Three Theories of *Lex Mercatoria*

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One of the most remarkable developments in international commercial law over the last fifty years has been the gradual acceptance of the existence of a new merchant 'law', or lex mercatoria, *spontaneously generated by the international community in the shadow of national legal orders. While the notion that there might be law beyond the state aroused the interest of legal scholars and theorists around the world, few wondered whether international commercial actors had a genuine interest in the development of an autonomous transnational law. This Article offers empirical evidence suggesting that commercial parties almost never opt into* lex mercatoria *pursuant to their freedom to contract, but instead use that freedom to select a particular national law to govern their contracts. This conclusion begs the question of whether anybody else might benefit from* lex mercatoria.

In a groundbreaking article published in 2005, Christopher Drahozal argued that the idea had lost practical significance and offered a signaling theory of lex mercatoria*: the interest in the idea can be explained by the willingness of would be arbitrators to market themselves. While essentially agreeing with Drahozal, this Article offers two other theories explaining the development of* lex mercatoria. *First, I argue that deciding disputes on the basis of* lex mercatoria *can bring important benefits to international arbitrators. If that is the case, though, their interests may conflict with that of the parties who hired them. That raises an agency problem which needs to be both acknowledged and addressed. Secondly, I demonstrate how* lex mercatoria *can also benefit organizations which are involved in the business of producing model contracts and maintain that the active promotion of the use of non-state law – thereby side-stepping mandatory rules of national law –is intended to reduce the costs of producing international model contracts by such organizations*.

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INTRODUCTION

Do international merchants or commercial actors want to break free? Do they want to free themselves from the laws of the states and replace them with their own trade usages and commercial customs? Do they want to take control of the making of commercial law to provide their community a more efficient, unified transnational commercial law?

One of the most remarkable developments in international commercial law over the last fifty years has been the gradual acceptance of the existence of a new merchant 'law' spontaneously generated by the international community in the shadow of national legal orders. This new law merchant, or new *lex mercatoria*,[1] is composed of commercial customs, but also includes a variety of other international norms that are regularly respected by international commercial actors. The idea of an autonomous transnational commercial law was first proposed by a handful of European scholars in the 1960s.[2] It has since become a reality, insofar as some states have endorsed *lex mercatoria*. For example, most arbitration laws accept that parties may subject their contracts to *lex mercatoria* and international commercial arbitrators regularly apply it. Moreover, national courts will typically confirm and enforce arbitral awards rendered on the basis of *lex mercatoria*.[3]

This limited, but undisputable recognition of *lex mercatoria* by national legal orders aroused the interest of legal scholars and theorists around the world: the notion that there might be law beyond the state raised new and fascinating theoretical legal issues. Was this 'law' a limited collection of rules, or a new legal order? Was it genuinely independent from national rules, or was it in fact largely fed by state norms? In any case, could such 'law' exist at all without being at least tolerated, if not supported, by the state(s)?

While these debates were raging, surprisingly little attention was paid to the actors purportedly subject to this new law merchant. Few wondered whether international commercial actors had a genuine interest in the development of an autonomous transnational law.[4] The reason for this neglect was perhaps that the answer seemed just

[1] *Lex mercatoria* was originally a body of rules and principles laid down by traveling merchants throughout the medieval and Renaissance periods to regulate their dealings: see, e.g., ROY GOODE, HERBERT KRONKE, AND ERWAN MCKENDRICK, TRANSNATIONAL COMMERCIAL LAW – TEXT, CASES, AND MATERIALS 12 (2007). Whether modern *lex mercatoria* truly compares with medieval *lex mercatoria* is disputed by historians: see below note 33.
[2] See below text accompanying notes 29-36.
[3] See below text accompanying notes 35-36.
[4] An important exception is Christopher R. Drahozal, *Contracting Out of National Law: an Empirical Look at the New Law Merchant*, NOTRE DAME L. REV. 523 (2005).

too obvious: as *lex mercatoria* was, by definition, the product of the common practices and customs of international merchants, it simply *had to be* in their best interest and their preferred rule of law, as it represented their best and most efficient behaviors.

The claim of this paper is that that question should have been asked, because the answer, far from being obvious, seems to be that international merchants do not benefit from *lex mercatoria*. Indeed, the little empirical evidence available suggests that commercial parties almost never opt into *lex mercatoria* pursuant to their freedom to contract, but instead use that freedom to select a particular national law to govern their contracts. This conclusion begs the question of whether anybody else might benefit from *lex mercatoria*, and indeed whether this fascinating idea has any practical significance today.

I begin this paper by introducing the concept of the new *lex mercatoria* in Part I. I then explore, in Part II, whether it could meet the needs of the international business community, concluding that its norms are too vague and incomplete for that purpose. In that regard, I present data from the International Chamber of Commerce (ICC) showing that, unsurprisingly, parties to international commercial contracts provide for the application of the new law merchant in less than 1% of the cases brought before the ICC's Court of International Arbitration.

I then consider, in Part III, the groundbreaking article published in 2005 by Christopher Drahozal, in which he concluded that the data on the contractual practices of international merchants suggest that *lex mercatoria* has simply lost practical significance, if it ever had any.[5] He argued that the interest in the idea – outside of academic circles – could be explained by the willingness of would be arbitrators to market themselves. Although I find his signaling theory of *lex mercatoria* convincing, I have an important disagreement with Drahozal: I do not agree that the doctrine of *lex mercatoria* has lost all practical significance. To the contrary, I find that it remains very much alive, and not only at international conferences. Both national legislators and arbitral institutions have empowered international arbitrators to resort to *lex mercatoria* in cases where the parties have remained silent on the law governing their contract, and significant anecdotal evidence suggests that arbitrators are indeed making use of this power.

In Part IV and V, therefore, I speculate as to whether other actors in the arbitral process might have an interest in the development of a transnational commercial law and articulate the two central arguments of this Article. First, in Part IV, I argue that deciding disputes on the basis of *lex mercatoria* can bring important benefits to international arbitrators. If that is the case, though, their interests may conflict with that of the parties who hired them. That raises an agency problem which needs to be both acknowledged and addressed.

Secondly, in Part V, I demonstrate how *lex mercatoria* can also benefit organizations which are involved in the business of producing model contracts. The clearest example is the International Chamber of Commerce which has been actively promoting *lex mercatoria* by encouraging parties to subject their contracts to non-state law. I maintain that the active promotion of the use of non-state law – thereby side-stepping mandatory

[5] See Christopher R. Drahozal, *supra* note 4.

rules of national law –is intended to reduce the costs of producing international model contracts by such organizations.

I –THE MANY FACES OF *LEX MERCATORIA*

The claim that an autonomous transnational commercial law exists can be understood in many different ways. In its least controversial form, the claim could merely be that commercial customs and usages should be recognized and used to define the contractual obligations of the parties in the absence of other written indications of intent.[6] The applicable national commercial law would either allow the incorporation of business norms in private contracts, or provide for their direct application in certain defined circumstances. In the United States, for instance, § 1-201(3) of the Uniform Commercial Code provides that the agreement of the parties is "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance". A similar rule is to be found in the commercial law of most other countries.

Lex mercatoria scholars have made, since the 1960s, a much broader and far reaching claim. Not only do those scholars recognize that commercial actors may autonomously produce some of their own norms, they further argue for far greater autonomy from national legal orders. They do not limit the scope of *lex mercatoria* to those instances where states have traditionally allowed business norms to be taken into account, but have instead claimed that business norms could be the only source of applicable rule, thereby entirely displacing national commercial law. As far reaching and remarkable as that may seem, this second understanding of the autonomy of transnational commercial law is now widely accepted. International commercial arbitration has played an instrumental role in this regard.[7] States first allowed international arbitration to be largely autonomous, agreeing to enforce foreign arbitral awards without reviewing them on the merits.[8] They then permitted arbitrators to decide international commercial disputes solely on the basis of *lex mercatoria*. The result is that it is now widely accepted that parties may choose *lex mercatoria* as the governing law for their contracts, so long as they also provide for arbitration, and that arbitral awards made in such circumstances will be enforced in most jurisdictions.

From the perspective of commercial actors, there is a crucial difference between the recognition of business norms through national commercial law and the claim of complete autonomy therefrom made by *lex mercatoria* advocates. In the former case, national commercial law remains available as a default. Thus, commercial parties may

[6] See, e.g., Roy Goode, *Usage and Its Reception in Transnational Commercial Law*, 46 INT. & COMP. L. Q. 1 (1997).
[7] Despite the critical importance of international commercial arbitration in the development of *lex mercatoria*, the focus of this paper is on the privatization of lawmaking, not dispute resolution. As noted by Drahozal (Christopher R. Drahozal, *Private Ordering and International Commercial Arbitration*, 113 PENN STATE L. REV. 1031, 1034 (2009)), the private ordering literature has traditionally been concerned with instances where privately-created norms were also enforced privately: see, e.g., Barack D. Richman, *Firms, Courts and Reputation Mechanisms: Towards a Positive Theory of Private Ordering*, 104 COLUM. L. REV. 2328 (2004); Amitai Aviram, *Regulation by Networks*, BRIGHAM YOUNG U. L. REV. 1179, 1181 (2003).
[8] 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Article 5.

still rely on the existence of clear and detailed rules of applicable national law if custom is incomplete or if the particular contract is incomplete. In the latter case, however, no such backstop exists, such that it is necessary to believe in the completeness of *lex mercatoria*.

Intuitively, the view that national commercial law remains applicable as a backstop is the safest option for commercial parties, and should be preferred. In Section A, I first show that, unsurprisingly, most instances of private ordering correspond to this model. With that in mind, I then present the expansively far-reaching doctrines of *lex mercatoria* scholars in Section B.

A) Autonomy as Freedom of Contract

The law of the vast majority of countries offers various tools allowing commercial parties to design private normative regimes. The most important of those tools is the freedom of contract. Parties may write detailed contracts reflecting the terms and conditions of their arrangement as well as their preferences in the event of a default or other issue, and such terms will generally displace the default rules of the applicable law. As already noted, commercial law often recognizes business norms by allowing the use of commercial customs and usages for the purpose of supplementing commercial contracts or interpreting their terms when the contract itself is unclear on the relevant point.

The literature on private ordering shows that commercial parties willing to design private normative regimes do so by relying on essentially that most important tool – freedom of contract. Such parties will sometimes write detailed contracts for particular transactions; more often, they will simply resort to contractual forms widely used in their industry. Despite their desire to subject their transactions to norms that they have produced, these parties do not typically claim that their private regime should be self-sufficient and thus completely displace the otherwise applicable commercial law. On the contrary, however detailed such contracts might be, they will typically include a choice of law clause providing for the application of a national law, which clearly shows that the parties recognize that their contract remains governed by a national law and that the source of their power to design a private normative regime is a rule of that national law that recognizes the freedom of contract.

Most instances of private ordering studied by legal scholars correspond to this model. A seminal article of Lisa Bernstein revealed that the American grain and feed industry has produced detailed substantive trade rules through its trade association, the National Grain and Feed Association (NGFA), for over a century[9]. These various rules, which were initially meant to codify the customs of the industry and which still claim to "reflect trade practices"[10], govern all NGFA members contracts.[11] Membership in the NGFA is conditioned upon the member agreeing to submit all disputes with other members to the NGFA's arbitration system. NGFA arbitrators decide such disputes by applying the relevant NGFA rules. Those rules are typically sufficient, as disputes over unforeseen

[9] Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PENN. L. REV. 1765 (1996).
[10] Lisa Bernstein, *supra* note 9, at 1772, who underscores that "however, changes in unwritten customary practices have not been the primary motivation for trade rules amendments." Id.
[11] Lisa Bernstein, *supra* note 9, at 1773.

contingencies seem rare.[12] Notwithstanding that, although it might appear that the NGFA is almost entirely self-regulated, the grain and feed industry has never claimed complete autonomy from national legal systems. From the American NGFA's perspective, the question would specifically be whether the industry claimed autonomy from American commercial law. However, such autonomous self-regulation is not the accepted by NGFA arbitrators who have repeatedly held that, in the rare cases in which the contract, trade rules and trade practices have proven insufficient to resolve a given dispute, they ought to rely on the Uniform Commercial Code or other applicable statute.[13]

Similarly, the international trade association of the industry, the Grain and Feed Trade Association (GAFTA), has also produced private norms in the form of dozens of model contracts, which are commonly used in the industry.[14] These model contracts all include an arbitration clause providing for arbitration under the rules of the Association by qualified arbitrators with extensive experience in commodities trading. In an international environment, GAFTA could have been tempted to claim full autonomy from national legal systems: It did not. Although GAFTA model contracts exclude the application of concurrent state norms such as international commercial conventions, they still provide that they "shall be construed and take effect in accordance with the law of England"[15], where GAFTA has its seat.

Another example of an industry which has generated many of the rules governing transactions between its members is the privately-negotiated derivatives industry[16]. Unlike other financial products, swaps and other derivatives are not traded over an organized exchange. As a consequence, these transactions largely fall outside of the scope of securities regulation, which was designed to regulate on-exchange activity. Thus, the industry is essentially regulated by the contracts that its members conclude. In 1985, the repeat players in the industry established the International Swaps and Derivatives Association (ISDA), which now has more than 800 members from 58 countries and 6 continents.[17] One of ISDA's the most important contributions was to develop the ISDA Master Agreement, a model contract. It is a detailed document, periodically revised, which is used as an umbrella contract, and is thus accompanied by transaction-specific documents. Because it is so widely used, it is perceived as defining key practices, rights and obligations, in the industry.[18] ISDA presents its contract as "the authoritative contract" used in the industry, which "has established international contractual standards governing privately negotiated [*sic*] derivatives transactions".[19]

[12] *Id*., at 1774.
[13] See the arbitral awards cited by Lisa Bernstein, *supra* note 9, p. 1777 note 41.
[14] As recognized by the English Court of Appeal in *Souffl et Negoce v Bunge SA.* [2010] EWCA Civ 1102.
[15] See, e.g., GAFTA Contract No. 64, General Contract for Grain in Bulk, Article 24 (2006).
[16] Annelise Riles, *The Anti-Network: Private Global Governance, Legal Knowledge, and the Legitimacy of the State*, 56 AM. J. COMP. L. 605 (2008).
[17] See http://www2.isda.org/about-isda (last checked Jan. 4th, 2012)
[18] Annelise Riles, *supra* note 16, at 609; Stephen Choi & Mitu Gulati, *Contract as Statute*, MICH. L. REV. 1129, 1140 (2006)
[19] See http://www2.isda.org/functional-areas/legal-and-documentation/opinions (last checked Jan. 4th, 2012)

Some argue that the ISDA Master Agreement is a set of private rules actually regulating the industry, a comprehensive code of self regulation,[20] because the norms to be followed by industry actors all seemed to originate from it. In that sense, it could be presented as a form of *lex mercatoria.*[21] But, this transnational set of norms has never claimed complete autonomy from national legal systems; rather, the ISDA Master Agreement is expressly governed by a national law. The industry is acutely aware of the fact that national insolvency laws may claim competence and may, in an appropriate case, invalidate some of the clauses of the Master Agreement.[22] ISDA's reaction, however, is not to claim any autonomy from these laws, but rather to lobby governments to amend them[23] by seeking, among other legislative acts, the conclusion of an international treaty ensuring the enforceability of choice of law clauses in contracts such as the Master Agreement.[24] Furthermore, unlike certain other instances of private ordering, the derivatives industry lacks an autonomous dispute resolution mechanism. When disputes arise, parties go to national courts, which will not automatically or even necessarily defer to the private norms of the industry, but might instead invalidate critical clauses of the Master Agreement.[25] If the ISDA Master Agreement has generated a financial *lex mercatoria*, it was clearly not autonomous from national legal orders but rather subjected to them.

It is probable that many other such examples exist.[26] It is unclear, however, whether this kind of private ordering ought to be characterized as *lex mercatoria*. On the one hand, transactions between members of the industry are, in effect, regulated by sets of norms which were privately produced and are common to most, if not all actors worldwide.[27] On the other hand, technically speaking, those norms are indisputably contracts governed by national commercial laws.[28] For the purpose of this Article, however, it is unnecessary to decide, because I am concerned with the special issues raised by the claim that parties might *want* to displace national laws entirely, and to be solely governed by transnational business norms.

