The Unidroit Principles are also intended to be available to supplement international conventions. There have been at least five cases where the Unidroit Principles were used to supplement the 1980 Vienna Convention on Contracts for the International Sale of Goods.⁵¹

⁴⁹ ICC Case No. 9651, discussed by Marrella, at p53.

⁵⁰ ICC Case No. 10022, discussed by Marrella, at p53.

⁵¹ Fabrizio, Marrella and Galenas, at p31; Marrella, at p54.

6. Conclusion

1. Sometimes contracting parties, or arbitrators, decide that a contract is not to be governed by a national law but by transnational rules or principles.
2. This occurs where the parties expressly designate transnational rules to govern or, in the absence of a designation, where arbitrators called upon to resolve a dispute, and with authority to do so, decide that transnational rules apply.
3. In such cases the contract is subject to a standard which is different to the domestic rules of a single nation state. It becomes subject to an international standard.
4. The transnational rules or principles selected may differ in formulation from case to case. Sometimes the *lex mercatoria* is applied. Sometimes reference is made to common legal principles either generally or of particular countries, and sometimes reference is made to general principles of law. In truth there is a bewildering possibility of formulations.
5. Application of the *lex mercatoria*, as such, is the subject of some controversy. Critics questions whether it constitutes a 'lex'. Its sources, content, identification and rules are questioned. Proponents point to the desirability of resorting to an international standard in appropriate cases and contend that rules can be identified, and help derived from more detailed international formulations such as the Unidroit Principles.
6. Ultimately the intent of the parties, and methodology employed, is important. Where contractors designate an international standard it must be carefully analysed to ascertain its ambit and extent. Then the disputing parties should be asked to submit on its content. It can then be determined in exactly the same way as other issues which arise in an arbitration.
7. Leaving aside detailed formulations such as the Unidroit Principles, the *lex mercatoria*, common principles of law and other such formulations, are somewhat vague and uncertain. When measured against a traditional national legal system they can be found wanting. But contractors in international transactions may have sound and compelling reasons for seeking to subject their arrangements to an international or transnational standard. When they do so it does not strain credibility to suggest that the parties will be able to establish appropriate

international standards utilising the significant resources now available and comprising formulations such as the Unidroit Principles, academic writings, international conventions and published awards.

8. The percentage of cases subjected to the *lex mercatoria* or other transnational standards is still modest. But it may well increase over time and perhaps is already doing so as the not-insignificant number of references to the Unidroit Principles in recent arbitral awards, may testify.