B) Autonomy as an Alternative to National Commercial Laws

In 1964, a French law professor of Romanian origin, Berthold Goldman, published the first in a series of articles in which he eventually argued that transnational commerce had generated not only a new transnational commercial law, but an actual transnational legal

[20] Hugh Collins, *Flipping Wreck: Lex Mercatoria on the shoals of* Ius Cogens, in CONTRACT GOVERNANCE (S. Grundmann, K. Riesenhuber & F. Möslein ed.), forthcoming.
[21] Id.
[22] Annelise Riles, *supra* note 16, at 614.
[23] Id.
[24] Id., at 615.
[25] As a U.S. bankruptcy court did in the Lehman Brothers litigation: see *Lehman Brothers Special Financing Inc v BNY Corporate Trustee Services Ltd* Case no. 09-01242 (Bankr. SDNY) January 25 2010. See also Hugh Collins, *supra* note 20.
[26] At the same time, there are also examples of industries in which trade associations failed to come to a consensus in developing trade rules: see Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710, 717 (1999).
[27] For some authors, this is enough to speak of a *lex mercatoria*: see, e.g., Hugh Collins, *supra* note 20.
[28] Scholars have often challenged the existence of *lex mercatoria* on the ground that most instances of private ordering amount to nothing more than private contracts that remain governed by national laws: see, e.g., Symeon Symeonides, *Party Autonomy and Private-Law Making in Private International Law: The Lex Mercatoria that Isn't*, LIBER AMICORUM K. KERAMEUS 1379 (2009).

order that was autonomous from national laws and that, as such, could displace such laws all together and take over their role as the law governing international business transactions.[29]

The claim that business norms could be elevated to the status of law and could, therefore, govern transactions independently from national laws was remarkable. Goldman supported his argument it by pointing to historical precedent. In the 1960s, it was widely believed that, in medieval times, the rules governing transnational commerce were essentially the customs followed in the community of international merchants, and that this Law Merchant, or *lex mercatoria*, was autonomous from any State.[30] Goldman presented his doctrine as a simple revival of the medieval concept of *lex mercatoria*. At the same time, another European scholar, Clive Schmitthoff, was also drawing parallels between the medieval *lex mercatoria* and the contemporary unification of international commercial law.[31] Together, Goldman and Schmitthoff are now widely considered as the intellectual fathers of the new *lex mercatoria.*[32] Despite obvious similarities, their doctrines and approaches were not identical: the idea of complete autonomy of transnational commercial law was essentially, if not exclusively, promoted by Goldman and students from his school established in Dijon, France.

Over the next fifty years, Goldman's and Schmitthoff's ideas would be harshly criticized: Legal historians challenged the notion that medieval *lex mercatoria* was ever genuinely autonomous from State legal orders,[33] and legal scholars vehemently denied the existence of any transnational commercial legal order[34]. Nevertheless, their theories survived; most interestingly, for the purpose of this Article, Goldman's suggestion that the new *lex mercatoria* was completely autonomous proved extraordinarily successful. As international arbitration rose and States became interested in competing for the invisible benefits associated therewith, lawmakers adopted a variety of rules based on this proposition. Thus, national arbitration laws empowered arbitrators to decide disputes

[29] Berthold Goldman, *Frontières du droit et lex mercatoria*, ARCH. DE PHILOSOPHIE DU DROIT 177 (1964) ; Berthold Goldman, *La lex mercatoria dans les contrats et l'arbitrage international : réalités et perspectives*, JOURNAL DU DROIT INTERNATIONAL 475, 499 (1979) ; Berthold Goldman, *Nouvelles Réflexions sur la Lex Mercatoria*, FESTSCHRIFT PIERRE LALIVE 241 (1993).

[30] Clive Schmitthoff, *The Unification of the Law of International Trade*, 1968 J. BUS. L. 105 (1968).

[31] Clive Schmitthoff, *supra* note 30.

[32] On the historiography of the new *Lex Mercatoria*, see Nikitas E. Hatzimihail, *The Many Lives – and Faces – of Lex Mercatoria: History as Genealogy of International Business Law*, 71 LAW & CONTEMP. PROB. 169 (2008).

[33] See Ralf Michaels, *The True Lex Mercatoria: Law Beyond the State*, 14 INDIANA J. GLOBAL LEGAL STUDIES 447, 453 (2007) citing Oliver Volckart & Antje Mangels, *Are the Roots of the Modern Lex Mercatoria Really Medieval?*, 65 S. ECON. J. 427, 446–47 (1999); Charles Donahue, Jr., *Medieval and Early Modern Lex Mercatoria: An Attempt at the Probatio Diabolica*, 5 CHI. J. INT'L L. 21, 27–29 (2004).

[34] Paul Lagarde, *Approche critique de la lex mercatoria*, ETUDES OFFERTES À BERTHOLD GOLDMAN 125 (1987); Georges R. Delaume, *The Proper Law of State Contracts and Lex Mercatoria*: *A New Appraisal*, 3 FOREIGN INVESTMENT JOURNAL, 79 (1988).

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solely on the basis of *lex mercatoria*[35], and national courts confirmed arbitral awards made thereunder[36].

Today, *lex mercatoria* is a legal reality in international commercial arbitration. Its content, however, is much debated, and has evolved since the 1960s. Most international arbitration scholars[37] accept that there are two alternative approaches towards assessing the content of *lex mercatoria*: the list method and the functional method.

1. The List Method

Despite the claim that modern *lex mercatoria* revived medieval Law Merchant, it became immediately obvious to its proponents that commercial customs, which were central to the concept in medieval times, were not particularly numerous in an era in which States produce lots of commercial law. If *lex mercatoria* was to have any significance, it would have to draw on other sources. Hence, from the outset, proponents suggested a need to rely on a variety of norms or practices which were reasonably global and could be included without overly contradicting the original concept of a law spontaneously generated by the international business community.[38] Although a few scholars still consider that modern *lex mercatoria* should be limited to commercial customs,[39] there is wide acceptance among arbitration scholars and practitioners of the need to incorporate a number of other norms.[40]

To begin with, it is understood that one may refer to widely-adopted international commercial treaties such as the United Nations Convention on Contracts for the International Sale of Goods[41] (hereinafter 'CISG'). The underlying rationale therefore is that, although one may argue that treaties are State law such that that including them contradicts the precept of a law autonomous from national legal orders, such treaties govern a high number of international transactions and constitute, to a large extent, the actual law of international business transactions. In the same vein, public international law is also often cited as a potential source of the new Law Merchant, despite the fact that private actors have not traditionally been considered subjects of international law. Further, contractual practices, including model contracts, are commonly accepted as

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[35] See, e.g., the influential 1985 UNCITRAL Model Law on International Commercial Arbitration, Article 28.

[36] See, e.g., Deutsche Schachtbau und Tiefbohrgesellschaft GmbH (F/Germ) v R'as Al Khaimah National Oil Co (R'as Al Khaimah, UAE) Shell International Petroleum Co Ltd (UK) [1987] 3 WLR 1023 (UK); Compania Valenciana de Cementos Portland SA c/ Primary, Cass. Civ. 1ère, 22 October 1991, J. DROIT INT'L 456 (1992) (France); Judgment of the Austrian Supreme Court, 18 November 1982, reproduced in IX YB COMM ARB 161 (1984). See also David Rivkin, *Enforceability of awards based on lex mercatoria*, 19 ARB INTL 47 (1993).

[37] See, e.g., NIGEL BLACKABY, CONSTANTINE PARTASIDES, ALAN REDFERN AND MARTIN H. HUNTER, REDFERN AND HUNTER ON INTERNATIONAL ARBITRATION 218, no 3-173 (2009); Michael Pryles, *Application of Lex Mercatoria in International Commercial Arbitration*, 3 UNSW L.J. 319, 321 (2008).

[38] See Berthold Goldman, *Frontières du droit et lex mercatoria*, ARCH. DE PHILOSOPHIE DU DROIT 177 (1964).

[39] See, e.g., Roy Goode, *supra* note 6, at 16.

[40] See, e.g. Ole Lando, *The Lex Mercatoria and International Commercial Arbitration*, 34 INT. & COMP. L. Q. 747 (1985); Lord Michael Mustill, *The New Lex Mercatoria: the First Twenty-Five Years*, 4 ARBITRATION INTERNATIONAL 86, 109 (1988); Michael Pryles, *supra* note 37, at 320.

[41] United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, 1989 U.N.T.S. 3 [hereinafter CISG].

legitimate sources of *lex mercatoria,* which proposition is probably the most controversial, since contractual practices and model contracts have no authority unless they have been adopted by the parties, or unless they are so widely used that they become trade usages. Finally, it is widely accepted that *lex mercatoria* includes general principles of law. The original idea behind this proposition was that, if some principles were common to all nations and could, as the case may be, also be found in public international law, it was safe to assume that they would also belong to *lex mercatoria*. Some arbitral tribunals endorsed this view and expressly relied on general principles of law. This reliance, in turn, confirmed the status of the principles as a source of *lex mercatoria*, since they had now been recognized by international trade adjudicators. Before long, it was clear that this source would remain, from a practical point of view, accessory, as it appeared that international arbitral tribunals had only identified a few dozens of such general principles.[42]

Such a wealth of sources, however, was unlikely to translate into an easily accessible code of transnational commercial law. A recent trend in the development of the new *lex mercatoria* has been to codify it and to try to put it into a user-friendly, or perhaps simply usable, form. Professor Klaus Berger has been working to identify all of the rules which can be deduced from the various accepted sources of *lex mercatoria* and putting them into one single, open-ended set of rules and principles[43]. This process of "creeping codification" has resulted in a list which, in 2010, contained around a hundred principles[44]. Some of them are reasonably precise and would certainly offer adjudicators rules of decision enabling them to settle many disputes. Others, however, are so vague that they would hardly offer guidance to any party or arbitrator[45].

Similarly, the International Institute for the Unification of Private Law (UNIDROIT) sponsored the work of a dozen academics interested in producing an international restatement of contract law. The UNIDROIT project was, however, quite different from Professor Berger's attempt to codify *lex mercatoria*, as the UNIDROIT working group did not focus on the sources of *lex mercatoria*, but rather used different national contract laws as its starting point. Indeed, that working group did not hesitate to adopt solutions which were rather rare in comparative contract law.[46] Nevertheless, the resulting UNIDROIT Principles of International Commercial Contracts[47] (hereafter the 'UNIDROIT Principles') are a coherent and complete code of contract law, comparable to many national laws. Despite the fact that they do not originate from customs and rules

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[42] See KLAUS PETER BERGER, THE CREEPING CODIFICATION OF *LEX MERCATORIA* (1st edn .1999) (39 principles); Lord Michael Mustill, *supra* note 40, at 91 (20 principles).
[43] KLAUS PETER BERGER, *supra* note 42.
[44] KLAUS PETER BERGER, THE CREEPING CODIFICATION OF *LEX MERCATORIA* (2nd edn 2010).
[45] See, e.g., Principle IV.4.1 on Forms Requirements (KLAUS PETER BERGER, *supra* note 44, at 383):

No IV.4.1 – *Principle of informality*:

(a) Contractual declarations are valid even when they are not evidenced in writing unless mandatory rules of any applicable domestic law provide otherwise.
(b) Parties to international business contracts may not insist on undue formalism without any good reason.

[46] For instance, the working group endorsed the right to ask for renegotiation of contracts in case of hardship, which is rejected by many national laws, and was, as a consequence, rejected by the drafters of the CISG, too.
[47] 3rd edition 2010.

actually followed by commercial parties in international business transactions, the preamble of the UNIDROIT Principles states that "They may be applied when the parties have agreed that their contract be governed by general principles of law, *lex mercatoria* or the like". In fact, a small-but-growing number of parties and arbitrators use them as a rules of decision in international commercial disputes. The new *lex mercatoria* might be slowly entering into a new era, one that some have already labeled the "new, new, *lex mercatoria*",[48] where the Law Merchant will be increasingly more accessible and usable, but also distinct from commercial customs and practices.

2. The Functional Method

In a series of influential articles,[49] Emmanuel Gaillard, a French academic and leading international arbitration practitioner, proposed an entirely different approach for assessing the content of *lex mercatoria*. He argued that *lex mercatoria* ought to be considered as a method of decision making rather than as a list of rules. When deciding disputes on the basis of *lex mercatoria*, arbitrators ought to conduct a comparative analysis and assess how the majority of the national laws connected to the dispute would resolve it. Arbitrators should then apply this widely-accepted solution, the inference being that the fact that the application of a rule common to most national legal orders would not come as a surprise to commercial parties.

Despite the on-going debate on the actual content of *lex mercatoria*, the concept of a modern Law Merchant – one largely autonomous from national laws -- is now widely accepted. Most sophisticated jurisdictions now acknowledge, through national law, that commercial parties may provide for its application and empower international arbitrators to decide dispute according to its rules and principles. The purpose of this Article, however, is to ask both *how* and *why* the concept developed and remains alive half a century after its (re)birth: Is it because it gave a unique opportunity to commercial actors to design the best legal regime for their transactions? Or, have other actors had incentives to promote the idea of an autonomous transnational commercial law?

II – DOES *LEX MERCATORIA* MEET THE NEEDS OF COMMERCIAL ACTORS?

While scholars hotly debated the nature and content of *lex mercatoria*, the reasons *why* the concept developed and whether it was beneficial for actors was little explored. One reason might have been that the answer seemed obvious. The original claim was that *lex mercatoria* was a set of rules generated by the merchant or commercial community for itself, with custom and commercial practices both central to its definition. Thus, it followed that *lex mercatoria* simply *had to* meet the needs of commercial actors, as it could be safely assumed that they would have designed rules which fit their needs.

However, as previously explained, *lex mercatoria* has numerous sources, many of which are not directly generated by the community of merchants. Thus, in the following pages, I

[48] Yves Fortier, *The New, New Lex Mercatoria, or Back to the Future*, 17 ARBITRATION INTERNATIONAL 121 (2001).
[49] Emmanuel Gaillard, *Thirty Years of Lex Mercatoria: Towards the Selective Application of Transnational Rules*, 10 ICSID REV. – FOREIGN INVESTMENT L.J. 208 (1995); Emmanuel Gaillard, *Transnational Law: A Legal System or a Method of Decision Making?* ARBITRATION INTERNATIONAL 59 (2001).

argue that the features of the modern *lex mercatoria* make it highly unlikely that it meets the needs of international merchants, and present empirical evidence that the latter rarely choose its application.

A) An Economic Analysis of Lex Mercatoria

1. Reducing Transaction Costs

Intuitively, one would think that the main reason commercial actors would want their international contracts to be governed by *lex mercatoria* would be to reduce transaction costs[50]. Concluding international contracts appears more costly than concluding domestic contracts because international contracts raise the specific issue of choice of law: The law governing an international contract must be determined. When negotiating the contract, the parties must, therefore, deal with an additional issue. As most legal systems allow them the freedom to choose the applicable law, that means that they should agree on the law governing their contract, and draft an appropriate clause to that effect. They must, therefore, dedicate additional resources to the negotiation of that particular clause.

a. The Relevance of Parties' Legal Sophistication

At the outset, it is important to underscore that this argument is based on the assumption that the parties do, in fact, care about which law *should* govern their contract, and they certainly should. The applicable law will provide default rules which will control in the absence of any specific contractual provisions. Both parties should know and understand the consequences of such default rules in order to determine whether they fit their particular needs and, if not, the parties must draft appropriate clauses providing otherwise. Moreover, the applicable law will provide mandatory rules which may invalidate some of the parties' contractual provisions and, in the worst case scenario, void the entire contract.

Yet, it would be foolish to believe that all parties concluding contracts, even international commercial actors, fully appreciate the importance of the applicable law. Most of them are, after all, businessmen, and although some may have some legal training, most will not, and still others will have no higher education at all. In other words, not all international commercial parties are sophisticated from a legal point of view. Some are unsophisticated, and simply do not care about the law governing their contract. That means that they typically do not spend time or effort wondering what the applicable law for the particular contract might be, and they certainly would not expend any significant resources to determine it. Such an attitude clearly generates risks which are obvious (and somewhat disconcerting) to any lawyer. But the business people's lack of interest in the subject is not without advantages: such parties incur fewer transaction costs when concluding contracts. In particular, they do not incur additional transaction costs when concluding international contracts, because they do not see the issue.[51] And, indeed, in

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[50] See Jürgen Basedow, *Lex Mercatoria and the Private International Law of Contracts in Economic Perspective*, in JÜRGEN BASEDOW and TOSHIYUKI KONO, AN ECONOMIC ANALYSIS OF PRIVATE INTERNATIONAL LAW 63 (2006); Alec Stone Sweet, *The New Lex Mercatoria and Transnational Governance*, JOURNAL EUROPEAN PUBLIC POLICY 637, 634 (2006).

[51] Not seeing the issue does not necessarily mean that such parties would not include choice of law clauses in their contracts. Rather, they might do so because contracts with which they have experience may have them or they may have seen or heard of other actors including such clauses so feel that they should as well,

many cases, there will not be any negative consequence of such lack of interest, as no dispute may arise in connection with the transaction or, if one does, it may be resolved by way of negotiation.

Similarly, the law governing the contract may simply be ignored by parties who, although they may appreciate its importance, might think that they cannot afford to incur the costs necessary to determine the applicable law. In other words, the value of a particular transaction may not justify dedicating resources to its determination. In such cases, the parties may conduct a cost-benefit analysis and choose to ignore the issue all together. Such parties may not be legally unsophisticated; rather the cost-benefit analysis suggests it is cheaper to leave the issue unresolved. But, the result is the same: the parties dedicate no resources to resolve, in advance, which law will govern the contract, thus, they do not incur higher costs when concluding international contracts.

Are there many parties falling within either of these two categories? In the absence of any empirical study, that is almost impossible to know.[52] The answer might well vary depending on the parties (including, perhaps, their perception of the local law generally applicable thereto), the industries, and the value of the transactions. In light of that, let us assume, for the moment, that there are very few such parties, and let us focus, instead, on sophisticated international commercial parties.

b. The Additional Cost of International Contracting

For parties who fully appreciate the importance of the law governing their contract, international contracting should be more costly than domestic contracting. Initially, as already mentioned, parties to an international contract must provide for the applicable law. The first additional cost, therefore, is the time and resources spent negotiating and drafting a choice of law clause. For genuinely sophisticated parties, however, that cost is unlikely be the only cost (not even the only negotiation and drafting cost), and certainly not the highest one. In order to fully appreciate the consequences of agreeing on the application of one law or the other, the parties ought to know and understand the provisions of the laws that might be chosen, meaning that the lawyers of the parties should advise them on the differences between – at a minimum – all potential laws connected to the particular transaction. However, as many legal systems do not limit the parties' freedom to choose the law governing their international commercial transaction to only those laws related to the transaction,[53] one could argue that the parties' counsel should even advise them on all unrelated laws of the world, not just a few of them, in order to allow the client to negotiate for the most beneficial. Quite clearly, if that were the

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or because they do not see the point of fighting about the issue with the other party. Indeed, they may feel that by accepting the law of the other party, they will be in a stronger position when negotiating other terms of the contract that, for them, are more important.

[52] Yet, legal scholars commonly wonder why "sophisticated parties" frequently omit particular clauses that seem to be extremely important – to the scholars (see e.g. Geoffrey P. Miller & Theodore Eisenberg, *The Market for Contracts*, 30 CARDOZO L.R. 2073, note 138 (2009)).

[53] See, e.g., Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), hereafter 'Rome I Regulation', article 3; 2010 Law of the PRC on the Laws Applicable to Foreign-Related Civil Relations, art. 41.

case, the mere preparatory work necessary to begin negotiating the choice of law provision would be prohibitive while skyrocketing the transaction costs.[54]

Whether and how much preparatory research is actually conducted by the parties' lawyers before negotiating most international contracts remains unclear.[55] It is much clearer, however, that when the parties eventually reach an agreement on a given national law, such law will be foreign to at least one of them. If that party had already asked his lawyers to advise him on the peculiarities of that law before or during the negotiation,[56] the costs associated therewith would have already been incurred. If not, such research would have to be conducted *after* reaching the agreement. Regardless of when such research is conducted (e.g., either before or after the negotiation and the conclusion of the contract), at least one of the parties needs to incur the cost of learning a foreign law.

Such additional cost of international contracting results from the absence of an international contract law. If such a law existed -- and if it applied automatically to international contracts -- parties would not need to concern themselves with the law governing their transaction, and could either ignore the issue or, in a belt-and-suspenders approach to the issue, specifically refer to such international law in little (if at all) negotiated choice of law provision. Further, as an international regime, it would be familiar to all such that no party would need to learn it. Finally, if such an international regime was embodied in an international treaty, for instance, it would become part of the laws of the contracting states, and would thus become an international transaction law common to all of them.

This cost reduction argument can be made for any international law regime. It works – and was often made, in connection with international treaties such as the CISG. But it works equally well for a body of international law produced by private, international trade actors such as *lex mercatoria.*[57]

It should be noted, however, that at least one cost of international contracting would not necessarily disappear even if an international law regime existed: most international commercial laws are just default rules that apply automatically only if the parties do not provide a different applicable law.[58] International commercial laws are not, therefore, mandatory in character, and the parties may exclude their application.[59] That means that if they so desire, contract parties may still decide to compare solutions offered by applicable international law against national laws and, as the case may be, choose a national law which better suits their needs. Of course, the parties would never be obliged

[54] Jürgen Basedow, *supra* note 50, at 67, citing EVA-MARIA KIENINGER, WETTBEWERB DER PRIVATRECHTSORDNUNGEN IM EUROPÄISCHEN BINNENMARKT 287 (2002).
[55] For Jürgen Basedow, *supra* note 50, at 67, and EVA-MARIA KIENINGER, *supra* note 54 at 287, this research is not conducted.
[56] For purposes of this paper, we must leave aside the question of whether a lawyer negotiating a choice of law provision without knowing and understanding the implications of the law of the jurisdictions under negotiation commits malpractice under the rules of professional conduct applicable to such lawyer.
[57] See, e.g., Bernado M. Cremades and Steven L. Plehn, *The New Lex Mercatoria and the Harmonization of the Laws of International Business Transactions*, 2 BOSTON UNIV. INT'L L.J. 317, 326 (1984) noting that *lex mercatoria* would provide a single harmonized body of law to the business community.
[58] See, e.g., CISG, art. 1-1(b).
[59] See, e.g., CISG, art. 6.

to undertake the research necessary to make such a comparison; they could avoid any such expense by simply accepting the international legal regime.

c. The Necessary Features of International Commercial Law

The claim that the existence of an international legal regime for commercial transactions reduces the cost of international contracting is based on the assumption that international commercial law can be used as an alternative to national contract law. The argument rests on the notion that parties to international contracts would welcome the application of international law in lieu of national law because it would allow them to save some of the cost generated by applying a national law. The argument is obviously based on an underlying assumption that all things are otherwise equal. In other words, there is an implicit assumption that international laws and national laws are otherwise comparable, such that it is not otherwise more costly to subject one's contract to international commercial law.

Choosing international commercial law over national commercial law, then, would only be beneficial if international law shares features valued by commercial actors.[60] One such value is legal certainty:[61] Contracts are an essential instrument of planning future of business relationships, and such planning requires a large measure of legal certainty.[62] Commercial parties really only care about which law governs their contract because they want (and need) to know, in advance, whether their contractual provisions are enforceable (or likely to be enforced) under that law and, in the absence of a specific contract provision, what default rules that law would apply.

In connection with the CISG, an argument can be made that the proffered international commercial law might not compare with national laws in this regard. In a seminal article, Gillette and Scott argued that the complicated international negotiation of the CISG favored compromise and, therefore, resulted in the adoption of vague rules.[63] They underscored that the CISG reflects a compromise among by representatives of over fifty States coming from all legal traditions, so that the resulting treaty would be acceptable to all of them. One method used to reach such compromises was a heavy reliance on legal standards rather than specific rules.[64] In this respect, it is interesting to note that many parties to international sales specifically exclude application of the CISG from the

[60] See, however, Tom Carbonneau, *A Definition of and Perspective Upon Lex Mercatoria Debate*, in THOMAS E. CARBONNEAU (ed.), *LEX MERCATORIA* AND ARBITRATION 14 (1998), arguing that "international law-making cannot be evaluated solely by reference to domestic law-making standards", as "a platitude in the domestic context may provide essential guidance in an unstructured international setting".
[61] See, e.g., Robert E. Scott, *The Rise and Fall of Article 2*, 62 LA. LR 1009, 1058 (2002); John Linarelli, *The Economics of Uniform laws and Uniform Lawmaking*, 48 WAYNE LR 1387-1448 (2003) ; Michael Whincop & Mary Keyes, *Towards an Economic Theory of Private International Law*, 25 AUSTR. J. LEG. PHIL. 1, 15 (2000).
[62] In the context of American corporate law, some argue Delaware won the corporate charter competition despite the indeterminacy of its law. I address this argument below: see text accompanying notes 82-86.
[63] Clayton Gillette and Robert Scott, *The Political Economy of International Sales Law*, INT'L REV. L. & ECON. 446 (2005).
[64] Gillette and Scott, *supra* note 63, at 469.

possible sources of law for their contracts,[65] although this might be for reasons other than its unsuitability to the needs of commercial actors.[66]

A critical question for assessing whether *lex mercatoria* could be a suitable alternative to national laws is, therefore, whether it affords the necessary degree of legal certainly that commercial parties require. The question has long been hotly debated.

2. How Precise is *Lex Mercatoria*?

Although the new *lex mercatoria* has gained wide recognition in the last fifty years, a variety of scholars and practitioners have always criticized it. Such critiques have been numerous, ranging from the conceptual impossibility of non-national law to the ideological coloration of the concept, which purportedly helped maintain the dominance of the West in international trade, or was designed to promote a doctrine of *laissez-faire*. But, the most important and frequent critique has been its overall lack of substance and the vagueness of those few new Law Merchant rules that could be identified.

From the outset, critics of *lex mercatoria* have underscored *lex mercatoria*'s lack of comprehensiveness.[67] On many issues, it seems virtually impossible to identify any rule or principle that adjudicators could use to settle a dispute. At first glance, this might come as a surprise, given the numerous sets of norms that its proponents consider to be legitimate sources of the new Law Merchant. In truth, however, those sources very rarely offer a comprehensive regime. There are, of course, noticeable exceptions, such as the CISG for international sales and the Uniform Customs and Practice for Documentary Credits produced by the International Chamber of Commerce. But, for most contracts, the law has simply not been sufficiently harmonized at the international level, and experience has shown that there are, in fact, no commercial customs, either. Rather, adjudicators seeking international norms are left with a few general principles previously identified by arbitral tribunals. For several decades, those norms included twenty- to thirty-odd principles. While that figure may have increased recently, it still cannot compare with most national laws, which offer hundreds of rules.

Further, *lex mercatoria*'s critics have long insisted that its rules, to the extent they can be identified, lack precision.[68] Again, it is useful to distinguish those few fields where the law has been harmonized internationally from others. The CISG, for example, offers a set of reasonably precise rules which are, from that perspective, comparable to the commercial laws of many States. Likewise, the Uniform Customs and Practice for Documentary Credits published by the International Chamber of Commerce offers a set of precise rules, which are regularly revised. But, for most types of contracts, the accepted sources of *lex mercatoria* will have no specific rules to offer, such that it will be

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[65] John Coyle, *Rethinking the Commercial Law Treaty*, 45 GA. L. REV. 343 (2011).
[66] Lack of knowledge of the Convention by lawyers is certainly one. Another might be the lack of authoritative case law interpreting the instrument.
[67] GARY B. BORN, INTERNATIONAL COMMERCIAL ARBITRATION 2236 (2009); JEAN-FRANCOIS POUDRET AND SEBASTIEN BESSON, DROIT COMPARE DE L'ARBITRAGE, no 697(2002); FILIP DE LY, INTERNATIONAL BUSINESS LAW AND *LEX MERCATORIA*, no 501 (1992).
[68] GARY B. BORN, *supra* note 67, at 2236; JEAN-FRANCOIS POUDRET AND SEBASTIEN BESSON, *supra* note 67, at no 697; Keith Highet, *The Enigma of Lex Mercatoria*, in THOMAS E. CARBONNEAU, *supra* note 60, at 142; Charalambos Pamboukis, *La Lex Mercatoria reconsidérée*, in LE DROIT INTERNATIONAL PRIVÉ : ESPRIT ET MÉTHODES – MÉLANGES EN L'HONNEUR DE PAUL LAGARDE 646, 657 (2005).

necessary to resort to the general principles of international commerce – as recognized by international tribunals. Thus, the actual "rules" of *lex mercatoria* will only be general principles, which gives an immediate indication of their precision. Moreover, those principles are indeed often *very* general. A particularly striking example thereof is the principle that "a contract should be performed in good faith".

An interesting response to these critiques was made by one of today's leading advocates of *lex mercatoria*, professor and arbitrator Emmanuel Gaillard. As previously noted,[69] Gaillard proposed a new approach whereby *lex mercatoria* is to be considered as a method of decision making rather than a mere list of rules. According to Gaillard,[70] seeing *lex mercatoria* as a method solves the issue of its lack of precision and vagueness, because one or more of the to-be compared national laws would have rules addressing all potential legal issues arising in the dispute. By comparing their solutions, adjudicators would be able to come up with a precise solution to any disputed issue. The method proposed by Gaillard may or may not, in fact, provide international arbitrators with a tool improving their capacity to decide disputes on the basis of *lex mercatoria*. Nevertheless, it seems clear that such a method gives a great deal of flexibility and discretion to adjudicators, making it equally clear that parties could never hope to predict with any reasonable degree of certainty the result arbitrators would reach when implementing it. One is, therefore, hard pressed to imagine how this new concept of *lex mercatoria* could possibly improve the contracting parties' ability to assess, *ex ante*, what their obligations are under a contract they made subject, wisely or not, to *lex mercatoria*.

Regardless of whether one understands *lex mercatoria* as a list of rules or as a method of decision making, the conclusion seems straightforward: The new Law Merchant does not offer rules of decision which can be compared to national laws in terms of precision or comprehensiveness. If the true benefit parties can (and should) expect from the law governing their contract is precise default rules that enable them to reasonably assess their future obligations under that contract, *lex mercatoria* seems, at best, woefully inadequate. As the purposes of establishing *lex mercatoria* as a separate and distinct commercial law cannot be met if it is defined as a decision-making method, the only remaining question, then, is whether *lex mercatoria* as a list of rules – that is, the new "codified" *lex mercatoria* – can one day achieve the goal of precision and legal certainty well enough to be considered satisfactory by commercial actors.

3. Is *Lex Mercatoria* Otherwise Beneficial for Commercial Parties?

While it is doubtful that *lex mercatoria* genuinely reduces transaction costs in international contract negotiation, it might bring other benefits to commercial parties which could justify choosing it as the governing law in a contract. Indeed, most *lex mercatoria* advocates base the need for its further development on other arguments. However, such arguments are equally unconvincing.

a. Unpredictable Choice of Law Rules

The most common argument in support of the notion suggests that commercial parties should prefer *lex mercatoria* to a national law because of the uncertainties generated by

[69] *Supra*, text accompanying note 49.
[70] Emmanuel Gaillard, *Thirty Years of Lex Mercatoria*, *supra* note 49, at 226.

the conflict of laws,[71] since commercial parties need legal certainty, a proposition which can hardly be challenged. Obviously, in any international dispute, the applicable law must be determined, which process, it is argued, creates uncertainty for the parties: modern choice of law rules have simply become too complex to permit them to accurately predict which law will govern the contract. Thus, *lex mercatoria*'s proponents argue, the only way to offer legal certainty to international commercial actors is to enable them to avoid the choice of law process by making a uniform law available to them.

There is no doubt that modern choice of law rules have become incredibly complex, both in Europe and in the United States, and that this has resulted in less predictability. There are, however, exceptions: One is the choice of law rule in contractual matters. Parties are free to choose the law governing their contract. The rule is clear and simple, and such choice of law clauses are generally enforced in most jurisdictions around the world.[72] This is even more true when parties choose arbitration rather than litigation. Of course, parties to international contracts may fail to specify the applicable law in advance. In such cases, a default choice of law rule would apply, and it would typically be complex and rather unpredictable. But, would parties – who have otherwise failed to include a choice of law clause in their contract – really care about legal certainty? Most of them would probably be unsophisticated from a legal point of view,[73] and would neither be ready to invest resources in assessing which law governs their contract, nor benefit from any uniform law. Conversely, legally sophisticated parties, in most cases, specify the law governing their contract therein, such that, in the event of a dispute thereunder, the choice of law process will not cause any significant problem, let alone create any uncertainty[74].

Furthermore, while the argument that applying a uniform law offers more legal certainty than applying a national law makes some sense if it incorporates a developed body of rules, it borders on ludicrous in the context of a uniform law composed of vague principles coupled with a complex comparative methodology for identifying potential rules of decision.[75]

b. Need for Rules Specifically Tailored for International Transactions

Another argument in favor of *lex mercatoria* suggests that its rules are uniquely adapted to international transactions, such that, when combined with a contractual stipulation that it applies, it avoids domestic rules which are unfit for such purposes.[76]

There is no doubt that some of the norms typically considered to be part of *lex mercatoria* are specifically tailored to some particular transactions. Model contracts developed by trade associations have been specifically designed for a particular industry and/or a particular type of transaction, and one trusts that they include clauses which are both more specific and better adapted to their object than the general default rules of national contract law. Similarly, in those industries where specific customs and usages have

[71] KLAUS PETER BERGER, THE CREEPING CODIFICATION OF *LEX MERCATORIA* 9 (1999); Alec Stone Sweet, *supra* note 50, at 631.
[72] South America might be a noticeable exception: see John Coyle, *supra* note 62, at 364.
[73] On the concept of legal sophistication, see the text accompanying notes 51-52.
[74] Celia Wasserstein Fassberg, *Lex Mercatoria - Hoist with Its Own Petard?*, 5 CHI. J. INT'L L. 67, 77 (2004-2005).
[75] *Supra*, Part I, B.
[76] See, e.g., Ole Lando, *supra* note 40, at 748.

developed, one trusts that they are better adapted and more specific than general rules of national laws.

However, using such norms is not – and never was – limited to cases in which *lex mercatoria* was chosen to govern a contract. Rather, national laws also typically apply such norms because virtually all developed countries both recognize the freedom of contract and allow the application of trade usages in dispute resolution. If a trade association drafts a detailed model contract, its detailed norms will be applied regardless of whether the parties chose *lex mercatoria* or the national law of any advanced nation to govern their contract.[77]

Lex mercatoria, moreover, encompasses many general norms, such as international treaties and general principles of law[78]. The claim that these norms are somehow better adapted to international trade than national law is weak.[79] Although they innovate from time-to-time, international commercial treaties typically adopt rules already existing in national legal systems and, it goes without saying that, by definition, general principles of the law are based on norms commonly found in national legal systems. In that regard, Celia Wasserstein Fassberg stated that she had not been able to identify a single rule unique to *lex mercatoria,*[80] rather, the origin of all its general rules is national law[81].

c. Highly-Skilled Adjudicators Suffice

One last argument could be made in support of *lex mercatoria*: its quality is not critical for commercial actors because the quality of the applicable law is not what really matters to them. Rather, so the argument goes, their critical concern is the quality of the adjudicators – they want great adjudicators – such that they are more than willing to rely on the adjudicators' expertise and wisdom instead of precise, efficient, and predictable rules of law.

A version of this argument has long been made in the context of the corporate charter competition debate in the United States. American corporate law is dominated by Delaware; more than half of publicly traded companies in the United States are incorporated therein. Under American conflict of laws, that incorporation is enough to trigger the application of Delaware corporate law to internal corporate issues, meaning that parties choose Delaware corporate law simply by incorporating in Delaware. One might, therefore, assume that Delaware built its success on detailed and precise corporate law rules. Many corporate law scholars indeed believe that the "greatest benefit that Delaware offers corporations is a highly developed case law that provides not only a useful set of precedents, but also a substantial degree of certainty about legal outcomes".[82] Other corporate law scholars, however, reject that glowing description of

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[77] Indeed, as underscored in Part II, trade associations will often include in their model contracts a choice of law clause providing for the application of a national law.
[78] *Supra*, Part II.
[79] Celia Wasserstein Fassberg, *supra* note 73, at 79.
[80] Id.
[81] Id., at 80.
[82] See, e.g., Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 484 (1987). See also Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 280 (1985); Lucian Arye Bebchuk and Assaf

Delaware corporate law, arguing instead that Delaware corporate law relies on many vague standards that make it difficult to predict legal outcomes.[83] While recognizing that such indeterminacy is costly for economic actors,[84] those scholars offer other theories to explain why companies continue to incorporate in Delaware: first and foremost among them is that Delaware has an illustrious, specialized equity court, its constitutionally-created Court of Chancery,[85] and that it is the experience and quality of its chancellors and vice chancellors that are the critical factors in Delaware's success in the corporate charter race.[86]

It is, of course, beyond the scope of this Article to discuss whether Delaware's success was achieved, notwithstanding the indeterminacy of its substantive corporate law, because of the quality of its Court of Chancery. It is quite clear, however, that even if it could be demonstrated that commercial actors are ready to trade precise legal rules for skilled and knowledgeable adjudicators, it cannot explain why commercial actors would choose *lex mercatoria* as the law governing their transactions. There is a fundamental difference between litigating in Delaware's Court of Chancery and going to international arbitration. Delaware's chancellors and vice chancellors are known and respected. In sharp contrast, arbitrators are not known before an actual dispute arises, and the most widely used appointment mechanism makes it virtually impossible to predict who most of them will be. A given party will only have the chance to freely appoint one arbitrator, with the second freely appointed by the other party and, finally, the president of the tribunal typically chosen by the two party-appointed arbitrators. It may be that the arbitral tribunal is composed of experienced commercial lawyers; on the other hand, unless otherwise stipulated in advance, there is no requirement that the arbitrators be experienced, or even attorneys. While a credible argument can be made that American companies value the quality of Delaware's Court of Chancery so much that they are willing to risk legal uncertainly, that same argument cannot be made in the context of international arbitration.

B) An Empirical Analysis of the Use of Lex Mercatoria *by Commercial Actors*

1. Methodology

Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition Over Corporate Charters*, 112 YALE L.J. 553, 554 (2002).

[83] See, e.g., Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1910 (1998).

[84] Ehud Kamar, *supra* note 83, at 1947.

[85] 2d Del. Const. art. VI, §14 (1792) ("The equity jurisdiction heretofore exercised by the Judges of the Court of Common Pleas, shall be separated from the common law jurisdiction, and vested in a Chancellor, who shall hold Courts of Chancery in the several counties of this State"); see also http://www.courts.delaware.gov/Chancery/judges.stm (last consulted January 8, 2013) ("The Court of Chancery consists of one chancellor and four vice chancellors . . . nominated by the Governor and must be confirmed by the Senate for 12-year terms. The Delaware Court of Chancery is a non-jury trial court that serves as Delaware's court of original and exclusive equity jurisdiction, and adjudicates a wide variety of cases involving trusts, real property, guardianships, civil rights, and **commercial litigation**. The chancellor and vice chancellors **must be learned in the law** and must be Delaware citizens." (emphasis added))

[86] See, e.g., Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 276 (1985); Ehud Kamar, *supra* note 83, at 1925.

Conducting an empirical study of the contractual practices of international commercial actors with regard to *lex mercatoria* raises certain methodological issues. Data is hard to collect for several reasons: most importantly, most international commercial contracts are not typically made public and are frequently subject to confidentiality provisions, prohibiting even the disclosure of their existence. In some very special circumstances, national law may compel certain persons to publish some of their contracts, but these contracts could, at best, help to understand the practices of the parties subjected to such an obligation. For instance, U.S. law requires that publicly traded companies publish certain types of contracts.[87]

A second difficulty in collecting empirical data on the use of *lex mercatoria* is that when disputes arise out of contracts providing for the application of *lex mercatoria*, they will not typically be litigated, but instead go to arbitration, and gathering data with respect to arbitral practices, or just disputes going to arbitration, is arduous. At the outset, arbitral awards, being part of private dispute resolution proceedings, are not public like judicial awards are. Indeed, arbitration proceedings are typically confidential. Furthermore, as arbitration is a decentralized mode of dispute resolution, no one can seriously pretend to be able to locate all arbitral awards, or be aware of the existence of all arbitration proceedings. Moreover, contracts giving rise to disputes are not necessarily representative of all concluded contracts: disputes may arise out of certain contracts precisely because of the clauses they contain, which may provide an incentive to the parties to introduce proceedings. In such cases, it could thus be that litigated contracts giving rise to disputes only represent contracts containing inappropriate clauses and, hence, giving rise to more disputes than others.

That being said, some arbitral institutions regularly publish data on some of the contractual practices of the parties referring cases to them. In particular, the International Court of Arbitration of the International Chamber of Commerce (hereinafter 'ICC') publishes, every year, data on the choice of law practices of the parties referring cases to its International Court of Arbitration (hereafter 'ICC Court') in its *ICC International Court of Arbitration Bulletin* (hereafter 'ICC Data'). This Paper will argue that ICC Data is meaningful for the purpose of studying – empirically – the contractual practices of international commercial parties with respect to *lex mercatoria*. The ICC is the leading arbitral institution in the world for settling international commercial disputes.[88] Although it only receives 600 to 800 requests for arbitration per year, it handles more international commercial arbitrations than any other institution in the world.[89] Those referred cases involve all industries and the origin of the parties is remarkably diverse,[90] although it

[87] One such example is the obligation to file Form 8K to the Securities and Exchange Commission. For an empirical analysis of contracts published as a consequence of this obligation, see Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VANDERBILT L. REV. 1975 (2006).

[88] Of course, the data would have been more representative if I had been able to include statistics of other important arbitral institutions, but other institutions do not publish similar data. I contacted some of them (Stockholm Chamber of Commerce, London Court of International Arbitration), but they declined to provide similar data to me. The most likely reason is that these institutions have simply not collected it.

[89] Surveys have revealed that it is the preferred institution of the majority of parties: see, e.g., Queen Mary Westfield College survey (50%).

[90] The ICC reports that parties came from 128 countries in 2009, 120 in 2008, 126 in 2007, 125 in 2006.

seems that European parties dominate. While it would be useful to have access to the millions of international commercial contracts concluded each year, as well as the resources to analyze all of them, that will not happen any time soon, if ever. Thus, in the meantime, no one is able to offer a more accurate description of international contractual practices than the ICC. It is noteworthy that the ICC Data has remained remarkably stable over the years, which again suggests that such data is, in fact, representative.

Of course, the ICC Data only covers contracts which gave rise to a dispute. There is, therefore, a possibility that the contractual practices revealed by the ICC Data are only those of parties who will eventually seek a binding resolution to their dispute. If a given practice provides an incentive to seek external dispute resolution, it could be that it is overrepresented in the data collected by a dispute resolution center, such as the ICC. As the topic under discussion here is the contractual practice of choosing *lex mercatoria* to govern the parties' contract, one could certainly argue that choosing to apply *lex mercatoria* in an international contract might prove to be just such an incentive: A reasonable argument can be made that because the solutions offered by *lex mercatoria* are far less precise and certain than solutions offered by many national laws, such that the parties are far less able to predict how an arbitral tribunal would rule on the basis of *lex mercatoria*, making them more likely to believe they have a chance to prevail in an arbitration. With such a belief, it is much easier to opt for arbitration rather than some other form of dispute resolution. In other words, it should be kept in mind that contracts providing for the application of *lex mercatoria* might actually be overrepresented in the ICC Data.

2. The ICC Data

For purposes of this Article, I have reviewed the ICC Data published for the years 1999 through 2009. During those 11 years, 6,563 requests for arbitration were filed with the ICC Court. In compiling the ICC Data, the ICC looks at the underlying contract in each dispute. Over a period of 11 years, the ICC Data, therefore, reveals the contractual practices followed in 6,563 instances.

On the most important points, the ICC Data is remarkably consistent over the years. First, parties chose the law governing their contract in 80% of the cases. Secondly, when they made a choice, they almost always chose a national law; on average, non-national rules were chosen in only 1 to 2% of the cases. Thirdly, no single national law dominated, although both English law and Swiss law were chosen more often than other national laws (i.e., each in more than 10% of the cases).

For this discussion, the most important figure is obviously that *less than 2%* of the parties who had referred cases to the ICC Court intentionally chose non-national rules to govern their contract: More precisely, over that 11 year period, only 100 contracts reviewed by the ICC contained such clauses. Given that the ICC reviewed a total of 6,563 contracts, that translates to just 1.5% of such contracts opting to apply non-national rules. That is not much. But, there are valid reasons to believe that this tiny fraction might actually be larger than it should be. As already pointed out, such clauses arguably provide an incentive to seek external dispute resolution, such that contracts containing such a choice are statistically overrepresented in data collected by dispute resolution institutions, such as the ICC Data. In addition, parties providing for arbitration as a mode of external dispute resolution are arguably sophisticated parties, and are thus more likely to be aware that it is possible to subject their contracts to non-national rules.[91]

Furthermore, the ICC defines non-national rules to include the CISG when it is specifically chosen to govern by the parties and most notably, the CISG was chosen as the governing law in about half of those 100 cases in which "non-national rules" were deemed to have been chosen by the parties.[92] Yet, the CISG is an international convention, which is in force in over 70 states.[93] It is not a private set of rules different and autonomous from national legal systems, such that one can legitimately question whether parties specifically opting for its application are genuinely selecting a non-national law. Indeed, had they had not expressly chosen it, the CISG might well have applied anyway.[94] In other words, it can be argued that at least half of the cases that the ICC Data presents as cases in which the parties chose to apply non-national rules to their contracts do not actually qualify.

What conclusions can be drawn from the fact that commercial parties so rarely choose to apply non-national rules to their contracts? There are two possible explanations. On the one hand, one might argue that many parties are simply unaware that they can choose non-national rules as the law governing their contracts. But, such a lack of party sophistication is hard to believe. First, the contracts underlying the disputes referred to the ICC typically involve millions of dollars[95]. One can reasonably assume that lawyers were often involved in the negotiation of such high-value contracts and that those lawyers knew about the possibility of providing for the application of a non-national law. Moreover, as previously noted, , the parties were, by definition, sophisticated enough to provide for ICC arbitration in their contract. As they were aware of their ability to choose an alternative to national court litigation, it is more than likely that they also were aware of their ability to choose an alternative to national law, that is, to choose non-national rules. On the other hand, a more convincing explanation is that the parties knew that they

[91] In all fairness, one should not make assumptions about the significance of the data without trying to explain why 20% of parties remain silent on the law governing their contract. There is no way to know why they do so, however. Suffice it to say that, in the absence of a choice by the parties, Article 17 of the ICC Rules of Arbitration gives the arbitral tribunal complete discretion to apply "the rules of law which it determines to be appropriate". It is, therefore, impossible to know – in advance – which rules of decision the tribunal will ultimately apply, such that parties who do not specify an applicable law would be wrong to believe that the tribunal would *automatically* find a non-national law appropriate. It is much more likely that most of them are, consciously or not, ignoring the issue, perhaps because (1) they could not reach an agreement during contract negotiations, (2) they found the cost of seriously addressing the issue too high, or (3) they were legally unsophisticated, so failed to see the importance of the choice, and thus did not make one.

[92] I present and discuss the ICC statistics on the different choices of non-national rules below: see text accompanying notes 96-101.

[93] The CISG has been ratified by 78 states, which include all major trading nations, the United Kingdom and India being notable exceptions.

[94] Article 1-1(a) of the CISG provides that it applies automatically when the parties have their place of business in different contracting states.

[95] Cases going to ICC arbitration rarely involve less than USD 200,000 (6% in 2009, 7% in 2008, 11.3% in 2007). The value of the disputes is between USD 200,000 and 1 million in less than a fifth of the cases (16.4% in 2009, 20.7% in 2008, 18% in 2007) and between USD 1 and 30 million in half of the cases (50.5% in 2009, 47.7% in 2008, 46.7% in 2007).

could subject their contract to non-national rules, but that they consciously chose *not to do so*. Rather, if they were going to choose a governing law, they would typically choose a national law.

In its *ICC International Court of Arbitration Bulletin*, the ICC sometimes includes in the ICC Data information about the kind of non-national rules actually chosen in the few cases in which the parties chose their application. Unfortunately, the ICC gathered such information less rigorously and less consistently over the years than other portions of the ICC Data. Thus, the *ICC International Court of Arbitration Bulletin* occasionally provides anecdotal reports that non-national rules of one type or another were chosen in some contracts without giving precise figures, but in the statistics provided for other years, the same *Bulletin* gave the exact number of contracts which included a clause providing for the application of each different kind of non-national rules. Nevertheless, it is still possible to summarize the provided data as follows: Between 1999 and 2009, of the parties referring disputes to the ICC Court who had expressly chose to apply non-national rules to their contracts, the preferred choice was the CISG (often accounting for half of such choices)[96], while the other regular, but less frequent, choices included "general principles of law",[97] public international law,[98] "principles of equity",[99] the UNIDROIT Principles,[100] and the law of the European Union ('EU').[101]

In considering the reasons behind the particular choice made, it should be noted that at least some such choices might have been dictated by the particulars of the relevant contracts. For instance, the parties might have provided for the application of public international law in contracts involving a sovereign State, or they might have provided for the application of EU law in contracts falling within the scope of those rare pieces of EU legislation which have harmonized the law of particular kinds of commercial contracts in the EU.[102] As neither the underlying contracts nor the arbitral awards

[96] In 2004, 2005 and 2006, half of the contracts providing for the application of non-national rules chose the CISG. In 2008, it was the "predominant" choice of the parties. In 2003 and in 2007, however, the CISG was chosen, respectively, in only three of the eight and only one of the three contracts providing for non-national rules. In 2000, it was only chosen in two contracts, while general principles of law and international business were chosen in seven contracts.

[97] "General principles of law" were chosen in one contract in 2004. "Universally recognized principles of law" were probably chosen in one contract in 2008. "Principles of international commercial law" were chosen in two contracts in 2004, in one in 2003 and 2005, and probably in one as well in 2006 and 2008. Remarkably, in 2000, it seems that "General principles of law and of international business law" were by far the preferred choice of the parties: seven out of nine contracts.

[98] Public international law was chosen in one contract in 2003 and 2005, and probably in one contract as well in 2001, 2006, 2008 and 2009.

[99] Principles of equity were chosen in a few contracts in 2001, 2002, 2003 and 2006, and probably in one contract in 2005 and 2009.

[100] The UNIDROIT Principles were chosen in one contract in 2002, and in a few contracts in 2007, 2008 and 2009.

[101] European legislation was directly chosen in one contract in 2003, and in a few contracts in 2008 and 2009.

[102] Commercial agency, for instance, has been harmonized by the EEC Directive of 18 December 1986 on the Coordination of the Laws of the Member States Relating to Self Employed Commercial Agents (86/653/EEC). In ICC award no 9032 (ICC INTERNATIONAL COURT OF ARBITRATION BULLETIN 123 (2001)), the parties to a distributorship agreement, which were both Europe based, had provided for the application of this directive.

eventually rendered in connection with the dispute are made publicly available, however, it is impossible to confirm whether that it is generally the case.

The ICC Data is, nevertheless, interesting insofar as it shows that parties are ready to provide for the application of non-national norms which are very different in character.

The set of non-national rules most often chosen is the CISG, which is significantly different from many of the other non-national norms chosen in two crucial respects. First, the CISG can be fairly presented as *the* international law of sales of goods: It is a rare example of a successful attempt to unify the commercial laws of most trading powers in one given field, the sale of goods. That means that when parties negotiate an international sale contract, subjecting it to international commercial law is a realistic option. Secondly, it makes sense to choose the CISG because it offers a reasonably detailed set of rules addressing most issues that can arise out of the performance of an international sale contract. The CISG is as detailed as many national laws governing the sale of goods, such that it should, offer comparable legal certainty to each of the contract parties.

In sharp contrast, many of the other non-national norms chosen by the parties are, at best, imprecise and, at worst, practically unidentifiable. Parties often characterize such norms as ‘principles’ rather than ‘rules’. When parties refer to the ‘principles of equity’, for instance, it seems clear that they accept that their contract is not governed by any precise rule at all.[103] In the context of international commercial arbitration, principles of equity are typically understood to refer to the arbitrators’ personal sense of right and wrong; such principles depend on their personal preferences and background. By definition, therefore, such principles cannot be identified in advance. Similarly, a reference to ‘general principles of law’, or ‘international business law, are hardly easier to identify: They are typically understood to be principles common to the laws of most countries or, at the very least, major countries.[104] If such common principles actually exist, which is far from certain, they are not easily identified. Particular contract law rules can sometimes be dramatically different from one jurisdiction to another and from one legal system to another, and such differences legitimately cast doubts on the existence of any common principle from which they could all derive. In any case, whether such principles exist or not, there is no authoritative list of them,[105] and the process of identifying them is a major comparative law effort. Indeed, when scholars undertook the task of preparing restatements of international contract law, under the aegis of UNIDROIT for instance,[106] it took them years to do so. In other words, before such international restatements existed and while their existence remained relatively obscure, , parties providing for the application of “general principles of law” could not, and clearly did not, have any detailed set of principles in mind, much less actual rules. Now that such restatements exist, parties seeking legal certainty should specifically choose the application of a given

[103] Indeed, the word equity has been defined as “the body of principles constituting what is fair and right.” BLACK’S LAW DICTIONARY, 8th edn (West 2004), at 579.

[104] See, e.g., Emmanuel Gaillard, *La distinction des principes généraux du droit et des usages du commerce international*, in ETUDES OFFERTES A PIERRE BELLET 204 (1991).

[105] There is, however, one unofficial collection of them (KLAUS PETER BERGER, *supra* note 44), which may prove influential in the future.

[106] See text accompanying notes 46 to 48.

international restatement.[107] Otherwise, if parties continue to refer to some kind of general principles in their contracts, it is clear evidence that legal certainty was not their major (or even minor) concern.

For purposes of this Article, the ICC Data teaches a very important lesson: commercial parties rarely choose to subject their contracts to *lex mercatoria*: it is chosen, most generously, in less than 2% of cases, and more accurately, in less than 1% (when international sales contracts in which parties subject their contracts to a specific international treaty are excluded). It seems clear, therefore, that commercial parties remain unconvinced that they actually benefit from application of *lex mercatoria*. Given the vagueness of most of its rules and its lack of comprehensiveness,[108] their skepticism is hardly surprising.

III – DRAHOZAL'S SIGNALING THEORY OF *LEX MERCATORIA*

Although its proponents have argued for fifty years that *lex mercatoria* is beneficial for commercial parties, available data suggests that the latter have voted with their feet and that there is still a long way to go before they are convinced. As long as the content of *lex mercatoria* remains so vague and/or complex to determine, it is hard to see how it can become more appealing to its alleged beneficiaries.

The logical consequence of international business people's lack of interest should have been to limit discussions and debate on *lex mercatoria* to academic circles. One can easily see why the proposition of a transnational law autonomous from national legal systems would attract a lot of attention from legal theorists. It has[109] and that should not come as a big surprise to anyone.

What is surprising, however, is the interest *lex mercatoria* has generated outside of academia. Many legal practitioners have also engaged in the debate, and some have argued strongly in favor of *lex mercatoria*. Arbitral institutions have also taken clear stands, some going as far as encouraging parties not to provide for domestic law in their contracts.[110] Finally, some national courts have agreed to enforce arbitral awards applying *lex mercatoria*, sometimes in cases where parties had not expressly empowered arbitrators to apply it. All of this activity and interest raises the question of whether the favor bestowed upon *lex mercatoria* by non-party actors in the arbitral process can best be explained by the fact that they benefit more clearly from *lex mercatoria* than commercial parties do.

In his article empirically studying the use of *lex mercatoria* by commercial parties,[111] Christopher R. Drahozal argued that the explanation for practitioners' continuing interest

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[107] Choice of law clauses providing for the application of UNIDROIT Principles are slowly increasing: see *supra* note 100.
[108] *Supra*, text accompanying notes 67-70.
[109] The literature on *lex mercatoria* and the development of transnational law is enormous. It is now also taking a pluridisciplinary turn: see, e.g., BEYOND THE STATE – RETHINKING PRIVATE LAW (Nils Jansen and Ralf Michaels eds., 2008); GRALF-PETER CALLIESS, ROUGH CONSENSUS AND RUNNING CODE – A THEORY OF TRANSNATIONAL PRIVATE LAW (2010).
[110] See below, Part V.
[111] Christopher R. Drahozal, *supra* note 4.

therein can be found in the market for international arbitration services.[112] He suggested that people willing to be appointed as arbitrators need to signal their quality as such to those who might appoint them. As arbitral proceedings, and the resulting arbitral awards, are typically confidential, Drahozal concluded that publishing articles on international arbitration issues was one of the few ways for prospective arbitrators to signal their quality to potential clients. He further argued that those prospective arbitrators understand very well that they would be better perceived by the market if they demonstrate their legal internationalism (i.e., their understanding of the diversity of different legal traditions).[113] Publicly participating in the debate on *lex mercatoria* might well be persuasive evidence of such legal internationalism; even though international commercial actors might not want their arbitrators to actually decide their particular dispute pursuant to *lex mercatoria*, those same parties might believe that a good international arbitrator should, at a minimum, understand the major differences between legal traditions and the available rules of decision. For them, an arbitrator should be a genuinely "international" – or "transnational" – lawyer.

I agree with Drahozal that many, if not most, publications on international arbitration can be explained by the author's desire to signal their availability as either a prospective arbitrator or a prospective counsel in arbitration proceedings[114]. I also agree with his proposition that *lex mercatoria* is a good topic on which to write for such purposes. Yet, the reason why it is such a good topic seems to be that it is (a) fashionable in arbitration circles, and (b) perceived as being beneficial to the development of international arbitration. That newcomers would grab on to a topic which is both fashionable and perceived as going with the tide should not startle anyone:[115] In most, if not all groups, junior members of the community are subject to cascade effects.[116] But, it cannot explain how *lex mercatoria* became fashionable in the first place.

More importantly, Drahozal only tries to explain why people have continued to *write* on *lex mercatoria*. Yet, although commercial actors themselves remain cool to it, , *lex mercatoria* exists outside of books and articles: It is regularly used by arbitrators to decide commercial disputes, most interestingly in cases in which the commercial parties did not provide for its application.

IV – AN AGENCY THEORY OF *LEX MERCATORIA*

Aside from the parties, the most important actors in the arbitral process are certainly the arbitrators. Most of the original writers who advocated in favor of *lex mercatoria* were leading international arbitrators, and there is no doubt that the concept owes much to them, as they were the driving force behind its development. Interestingly, most of those

[112] Id., at 550.
[113] Id.
[114] BRUNO OPPETIT, THEORIE DE L'ARBITRAGE 10 (1998) ; Pierre Lalive, *Sur une « commercialisation » de l'arbitrage international*, in LIBER AMICORUM CLAUDE REYMOND : AUTOUR DE L'ARBITRAGE 167, 171 (2004).
[115] YVES DEZALAY & BRIAN G. GARTH, DEALING IN VIRTUE – INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER 90 (1996)
[116] See, e.g., in the context of academic circles, Cass R. Sunstein, *On Academic Fads and Fashions*, 99 MICH. L.R. 1251 (2001).

distinguished jurists were law professors as well as leading practitioners. Thus, it could be that their interest in *lex mercatoria* was only academic, such that they wrote on the topic – and promoted the concept –out of an intellectual fascination with what they saw as an emerging autonomous transnational legal order. Yet, this paper queries whether, as international arbitrators, they did not hope for more tangible benefits, apart from engaging in an interesting intellectual debate.

In a study published in 1996,[117] Yves Dezalay and Bryant G. Garth argued that *lex mercatoria* was invented in the 1960s by a handful of European continental arbitrators to give them total discretion in deciding disputes between western petroleum corporations and newly independent third world countries and to eventually advance the interests of oil companies. These cases were not common commercial disputes, as they involved States. The issue of the applicable law was, therefore, a delicate one, as States are generally reluctant to be subjected to the law of another sovereign, and newly independent States would be even less willing to agree to the application of the law of its former colonial power. By providing for the application of "general principles of international commerce", Dezalay and Garth posited that such young States were able to avoid losing face, while the arbitrators were given complete discretion to decide the dispute however they wanted.[118] For the authors, such discretion was used to favor western corporations.[119] Dezalay and Garth concluded, however, that those States eventually became critical of the consequences of allowing arbitrators to rule under *lex mercatoria*, such that the doctrine has gradually lost practical significance.[120]

A different story, however, is that *lex mercatoria* remains popular with -- and still has many advocates among – leading arbitration practitioners. Anecdotal evidence suggests that *lex mercatoria* remains appealing to a number of international arbitrators, whom have expressed their inclination to use it in cases in which the parties did not even provide for its application.[121] Some arbitration laws[122] and many arbitration rules[123] empower international arbitrators to decide disputes pursuant to non-national rules in cases where the parties have not specified the applicable law.[124] Thus, when the

[117] YVES DEZALAY & BRIAN G. GARTH, *supra* note 115.
[118] Id.
[119] Id. at 87: "this rather vague formula appeared to them sufficient to preserve the interest of their clients and to assure them a margin of maneuver in case of conflict".
[120] YVES DEZALAY & BRIAN G. GARTH, *supra* note 115, at 91.
[121] See Emmanuel Gaillard, *Thirty Years of Lex Mercatoria*, *supra* note 49, at 221; JULIAN LEW, LOUKAS MISTELIS AND STEFAN KRÖLL, COMPARATIVE INTERNATIONAL COMMERCIAL ARBITRATION, no 18-4 (2003). See also YVES DERAINS AND ERIC A. SCHWARTZ, GUIDE TO THE ICC RULES OF ARBITRATION 235 (2005), stating that references by arbitrators to *Lex Mercatoria* has been increasing.
[122] See, e.g., French Code of Civil Procedure, Article 1511; Dutch Code of Civil Procedure, Article 1054; Swiss Law of Private International Law, Article 187.
[123] See, e.g., 2011 International Chamber of Commerce Arbitration Rules, Article 17; 2009 American Arbitration Association International Arbitration Rules, Article 28; 2010 Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, Article 2. See also Swiss Rules of International Arbitration, Article 33.
[124] Instead of requiring the arbitral tribunal to decide the dispute according to "the conflict of laws rules which it considers applicable", such laws and rules merely provide that tribunals may apply any "rules of law" that they deem applicable. This difference of language is unanimously understood as allowing them to choose *lex mercatoria*: see, e.g., EMMANUEL GAILLARD AND JOHN SAVAGE (EDS), FOUCHARD GAILLARD

arbitration is governed by such arbitration law and/or rules, arbitrators may decide that the law applicable to the merits of the dispute will be *lex mercatoria*. While it is very difficult to conduct empirical research on the practices of international arbitrators,[125] anonymous extracts of arbitral awards are regularly published for scholarly purposes, or mentioned in publications by practitioners. This anecdotal evidence shows that international arbitrators have applied non-national rules to decide the merits of disputes in a significant number of cases where parties have not pre-selected the applicable law. In that regard, I identified[126] 53 such awards rendered in the last 50 years. Interestingly, , the vast majority of them (47 out of 53), and virtually all such awards rendered over the last 30 years, were delivered under the auspices of the ICC,[127] which may be evidence either

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GOLDMAN ON INTERNATIONAL COMMERCIAL ARBITRATION no 1444 (1999); JULIAN LEW, LOUKAS MISTELIS AND STEFAN KRÖLL, *supra* note 121, at no 18-44.

[125] As already underscored (*supra*, Part II, B), conducting empirical studies in the field of international arbitration is particularly difficult, because arbitration proceedings are typically confidential and decentralized. I have argued that the statistical reports published by the ICC are the only exception (*supra*, Part II, B). Unfortunately, the ICC only reports about the positive choices made by the parties when drafting their contracts. It does not report about the decisions of arbitrators with respect to choice of law where the parties have not provided for the applicable law.

[126] I am grateful to Ms Iuliana Iancu for her assistance in this matter.

[127] The 47 arbitral awards in which an ICC arbitral tribunal decided to apply non-national law in the absence of a choice of the parties on applicable law were rendered over a period of 50 years.
ICC Awards made in the 1960s (3): Award in ICC case 1434, 103 JOURNAL DU DROIT INTERNATIONAL 982 (1976); Award in ICC case 1634, 100 JOURNAL DU DROIT INTERNATIONAL _ (1973); Award of 1969 in ICC case 1641(unpublished), cited by Horacio Grigera Naón, *Choice-of-Law Problems in International Commercial Arbitration*, 289 RECUEIL DES COURS 9, 283 (2001).
ICC Awards made in the 1970s (8): Award of 1970 in ICC case 1569 (unpublished), cited by FABRIZIO MARRELLA, LA NUOVA *LEX MERCATORIA*. PRINCIPI UNIDROIT ED USI DEI CONTRATTI DEL COMMERCIO INTERNAZIONALE 340 (2003); Award of 1973 in ICC case 1859 (unpublished), cited FABRIZIO MARRELLA, id., at 333; Award of 1972 in ICC case 2103, III Y.B. COMM. ARB. _ (1978); Award of 1975 in ICC case 2291, 103 JOURNAL DU DROIT INTERNATIONAL 989 (1976); Award of 1975 in ICC case 2375, in S. JARVIN and Y. DERAINS (eds.), COLLECTION OF ICC ARBITRAL AWARDS (1974-1985) 257 (1990) [hereinafter I COLLECTION]; *Pabalk Ticaret Limited Sirketi v. Norsolor S.A.*, Award of 1979 in ICC case 3131, I COLLECTION 122; Award in ICC case 3267, 107 JOURNAL DU DROIT INTERNATIONAL _ (1980); Award in ICC case 3344, 109 JOURNAL DU DROIT INTERNATIONAL _ (1982).
ICC Awards made in the 1980s (8): Award of 1980 in ICC case 3540 (unpublished), cited by Horacio Grigera Naón, id., at 245; *Deutsche Schachtbau und TiefbohrgesellschaftmbH (DST) et al. v. The Government of the State of R'as Al Khaimah and The R'as Al Khaimah Oil Company (Rakoil)*, Award of 1982 in ICC case 3572, in Y. DERAINS and J.-J. ARNALDEZ (eds.), COLLECTION OF ICC ARBITRAL AWARDS (1986-1990) 1154 (1994) [hereinafter II COLLECTION]; Award of 1986 in ICC case 4840, II COLLECTION 465; Award of 1988 in ICC case 5466 (unpublished), cited by Horacio Grigera Naón, id., at 234; Award of 1988 in ICC case 5587 (unpublished), cited by Horacio Grigera Naón, id., at 235; *Primary Coal inc. (U.S.A.) v. Compañia Valenciana de Cementos Portland*, Partial Award of 1988 in ICC case 5953, REVUE DE L'ARBITRAGE 701 (1990); Award of 1989 in ICC case 5881 (unpublished), cited by Horacio Grigera Naón, id., at 235; Award of 1989 in ICC case 5713, II COLLECTION 223.
ICC Awards made in the 1990s (20): Award of 1991 in ICC case 6786 (unpublished), cited by Horacio Grigera Naón, id., at 294; Award of 1992 in ICC case 5030, J.-J. ARNALDEZ, Y. DERAINS and D. HASCHER (eds.), COLLECTION OF ICC ARBITRAL AWARDS (1991-1995) 475 (1997) [hereinafter III COLLECTION]; Award of 1994 in ICC case 7331, 122 JOURNAL DU DROIT INTERNATIONAL 1001 (1995); Award of 1995 in ICC case 7110, 10 ICC INTERNATIONAL COURT OF ARBITRATION BULLETIN 40 (1999); Award of 1995 in ICC case 8128, 123 JOURNAL DU DROIT INTERNATIONAL 1024 (1996); Award of 1996 in ICC case 8655, (unpublished), cited by Horacio Grigera Naón, id., at 242; Award of 1996 in ICC case 7077 (unpublished), cited by Horacio Grigera Naón, id., at 283; Partial Award of 1996 in ICC case 7375 (unpublished), cited by Horacio Grigera Naón, id., at 290; Second Partial Award of 1996 and Third Partial Award of 1998 in ICC

demonstrating the ICC's central role in developing *lex mercatoria*, or simply that ICC awards are more widely publicized than others.

The fact that any national arbitration laws or other arbitration rules authorize arbitrators to apply non-national rules in cases in which the parties have not pre-selected an applicable law is very telling. The current norm in international commercial arbitration is to direct arbitrators to apply a national law when the parties did not include a choice of law clause in their contract; in that regard, the influential 1985 UNCITRAL Model Law on International Commercial Arbitration, for example, instructs arbitrators to apply a choice of law rule to determine the applicable law in such circumstances,[128] implicitly forcing them to apply a national law. Likewise, virtually all arbitration laws and rules in the world expressly forbid arbitrators from deciding *ex aequo et bono* in the absence of a clear choice by the parties empowering them to do so.[129] Yet, notwithstanding that norm, a few national lawmakers,[130] and numerous arbitration institutions[131] have adopted a very liberal rule allowing arbitrators to apply non-national rules even in cases where parties have otherwise remained silent. It is hard to believe that this result could have been achieved without a strong lobbying effort by influential actors in the arbitral community. As one would expect, the first such liberal rules were successfully adopted in arbitration institutions, which are dominated by arbitration practitioners. One can only assume that similar lobbying efforts may have induced other departments of the same institutions to incorporate into their model contract clauses providing for the application of non-national rules.[132]

It seems clear that at least some actors in the arbitral process have professional, rather than academic, incentives to support *lex mercatoria* as an alternative to national law and to encourage its application in arbitral proceedings. Below, I first explore what those

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case 7472 (unpublished), cited by Horacio Grigera Naón, id., at 239; Award in ICC case 8501, J.-J. ARNALDEZ, Y. DERAINS and D. HASCHER (eds.), COLLECTION OF ICC ARBITRAL AWARDS 2001-2007 528 (2009); Award of 1996 in ICC case 8502, 10(2) ICC Bulletin 72 (1999); Award of 1996 in ICC case 8503 () at 419; Award of 1997 in ICC case 7304 (unpublished), cited by Horacio Grigera Naón, id., at 285; Award of 1997 in ICC case 8817, *Agent (Spain) v Principal (Denmark)*, XXV Y.B. COMM. ARB. 355 (2000); Award of 1998 in ICC case 9427 (unpublished), cited by Horacio Grigera Naón, id., at 286; Award of 1998 in ICC case 9117 (unpublished), cited FABRIZIO MARRELLA, id., at 457; Award of 1998 in ICC case 9419, 10 ICC INTERNATIONAL COURT OF ARBITRATION BULLETIN 107 (1999); Award of 1999 in ICC case 9479, 12 ICC INTERNATIONAL COURT OF ARBITRATION BULLETIN 71 (2001); Award of 1999 in ICC case 9455 (unpublished), cited FABRIZIO MARRELLA, id., at 350; Award of 1999 in ICC case 9875 (unpublished), cited by Horacio Grigera Naón, id., at 237.
ICC Awards made in the 2000s (8): Interim Award on Preliminary Issues of 2001 in ICC case 11061 (unpublished), cited by Horacio Grigera Naón, id., at 266; partial Award of 2001 in ICC case 9914 (unpublished), cited by Horacio Grigera Naón, id., at 237; Award of 2001 in ICC case 10422 (unpublished), cited by Horacio Grigera Naón, id., at 235; Award of 2001 in ICC case 10076 (unpublished), cited by Horacio Grigera Naón, id., at 242; Award of 2002 in ICC case 11018, Award of 2003 in ICC case 11265, Award of 2004 in ICC case 13012; Award in ICC Case 13129, XXXIV Y.B. COMM. ARB. 230 (2009).

[128] 1985 UNCITRAL Model Law on International Commercial Arbitration, Article 28.

[129] See, e.g., JULIAN LEW, LOUKAS MISTELIS AND STEFAN KRÖLL, *supra* note 121, at 469, stating that "Almost all the laws and rules which contain such authority are in similar terms."

[130] *Supra* note 122.

[131] *Supra* note 123.

[132] See below Part V.

incentives might be for arbitrators and then consider whether an agency conflict arises out of the relationship of those incentivized arbitral actors to the parties to the dispute.

A) Assessing Incentives of International Arbitrators

A useful starting point for assessing the potential benefits of *lex mercatoria* for arbitrators is to ask how they would have performed their task if it did not exist. The answer is quite simple: they would have had to first determine the applicable national law, and then apply it. The critical question is, therefore, whether arbitrators would be worse off if obligated to determine and apply national law instead of permitted to directly apply *lex mercatoria*. It seems rather obvious that, at least in a few areas, they are worse off.

1. *Lex Mercatoria* Gives Increased Discretion

As already discussed, a first major difference between the national laws of developed nations and *lex mercatoria* is that those national laws are typically much more detailed than the general principles of *lex mercatoria*. In most instances, national law will offer a precise rule of decision for the dispute. Thus, the decision maker (be it a judge or an arbitrator) will have limited discretion in the ultimate resolution of the dispute. In sharp contrast, arbitrators deciding disputes pursuant to *lex mercatoria* are only constrained by vague principles and indeterminate sources: They have virtually unlimited discretion to resolve the dispute however they see fit.[133] Indeed, some well known practitioners have argued that arbitrators ruling *ex aequo et bono* or pursuant to *lex mercatoria* use similar (if not identical) decision-making techniques.[134] Recall that Dezalay and Garth already argued that, in the 1960s, *lex mercatoria* was invented by arbitrators in order to legitimize resolving disputes in favor of western oil companies in disputes arising from State contracts.[135] *Lex mercatoria*'s use in commercial arbitration gives the same virtually boundless discretion to the arbitrators. While there is no evidence that current international commercial arbitrators have any special agendas or wish to favor certain classes of litigants, they might welcome broad discretion for other reasons.

Being appointed an arbitrator is a prestigious, and remunerative, activity. Candidates are bountiful, and to distinguish themselves from the pack, some aggressively market themselves by, for example, writing for specialized journals and actively participating in topical conferences.[136] If they succeed in being appointed to a tribunal, they will naturally want to be appointed to other tribunals.[137] Some successful international jurists may

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[133] See Pierre Mayer, *The UNIDROIT Principles in Contemporary Contract Practice, in* ICC BULLETIN—SPECIAL SUPPLEMENT: UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS—REFLECTIONS ON THEIR USE IN INTERNATIONAL ARBITRATION 111 (2002); NIGEL BLACKABY, CONSTANTINE PARTASIDES, ALAN REDFERN AND MARTIN H. HUNTER, REDFERN AND HUNTER ON INTERNATIONAL ARBITRATION 219, no 3-179 (2009).
[134] See, e.g., Bernado M. Cremades and Steven L. Plehn, *supra* note 57, at 332; Michael Pryles, *supra* note 37, at 321.
[135] *Supra*, text accompanying note 119.
[136] BRUNO OPPETIT, *supra* note 114, at 10; Pierre Lalive, *supra* note 114, at 171.
[137] While it seems clear that arbitrators wish to be appointed in other arbitrations, the actual reason may vary a great deal. For some, it will be the prospect of receiving additional fees. However, specialists of international arbitration also act as counsel, which typically attracts more fees (see Jan Paulsson, *Ethics, Elitism, Eligibility*, 14:4 J. INT'L ARB. 13 (1997)). Their incentive seems to be to maintain or to enhance their reputation.

eventually decide to become full time arbitrators and, as such, are eager to receive new appointments. Hence, arbitrators (unlike national court judges obligated take any case that come their way) have a clear incentive to satisfy the actors who appoint them. Most arbitrators are appointed by one party, who is most likely simply following the advice of his lawyers. While virtually all arbitration regimes specifically impose a duty of impartiality on the appointed arbitrators[138], every individual arbitrator nevertheless has an obvious incentive to do his best to meet whatever expectations the party who appointed him (and that party's lawyers) might have. For that reason alone, no arbitral tribunal could ever be composed of members appointed by just one party. Thus, international arbitral tribunals are typically composed of two appointed arbitrators (in a typical two-party dispute, one appointed by each of the disputants) and a president who is not appointed by either party. The presence of that third impartial arbitrator normally makes it difficult for a party-appointed arbitrator to be overly zealous in promoting the interests of the party who appointed him.[139]

The president of the tribunal, however, is not immune to the same professional incentive to ensure his continuing appointment to tribunals. He will likely be an experienced arbitrator who has been a party-appointed arbitrator many times. All members of the tribunal, therefore, may share a common-if-unspoken understanding that no party should be absolutely dissatisfied with the arbitral outcome, so that no party-appointed arbitrator could be accused of inadequately defending the interests of the party who appointed him. As a consequence, all of the arbitrators involved might be willing to reach outcomes that are satisfactory to both parties. To ensure the arbitrators' ability to reach such mutually-satisfactory outcomes, the vaguer and less constraining the applicable rules of decision are, the better it is. The ability to apply *lex mercatoria* fills the bill nicely.

2. Avoiding "Foreign" Law

Another important reason why arbitrators may welcome the broad discretion provided by *lex mercatoria* is that the alternative might require them to apply the precise rules of an unfamiliar national law. The vast majority of international commercial arbitral tribunals are composed of arbitrators who are not specialists in the applicable national law, and who are often not even trained in that particular law. At the outset it should be remembered that, unless the underlying agreement to arbitrate so requires the arbitrators need not be lawyers. They may be technical experts, for example, engineers in construction disputes. More importantly, international commercial arbitration has been so successful because it offers neutral dispute resolution.[140] Sophisticated parties prefer, all

[138] See, e.g., English *Arbitration Act* 1996, s. 33; UNCITRAL Model Law on International Commercial Arbitration, art. 11-12 (1985).

[139] See, e.g., ANDREAS F. LOWENFELD, LOWENFELD ON INTERNATIONAL ARBITRATION, COLLECTED ESSAYS OVER THREE DECADES 101 (2005).

[140] See, e.g., W. MICHAEL REISMAN, W. LAURENCE CRAIG, WILLIAM PARK & JAN PAULSSON, INTERNATIONAL COMMERCIAL ARBITRATION lxxvii (1997); ANDREAS F. LOWENFELD, *supra* note 139, at 1; Pierre Lalive, *On the Neutrality of the Arbitrator and the Place of the Arbitration*, in SWISS ESSAYS ON INTERNATIONAL ARBITRATION, 28 (1984).
See also the survey conducted by Mr Bürhing-Uhle between November 1991 and June 1992 which revealed that forum neutrality was considered one of the two most significant advantages of international arbitration, together with higher prospects of enforcement internationally (See CHRISTIAN BÜRHING-UHLE, ARBITRATION AND MEDIATION IN INTERNATIONAL BUSINESS 109 (2nd ed., 2006).

things being equal, to have the home court advantage – that is to say, they prefer to litigate any dispute arising from such contracts in their home courts under their own national law. Assuming both parties are equally sophisticated, neither will risk giving the other such an advantage. , Because failing to address the issue in the contract could very well result in one party grabbing the home court advantage at the first hint of a dispute, by being the first to file suit, the parties have little choice but to address it during the contract negotiations; in that regard, they have few options other than a resort to binding arbitration.[141]

The neutrality of international arbitral tribunals, of course, is not a given; that will depend on the composition of the tribunal. For that reason, most tribunals are typically composed of jurists of different nationalities and expertise, with parties typically appointing a member of the tribunal who shares their nationality. The nationality of the president of the tribunal, typically chosen by party agreement or by the two party-appointed arbitrators, will most often be different from that of the parties and the party-appointed arbitrators, in order to preserve the neutrality of the tribunal.[142] The result is that most international arbitral tribunals are composed of three arbitrators of three different nationalities and, if they are lawyers, typically trained in three different national laws. In the best case scenario, one tribunal member will be familiar with the applicable national law, but in the worst case, none will be.

In any case, many (if not most) international arbitration practitioners argue that training in the applicable law is not a critical factor in appointing an arbitrator;[143] rather, they argue that what matters most is choosing a reliable international dispute resolution expert.[144] Hence, most international arbitrators are appointed without regard to their familiarity with the substantive law governing the dispute. Rather, international arbitration is dominated by a number of distinguished jurists who decide disputes pursuant to a variety of national laws. For leading arbitrators, then, virtually every dispute involves a need to understand the complexities of a foreign law (i.e. a law in which they were never trained and never practiced).[145] With that recurring burden in mind, it is quite clear, that if all such disputes were governed by a unique body of transnational rules, an arbitrator's life would be much easier: It would, obviously, save them the trouble of ascertaining the intricacies of an unfamiliar national law.[146] But, it would also allow them

[141] Some go as far as arguing that it is their only option, and that, for that reason, arbitration actually enjoys a *de facto* monopoly over international commercial disputes: see Jan Paulsson, *International Arbitration is not Arbitration,* STOCKHOLM INT. ARB. R. 1, 2 (2008).
[142] NIGEL BLACKABY, CONSTANTINE PARTASIDES, ALAN REDFERN AND MARTIN H. HUNTER, *supra* note 133, at 260, no 4-60 (2009); Nathalie Voser and Pascale Gola, *in* GABRIELLE KAUFMANN-KOHLER AND BLAISE STUCKI (eds.), INTERNATIONAL ARBITRATION IN SWITZERLAND: A HANDBOOK FOR PRACTITIONERS 37 (2004).
[143] Challenges of arbitrators on the ground that they were not knowledgeable in the applicable substantive law have typically been rejected: see e.g. YVES DERAINS AND ERIC A. SCHWARTZ, *supra* note 121, at 160.
[144] NIGEL BLACKABY, CONSTANTINE PARTASIDES, ALAN REDFERN AND MARTIN H. HUNTER, *supra* note 133, at 262, no 4-65; Nathalie Voser and Pascale Gola, *The Arbitral Tribunal*, *supra* note 142, at 37.
[145] JULIAN LEW, LOUKAS MISTELIS AND STEFAN KRÖLL, *supra* note 121, at no 18-2. Fabrizio la Spada, *The Law Governing the Merits of the Dispute and Awards ex Aequo et Bono***,** *in* GABRIELLE KAUFMANN-KOHLER AND BLAISE STUCKI (eds.), INTERNATIONAL ARBITRATION IN SWITZERLAND: A HANDBOOK FOR PRACTITIONERS, 131 (2004).
[146] JEAN-FRANCOIS POUDRET AND SEBASTIEN BESSON, *supra* note 67, at no 704.

to avoid problems which might arise if one member of the tribunal is well versed in the applicable law and could, therefore, be accused of using his knowledge to the advantage of a particular party.[147] In such cases, rather than introducing an imbalance in the tribunal, all three arbitrators may prefer to agree to apply transnational rules thereby putting them all on an equal footing.[148]

3. Enhancing Legitimacy

Ascertaining the intricacies of a foreign national law, and properly applying it, does more than just significantly complicate the international tribunal's task. It also puts at risk its legitimacy, in particular in the eyes of other actors in the arbitral process who might be specialists in the applicable law. Imagine an arbitral tribunal composed of French, Swiss and English arbitrators. If the applicable law is English law, the parties may each hire English law firms to represent them, and add English barristers for the advocacy work. What would be the legitimacy of an award, and of the tribunal who made it, if it failed to grasp the complexities of the relevant English precedents, neglected to take the factual background of the applicable authorities seriously, or otherwise over generalized their meaning?[149] The parties' English lawyers would certainly not be impressed, and although the winner's lawyer may accept that such errors are a natural consequence of using neutral international dispute resolution, the loser's lawyer may well question the professional competence of those highly regarded arbitrators, and maybe question the appropriateness of choosing arbitration in the first place. Further, if an opportunity to resist enforcement of the award arises, he is much more likely to advise his clients to make the best use of it, perhaps damaging the reputation of the individual arbitrators as well as the arbitral process, itself.

Those risks would evaporate if the arbitral tribunal could instead apply vague (and otherwise poorly defined) transnational rules. Although some of *lex mercatoria*'s self-appointed guardians might still disagree with the arbitral tribunal's ultimate reasoning, a tribunal's use of such transnational rules allows it (and its members) to avoid the possible embarrassment of being thought incompetent –perhaps, if the arbitral award is challenged, being publicly found incompetent – to apply complex rules of foreign law by leading specialists of the relevant legal system. One can, thus, understand why international arbitrators would be inclined to apply some international legal regime or try to denationalize applicable norms.[150] In cases where a clear choice of the parties would not prevent them from doing so,[151] that could mean ruling that *lex mercatoria* applies. But, even in cases in which the parties specified the national law applicable to their dispute, it is still be possible to use *lex mercatoria* to mitigate risks arising out of the arbitral tribunal's application thereof. Remarkably, international arbitral tribunals often

[147] Ole Lando, *Assessing the Role of the Unidroit Principles in the Harmonization of Arbitration Law*, 3 TUL. J. INT'L & COMP. L. 129, 140 (1995).
[148] For an example, see Ole Lando, Idem.
[149] As civil lawyers would not doubt be tempted to. In the civil law tradition, case law is as important a source of the law as in the common law tradition, but facts play virtually no role in defining the scope of precedents.
[150] See JULIAN LEW, LOUKAS MISTELIS AND STEFAN KRÖLL, *supra* note 121, at no 18-4, arguing that arbitrators should internationalize, or denationalize, applicable norms, and when possible prefer international conventions over national laws.
[151] And the applicable arbitration regime would allow.

justify the decision both under the applicable national law and some principle or rule of transnational law.[152] By doing so, the tribunal provides a preemptory response to any potential criticism of its skill in applying the national law by confirming the decision's appropriateness under international principles.[153] Similarly, there are examples of arbitral tribunals cumulatively applying several potentially- applicable substantive laws in order to enhance the legitimacy of their decision.[154]

International arbitrators may resort to transnational principles to avoid venturing into the unknown of foreign laws. However, knowledge of *lex mercatoria* and of transnational principles is becoming an expected competence for admission into the highest rank of international commercial arbitrators. In certain international arbitration circles, international arbitration is viewed as fundamentally different from litigation, such that arbitration should not, in any way, try to mimic domestic dispute resolution. Rather, international arbitration should be genuinely and distinctly international and, thus, separate and autonomous from national law; thus, international arbitrators should not "merely" be leading practitioners in one jurisdiction, but should have an understanding of international business and know particular rules and customs applicable in this context. They should, therefore, demonstrate that their expertise is not only national, but transnational,[155]by showcasing their awareness of different legal traditions[156] as well as their "legal internationalism".[157] As a consequence, mastery of *lex mercatoria* becomes both a defining quality for international arbitrators and a critical component of their legitimacy. From that perspective, a decision maker's lack of expertise in a particular national law is far less relevant than it would be in a national court setting, especially if the tribunal's ultimate decision can be justified under some transnational rule or principle. Moreover, this separate and autonomous vision of international arbitration effectively excludes potential competitors without the "necessary" transnational credentials.

4. Reducing Accountability

The tribunal's ability to apply vague principles instead of precise national rules does more than simply increase the arbitrators' discretion and make their lives easier; it also helps to preserve their professional reputations. National commercial law is often

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[152] See e.g., Award in ICC case No. 9651 (unpublished), cited by Horacio Grigera Naón, *supra* note 127, at 262; Interim Award in ICC Case No. 5314, XX Y.B. COMM. ARB. 35 (1995); Award of 1969 in ICC case 1675, in S. JARVIN and Y. DERAINS (eds.), COLLECTION OF ICC ARBITRAL AWARDS (1974-1985) 197 (1990) [hereinafter I COLLECTION]; Award in ICC Case No. 12112, XXXIV Y.B. COMM. ARB. 76 (2009). See as well Award in ICC Case No. 13129, XXXIV Y.B. COMM. ARB. 230 (2009) (applying international principles, but noting that English law would lead to the same result).
[153] Charalambos Pamboukis, *supra* note 68, at 657.
[154] See, e.g., Award in ICC Case No. 3540, I COLLECTION 105; Award in ICC case No. 2272, II YB COMM. ARB. 151 (1977). See also Award in ICC case No. 9651, *supra* note 152; Second Partial Award of 1996 in ICC case 7472 (unpublished), cited by Horacio Grigera Naón, *supra* note 127, at 239; Award in ICC case No. 6618 (unpublished), cited by Horacio Grigera Naón, id. at 263.
[155] ALAN REDFERN & MARTIN HUNTER, LAW & PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 207 (student ed. 2003); Christopher R. Drahozal, *supra* note 4, at 550.
[156] See, e.g., Stephen R. Bond, *The International Arbitrator: From the Perspective of the ICC International Court of Arbitration*, 12 NW. J. INT'L L. & BUS. 1, 10 (1991); ALAN REDFERN & MARTIN HUNTER, *supra* note 155, at 207; Christopher R. Drahozal, *supra* note 4, at 550.
[157] In the words of Stephen R. Bond, *supra* note 156.

complex and subtle. First identifying the correct national rules to apply, and then properly applying them, can require a relatively sophisticated understanding of the particular legal system (e.g., how it works, the potential sources of its rules, and the relative authority thereof). Arbitrators applying foreign national laws have a significantly greater chance of making mistakes than domestic adjudicators do. And, while errors of law would typically not jeopardize the validity or the enforceability of the resulting award, they would hardly be good for the arbitrators' reputations. Although the decision and, more particularly, its underlying reasoning, are not typically made public, the parties and, more importantly, their lawyers will be well aware of the arbitrators' mistakes. Those lawyers are likely to share their impressions of the arbitrators and their expertise with other members of the arbitral community when meeting at one of the many conferences organized in the field. Most importantly, they are highly unlikely to encourage others to appoint those same arbitrators when specifically asked to give their opinion in the early stages of a new case. Conversely, arbitrators applying vague principles and unclear methodologies take far fewer risks. Indeed, with almost unlimited discretion, it is extremely unlikely that the arbitral decision could be proven simply wrong. Analysts might disagree with it or its reasoning, but no one could actually establish that the arbitrators misunderstood the applicable rules or misapplied them.

B) International Arbitrators as Agents

Lex mercatoria is not just an academic debate; as previously shown, it provides international arbitrators concrete benefits. But, as also shown, commercial parties do not appear to receive equal benefits from its application. Thus, a reasonable hypothesis is that it developed, in spite of the lack of real benefits to commercial actors, because of those concrete benefits to the market for an international alternative to domestic litigation and, in particular, the international arbitrators, themselves.

Over a decade ago, Judge Frank Easterbrook in *George Watts & Son, Inc. v. Tiffany and Co.*[158], first articulated the proposition that the relationship between the parties and the arbitrators in an arbitration proceeding was one of agency; the argument has since been enthusiastically endorsed by academic writers.[159] Agency theory addresses situations in which one party (the principal) hires another (the agent), who is typically more expert that the principal, to carry out a given task. In the arbitration context, the disputing parties, being unable to resolve the dispute between themselves, hire experts in dispute resolution (the arbitrators) to resolve the dispute for them. Thus, the arbitrator-party relationship falls squarely within the agency theory.

The inevitable problem in such a relationship arises when the agent has his own interests in whether, or in what manner, the requested task is performed. An agent might contradict the wishes of his principal to pursue his own interest instead of the interests of his principal. Agency theory finds that such conflicts of interest should be resolved in favor of the principal, as it was he who hired the agent to perform the given task for and

[158] 248 F3d 577 (7th Cir 2001).
[159] Tom Ginsburg, *The Arbitrator as Agent: Why Deferential Review is not Always Pro-Arbitration*, 77 CHICAGO L. REV. 1013 (2010); Alec Stone Sweet, *Arbitration and Judicialization*, 1 OÑATI SOCIO-LEGAL SERIES (2011).

on behalf of the principal. Of course, not every agent's choice to pursue his interest results in a problem for his principal. An agent may be able to fulfill his task in variety of ways, and the choice of which one may be completely irrelevant to the principal. In that case, the principal should not care if, and indeed should expect that, his agent to choose the method that both achieves his principal's goal and best suits the agent's interests. However, an agency problem only arises if the interests of the actors are not just different, but in conflict.

The arbitrator-party relationship fits well into the agency model. The parties hire expert arbitrators to resolve their disputes. The arbitrators' mission may be completed using different methods. The parties should only be concerned about which method the arbitrators choose if the interests pursued by the arbitrators in making that selection diverge from and conflict with the parties' interests. By choosing to apply *lex mercatoria* instead of a national law to resolve the parties' dispute, arbitrators are arguably pursuing their own interests, and not those of the parties, such that the "different" component of a classic conflict of interest is present. But is there the requisite "conflict" component, as well? It is, therefore, important to assess the scope of the problem before exploring which strategies could be used to address it.

1. The Scope of the Problem

Principal-agent relationships only create agency problems when an actual conflict of interests exists between the agent and principal. I have argued that arbitrators have a variety of incentives to choose *lex mercatoria* as the applicable law in absence of the parties' choice to that effect. Some of them do not raise any issue because arbitrators can pursue those particular interests at no cost to the parties. Others, however, create a genuine conflict of interest.

Logically, the most legitimate interest any agent can pursue is to reduce the agent's cost of performance. Not only should the principal expect the agent to pursue that goal, but it might actually benefit the principal if lower agent costs result in lower fees to be paid to the agent.[160] Applying *lex mercatoria* or any other international legal regime for that matter, offers the tribunal a tremendous advantage by allowing the arbitrators to avoid first determining the applicable national law, and then establishing its relevant content, particularly if that national law is foreign to all or a majority of the members of the tribunal.[161] The tribunal's decision to apply or not apply an international legal regime is neutral for the parties.[162] Of course, if the content of *lex mercatoria* is equally, if not more complex to assess, it is not less costly for the arbitrators to resort to it. But that is also neutral for the parties as long as the choice does not impact the fees charged by the

[160] The rules of some arbitral institutions (the London Court of International Arbitration, for instance) provide that arbitrators charge the parties on an hourly basis. The most commonly used practice, however, which is also the rule in many other arbitral institutions such as the ICC, is that the fees of the arbitrators depend on the amount of the dispute, and are thus unrelated to their actual work.
[161] *Supra* text accompanying note 142.
[162] While the decision of arbitrators to use *lex mercatoria* instead of a national law to decide the dispute would typically not impact the fees charged by the arbitrators, one could easily imagine how it could impact the services of the lawyers of the parties and thus their costs.

arbitrators. And, as noted below, available international legal regimes can be easily applied at virtually no cost to the parties.

In sharp contrast, increasing his discretion (and thereby shielding him from claims of legal error) is an arbitrator interest which comes at a real cost to the parties. My assumption is, again, that commercial parties value legal certainty. They want to be able to determine with precision what their rights and obligations are under their contract. They want to know whether their contractual provisions would be enforceable under the applicable law, and which default rules would apply in the absence of an express contractual provision. As *lex mercatoria* contains virtually no mandatory rules,[163] there is very little risk that arbitral tribunals would not enforce the contract's terms. Most contracts, however, are incomplete, and unforeseen contingencies may only be resolved by applying default rules. If the arbitrators decide to apply *lex mercatoria*, it makes it virtually impossible for the parties to predict with reasonable certainty which default rule might eventually be applied. When default rules are clear, outcomes can be predicted and further dispute resolution costs seem wasteful. On the other hand, in an uncertain legal environment, each party can hope for the application of very different default rules ,such that the parties' interest in settling the dispute before the final decision is low. Thus, the choice to apply *lex mercatoria* results in higher dispute resolution costs for the parties.

I have also argued that international arbitrators may also feel that they increase their legitimacy if they decide disputes pursuant to *lex mercatoria*. The issue of the legitimacy of international arbitrators is a larger and much more important question than just its potential to generate agency conflicts of interest between arbitrators and parties. The legitimacy of international arbitrators is not only relevant to the arbitrators and the parties; rather, it is critically important to the community of international merchants and to international trade in general. Arbitration is an essential tool for resolving international commercial disputes because it, alone, offers a neutral dispute resolution forum. The parties' national courts can offer no such alternative precisely because each party fears that the other will enjoy an unfair advantage if the dispute is litigated in its home court. Therefore, the success of international arbitration should be considered an issue of general welfare because it is critical to international trade. Protecting and enhancing its legitimacy is central to its continuing success. Thus, the need for legitimacy goes far beyond simply ensuring that parties respect and comply with arbitral awards. Rather, because arbitration is contractual in nature, and requires an agreement of the parties, if the arbitrators appear to lack legitimacy, parties might well abandon arbitration in favor of a different dispute resolution process they perceive to be more legitimate.

For that reason alone, the impact the application of *lex mercatoria* has on the legitimacy of international arbitrators must be carefully assessed. I have argued that one incentive arbitrators have to apply it is to avoid having to assess and apply a national law they have not fully mastered. At first glance, one might think that arbitrators who are not specialists in the applicable national law should not try to hide that fact by choosing a different set

[163] Some arbitration scholars have submitted that there could exist a genuinely transnational public order including a few rules such as the prohibition of corruption, racial discrimination or drug trafficking (see e.g. EMMANUEL GAILLARD AND JOHN SAVAGE (Eds), *supra* note 124, at no 1535). In practical terms, however, it is virtually never used (as recognized by EMMANUEL GAILLARD AND JOHN SAVAGE (Eds), *supra* note 124, at no 1533).

of rules, or that parties should only appoint arbitrators who possess the proper skill set. But, that would be wrong. International arbitration achieves neutrality in dispute resolution by offering the parties a chance to appoint arbitrators of different nationalities and backgrounds, typically including a president who has no connection whatsoever to the parties or their dispute. That quest for neutrality excludes a resort to only those decision makers well trained in, and masters of, a particular national law. Because such neutrality is needed, any arbitrator efforts to decide disputes on the basis of an international legal regime, when otherwise appropriate, should be encouraged.

However, encouraging arbitrators to apply an inappropriate international regime may well defeat the purpose. In particular, applying non-national rules that combine virtually unlimited discretion with very limited accountability is a cocktail more likely to damage the legitimacy of international arbitrators than enhance it. While the appointment process provides a large measure of legitimacy to arbitrators, the decision-making method selected and implemented by those arbitrators is, perhaps, even more crucial to its legitimacy. Specifically, to maintain legitimacy, arbitrators cannot be perceived as acting in a vacuum, without constraints or according to personal whim; instead, their decisions must appear to be derived from the thoughtful application of established rules. Parties do not go to international arbitration to avoid the application of law; rather, they go to international arbitration because it uniquely offers neutrality of adjudication. That is the very reason why virtually all arbitration laws never allow arbitrators to decide *ex aequo et bono* without the parties' *express* grant of that specific authority. Rather, in the absence of such specific party permission, they are bound to apply rules of law. Thus, the legitimacy of arbitral tribunals depends, therefore, on a general perception that the decision was made pursuant to clear rules that different arbitrators would have also applied in the same circumstances. If parties have not specified the applicable law for resolving their dispute, and have not otherwise given the tribunal's arbitrators express authority to rule *ex aequo et bono*, allowing arbitrators to decide pursuant to *lex mercatoria* – that is, pursuant to a transnational legal regime which provides virtually the same unlimited discretion and lack of accountability without any need for express party permission – can damage the legitimacy of international arbitration as an institution and, thus, the general welfare of parties involved in international trade.

2. Strategies

Using *lex mercatoria* may appear attractive to international arbitrators for two distinct reasons: First, it is a transnational legal regime that allows them to avoid applying a national law they may not have fully mastered. Second, it incorporates many vague norms which offer little, if any, limits on the arbitrators, thereby giving them broad, if not unlimited, discretion. Thus, the very vagueness of *lex mercatoria* raises a genuine agency issue if it is applied without the parties' express consent. In contrast, the incentives of arbitrators to apply other transnational legal regimes do not raise a similar problem. Quite to the contrary, issues that arbitrators address when resorting to a transnational regime appear to be entirely legitimate and, indeed, important not only for their own welfare, but for international commerce in general.

In light of such legitimate interests, the most obvious solution to the potential agency problem – that is, an outright ban on the use of any transnational legal regime in the absence of specific party authorization – is not the most efficient. A better solution would be to ensure that, when arbitrators are called upon to decide a case in which the parties have not selected an applicable law and have not given them any special authorizations, those arbitrators are only permitted to apply transnational rules that would be sufficiently precise to limit their discretion.

Such transnational legal regimes exist as a result of the recent efforts of scholars to produce international codes of contract law.[164] Some such codes or sets of principles attempt to codify *lex mercatoria* and are based on actual customs, rules, and principles applied in international commerce. Others are scholarly projects intended to be international restatements of contract law. While they do not represent actual customs and rules observed by international merchants, they are far more coherent, exhaustive, and detailed. One excellent example of the latter is the UNIDROIT Principles, which are a coherent code of contract law affording precise and detailed rules. If arbitrators were to apply such a legal regime when the parties did not choose the applicable law,[165] they would not have to apply a national law, but their discretion would be appropriately restricted by precise rules. Several arbitral awards have applied the UNIDROIT Principles as rules of decision and some have ruled that their use makes *lex mercatoria* more precise and more foreseeable.[166]

As the foregoing discussion shows, the agency problem can be addressed by restricting, in the relevant circumstances, the arbitrators' choice to only international codes of contract law or other detailed codifications of the norms actually observed by merchants. The EU Commission made a similar proposal in 2006, though in a different context. In 2005, the European lawmaker considered reforming European choice of law rules in contractual matters; in a first draft of a new regulation, the European Commission proposed allowing EU Member States to enforce contract clauses choosing "principles and rules of the substantive law of contract recognized internationally or in the Community" as the applicable law.[167] The proposal only addressed the power of national courts to apply non-state law, not the power of arbitral tribunals to do so, which explains its modest reach: it only permitted parties to choose non-state law, but did not propose that judges have the authority to choose, *sua sponte*, the applicable law. Interestingly, even that rather modest proposal proved too innovative; the EU Member States rejected it. In the arbitration context, however, the parties' power to apply a non-state law to their dispute is already widely accepted. What remains under discussion, though, is whether arbitrators have (or should have) the right to apply non-state law in the absence of a choice by the parties. Some arbitration laws already grant arbitrators that right, while

[164] See *supra* text accompanying notes 46-48.
[165] As the parties would not have agreed on the application of any particular legal regime, the fact that the UNIDROIT Principles are not based on the norms actually observed by international merchants and thus do not correspond to the initial concept of *lex mercatoria* would be irrelevant: arbitrators would not have been instructed to apply *lex mercatoria* or any similar regime.
[166] See, e.g., ICC Case no 7110 (1995) 10 ICC COURT BULL. 39 (1999); ICC case 12040, award of 2003; ICC case 11575, award of 2003. See also YVES DERAINS and ERIC A. SCHWARTZ, *supra* note 121, at 237.
[167] Proposal for a Regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I), COM (2005) 650, Article 3**.**

many others instruct arbitrators to apply conflict of laws rules, and thus a national law.[168] My proposal would, therefore, represent a compromise, perhaps a middle ground solution.

Agency theory offers a variety of strategies to address agency problems and to protect principals. Regulatory strategies, on the one hand, dictate substantive terms governing the content of the principal-agent relationship, which tend to impose direct constraints on the agent. Governance strategies, on the other hand, facilitate the principals' control over the agent's behavior. Some strategies operate *ex ante*, by proscribing certain behavior or by facilitating principal control before an agent acts while others operate *ex post* (e.g., by reviewing an agent's acts after the fact).[169]

These strategies were developed in the context of corporate law. While the arbitrator-party relationship can be analyzed from an agency perspective, the two fundamental peculiarities related to the international arbitrator's task must be taken into consideration to assess which of them might be appropriate in that context. The first and most obvious peculiarity is that arbitrators are hired by the parties to resolve a dispute between the parties as adjudicators. As a consequence, that they are expected by the hiring parties to act independently from, and impartially with respect to, both parties to the dispute, who both happen to be their principals. As a consequence, strategies for addressing agency problems in the context of the arbitrator-party relationship cannot negatively impact the arbitrator's independent and impartial decision-making process. Obviously, that restriction excludes a resort to widely-used strategies in the corporate context, such as offering incentives to agents to behave in a certain manner or granting to principals the power to control, *ex post*, the agents' decisions.

The second peculiarity of the arbitrator's task relates to the essential reason parties choose to go to arbitration: the parties want to avoid national courts because they fear that any national court other than their own will be biased against them. As no international commercial court yet exists, international arbitration offers them a chance to limit, to the maximum extent possible, their exposure to national courts while achieving a neutral decision-making forum. In that regard, the 1958 New York Convention on the Recognition and the Enforcement of Foreign Arbitral Awards, which can be considered a cornerstone in the international arbitration process, limits the involvement of national courts in arbitration proceedings to its final, albeit critical, stage: enforcement of the arbitral awards. Consequently, to involve national courts in any strategy purporting to address the agency problems raised by the arbitrator-party relationship would be problematic, which could only be partially ameliorated if national courts applying any such strategy were only authorized to apply a mechanical rule subject to virtually no discretion.

In light of the foregoing, an appropriate strategy might be to follow a regulatory approach, adopting a rule that provides, in those cases in which parties did not specify the applicable law, that arbitrators are authorized to apply either a national law or an

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[168] See *supra* text accompanying note 128.

[169] For a useful survey, see John Armour, Henry Hansmann and Reinier Kraakman, *Agency Problems and Legal Strategies and Enforcement*, in THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda and Edward Rock, eds. 2nd edn 2009).

internationally-recognized set of rules of contract law. Arbitral awards made in contravention of that rule could be set aside by the competent national court. Such a rule would be straightforward so easily applied, and would not confer on national courts any additional opportunity to review the arbitral award on its merits.

The proposed rule, , however, raises some issues. First of all, the phrase "internationally-recognized set of rules of contract law" is imprecise; to avoid that criticism, a better solution might be to expressly specify one or more particular sets of rules that can be used (e.g., the UNIDROIT Principles or a particular international restatement). Secondly, the power of arbitrators to apply *lex mercatoria* in the absence of positive choice made the parties typically lies in arbitration rules, as most national arbitration laws instruct arbitrators faced with that situation to apply conflict of laws rules that, by definition, result in a national applicable law. To be effective, then, the proposed rule would have to be either adopted by arbitral institutions or considered a mandatory rule of the applicable arbitration law.

V – A PRODUCTION COST THEORY OF *LEX MERCATORIA*

Over the last few decades, the ICC has been remarkably active in promoting the use of *lex mercatoria* by international commercial parties. It is, of course, the home of the leading arbitral institution in the world – the ICC Court, but it also actively produces international commercial norms, particularly model contracts. Below, I show how, in each of these capacities, it has promoted the use of *lex mercatoria*, and argue that it has done so to reduce its cost to produce those model contracts.

A) The ICC's Efforts to Promote Lex Mercatoria

Most, if not all, international commercial actors have heard of the ICC's International Commercial Terms or INCOTERMS, which are widely used throughout the world in international sales of goods. But that is not the limit of the ICC's work in creating international commercial norms: one of its most important activities is to produce international model contracts. It has, for example, issued model sales contracts,[170] commercial agency contracts,[171] distributorship contracts,[172] and intermediary contracts.[173] As all such model contracts are meant to be used in an international context, the ICC could not possibly avoid addressing the issue of the applicable law therein. Remarkably, the model contracts typically include a choice of law clause that encourages the parties to choose non-national rules to govern their relationship. The most common model clause offers an option to the parties:[174] the first alternative offered, Alternative A, adopts a clause choosing, "in the following order", of: (1) "the rules and principles of law

[170] See, e.g., INTERNATIONAL CHAMBER OF COMMERCE, THE ICC MODEL INTERNATIONAL SALE CONTRACT – MANUFACTURED GOODS INTENDED FOR RESALE (1997).
[171] INTERNATIONAL CHAMBER OF COMMERCE, THE ICC MODEL COMMERCIAL AGENCY CONTRACT (2002).
[172] INTERNATIONAL CHAMBER OF COMMERCE, THE ICC MODEL DISTRIBUTORSHIP CONTRACT (2002).
[173] See, e.g., INTERNATIONAL CHAMBER OF COMMERCE, THE ICC MODEL OCCASIONAL INTERMEDIARY CONTRACT (2000).
[174] See, e.g., Article 13.1 of the General Conditions of the ICC's Model Occasional Intermediary Contract (*supra* note 173), Article 24.1.A of the ICC Model Commercial Agency Contract (*supra* note 171), Article 24.1.A of the ICC Model Distributorship Contract (*supra* note 172).

generally recognized in international trade as applicable to international contracts", (2) trade usages, and (3) the UNIDROIT Principles.[175] The second alternative, Alternative B, is a clause choosing a national law. However, the drafters warn potential users that the model contracts "were drafted under the assumption that [they] would not be governed by a specific national law (as stated in Alternative A of [the relevant article])" and they further explain that "[I]f the parties prefer nevertheless to submit their agreement to a national law (by choosing Alternative B), they should carefully check in advance if the clauses of the model form conform with the provisions of the law that they have chosen".[176] While it is true that some ICC model contracts include very different choice of law clauses (e.g., the Model International Sale Contract proposes the combined application of the CISG and of a national law for issues not settled by the CISG),[177] the ICC still encourages the parties, in its introductory remarks to such contracts, "not to choose a domestic law".[178]

Whether the ICC's efforts to promote *lex mercatoria* through its model contracts have been successful remains unclear. If so, one would think that there would be far more instances of arbitration in which the parties selected *lex mercatoria* to apply to their transaction. The fact that so few disputes referred to the ICC Court of Arbitration include choice of law clauses applying non-state rules suggests either that the model contracts are not widely used, or that parties using them typically choose Alternative B, selecting a national law to govern their transaction.[179] In any case, regardless of how successful these contracts may be, they are unequivocal evidence of the ICC's active promotion of the use of *lex mercatoria*.

That conclusion is further corroborated by some of the ICC's choices as an arbitration institution. I have already noted that it has been instrumental in advancing *lex mercatoria* as a set of rules to be applied by international arbitrators. Specifically, the ICC Rules of Arbitration allow arbitrators to apply "rules of law" both when the parties provided so and when they have remained silent on the applicable law.[180] The ICC is not unique in this respect, however, as the rules of all other international arbitral institutions give the same power to arbitral tribunals.[181] On that basis, one might assume that all major arbitral institutions are equally *lex mercatoria* friendly, but they are not. While the ICC encourages parties not to select an applicable law in advance, many other institutions encourage parties to choose the law governing their transaction, more precisely, a national law. From a practical point of view, that means that those other institutions encourage parties to include a clause that excludes the arbitrators' power to apply *lex mercatoria*.

[175] See, e.g., Article 24.1.A of the ICC Model Commercial Agency Contract (*supra* note 171), Article 24.1.A of the ICC Model Distributorship Contract (*supra* note 172).
[176] See, e.g., footnote to Article 24.1.A of the ICC Model Commercial Agency Contract (*supra* note 171) and to Article 24.1.A of the ICC Model Distributorship Contract (*supra* note 172).
[177] Article 1.2 of the General Conditions of Sale (*Supra*, note 170).
[178] Alec Stone Sweet, *supra* note 50, at 634.
[179] A third possibility could be that they are widely included in actual contracts, including Alternative A, but that disputes do not arise out of them.
[180] 2011 International Chamber of Commerce Arbitration Rules, Article 17.
[181] See, e.g., 2009 American Arbitration Association International Arbitration Rules, Article 28; 2010 Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, Article 2. See also Swiss Rules of International Arbitration, Article 33.

All arbitral institutions have a suggested standard dispute resolution clause, which, in practice, plays a critically important role. It is likely to be used by the vast majority of parties otherwise willing to provide for institutional arbitration, if only because, by using the standard clause, they exclude the risk of being held responsible for not using it if things go wrong. Of course, the point of these standard clauses is to provide for arbitration under the auspices of the relevant institution. But many standard clauses also include, in addition to the arbitration clause, a choice of law clause. And this choice of law clause virtually always encourages the parties to choose the law of a nation. The recommended clause of the London Court of International Arbitration, for instance, provides that "The governing law of the contract shall be the substantive law of [__]"[182]. Similar model clauses are also suggested by the Singapore International Arbitration Center,[183] the German Institution for Arbitration[184] or the Arbitration Institute of the Stockholm Chamber of Commerce.[185]

The ICC (like some other arbitral institutions[186]), does not include any choice of law provision in its standard arbitration clause. Given that all of its model contracts include a choice of law provision, and that most of these provisions designate non-state rules, it is hard to believe that the ICC inadvertently forgot to address such an important issue in that clause. Rather, it is much more likely a conscious choice to exclude it,[187] particularly as its arbitration rules address the power of the arbitrators when there has been no law selected by the parties. As many of its competitors include a choice of law clause that encourages the parties' advance selection of a national law, it seems obvious that the ICC's silence amounts to a rejection of that solution. The choice not to provide the applicable law in its standard arbitration clause is a way to preserve the application of *lex mercatoria* by arbitral tribunals. The only remaining question is why the ICC does not promote it more actively, as it does in its model contracts.

B) The ICC's Incentives to Promote Lex Mercatoria

Why would the ICC so actively promote the use of *lex mercatoria* instead of taking the safer, and less controversial, route of encouraging parties to submit their transactions to a national law? It could be for either of two reasons. First, advocates of *lex mercatoria* may have effectively lobbied the ICC to take an active role in its promotion: international arbitrators, who are logically very much involved in the ICC's functioning, in general, and of its arbitration services, in particular, immediately come to mind for all

[182] See http://www.lcia.org/Dispute_Resolution_Services/LCIA_Recommended_Clauses.aspx (last visited Nov. 8th, 2012)
[183] See http://www.siac.org.sg/index.php?option=com_content&view=article&id=66&Itemid=57 (last visited Nov. 8th, 2012)
[184] See http://www.dis-arb.de/en/16/rules/dis-arbitration-rules-98-id10 (last visited Nov. 8th, 2012)
[185] See http://www.chamber.se/english-14.aspx (last visited Nov. 8th, 2012)
[186] Other institutions which do not specifically encourage parties to choose the applicable law include: the American Arbitration Association (International arbitration rules), the Swiss Chambers' Court of Arbitration and Mediation, the Cairo Regional Center for International Arbitration.
[187] The ICC regularly revises its arbitration rules (most recently in 1998 and 2011), and could thus have revised its standard clause as well.

the reasons previously mentioned.[188] Alternatively, the ICC may have its own interest in promoting *lex mercatoria* as a set of rules of decision.

The ICC has a patent interest in *lex mercatoria*'s acceptance and development in its role as a norm producer. Because it is private organization, it has no lawmaking power. It cannot pretend to establish authoritative rules. Thus, if its norms are to be used, it must be either because they are considered to be representative of trade usages or because commercial parties voluntarily incorporate them into their contracts. A few norms produced by the ICC have been so successful that they have been recognized by national courts as trade usages.[189] Unfortunately, most of them never achieved that level of acceptance. Thus, the impact and success of ICC-generated norms depend not just on the willingness of private parties to incorporate them in their contracts, but also on the parties' power to do so.

The extent to which private parties are permitted to incorporate a set of norms in their contract depends on the extent to which contract law curtails their freedom of contract. Most jurisdictions do not grant the parties absolute power to incorporate norms; certain mandatory rules apply. Before one can incorporate norms in one's contract or, put differently, use a model contract, one must first verify that the proposed norms or clauses comport with those mandatory rules. Those mandatory rules, however, vary from one jurisdiction to another, meaning that, if an organization is willing to engage into the business of producing norms or model contracts to be used by any commercial party to an international transaction, that organization should first verify that its product comports with the laws of all jurisdictions of the world, (i.e., more than 200 national contract laws). Whether any organization has ever really done that remains a mystery, but it is clear that some have sought legal opinions as to the enforceability of the essential clauses of their models in a number of jurisdictions.[190] A less costly option would be to incorporate a particular national law into the model or, at a minimum, advise parties using the model to choose that particular national law, after verifying that the model contract in fact comports with the mandatory rules thereof.[191] Of course, international commercial parties originating from other jurisdictions might be reluctant to simply choose the particular law chosen by the model's drafters, especially if it happens to be the law of the other contracting party, such that the model may not be well received in the market.

From the ICC's standpoint, neither of these options is viable. One can easily understand that attempting to verify whether a particular model contract (much less all of an organization's model contracts) comports with 200 contract laws is prohibitively expensive, both in terms of time, money, and efficacy. The monetary costs alone would be enormous.[192] Moreover, there would be no way to assure that the laws of any one

[188] I discuss their incentives in the previous section.
[189] For instance, U.S. Courts have given such status to INCOTERMS (see e.g. *BP Oil Intern., Ltd. v. Empresa Estatal Petroleos De Ecuador*, 332 F.3d 333 C.A.5 (Tex.), 2003.), and French courts have ruled likewise with respect to the Uniform Rules and Customs on Documentary Credit (see, e.g., Cass. Com. 14 October 1981, case n° 80-12336).
[190] This is the case of ISDA, for instance.
[191] GAFTA, for instance, includes in its model contracts a clause providing for the application of English law. This obviously simplifies the job of verifying whether they are enforceable.
[192] See Fabio Bortolotti, *Reference to the UNIDROIT Principles in Contract Practice and Model Contracts*, ICC BULLETIN, SPECIAL SUPPLEMENT, UNIDROIT PRINCIPLES: NEW DEVELOPMENTS AND APPLICATIONS,

jurisdiction had not changed, requiring an ongoing monitoring system to maintain the organization's assurance that its model complies with all national laws. That option is simply a nonstarter.

The less costly alternative of imposing a particular national law on the model contract is equally unpalatable. As an institution based in Paris, the ICC might have been tempted to impose French law, but its limited availability in English would certainly lead many parties to pass on that choice of law and, perhaps, on the entire model contract. *Lex mercatoria,* on the other hand, has several advantages. First, being non-national in nature, it can never be the law of one of the parties; it can never be perceived as favoring one over the other. Secondly, *lex mercatoria* contains minimal (if any) mandatory rules,[193] thereby greatly simplifying the drafter's task because they do not need to verify whether their model comports with any particular contract law, let alone all potentially applicable laws. As already noted, the typical ICC model contract alerts potential users that it was drafted with the assumption that parties would provide for the application of non-national legal regime, and warns parties deciding to submit their contract to a national law to verify, for themselves, whether the model complies with the mandatory rules of the chosen law.[194]

Fabio Bortolotti, an Italian academic and arbitrator who currently chairs the ICC's policy commission responsible for drafting model contracts (Commercial Law and Practice Commission) and formerly chaired the ICC task forces that drafted model contracts on international agency, distributorship, franchising and contracts with occasional intermediaries, confirms the foregoing in various writings. In an article presenting the new ICC Model Commercial Agency Contract, Mr. Bortolotti explained why his most recent product included a choice of law clause providing for the application of non–national law.[195] He suggested that principals would typically want to use the same model contract for all their agents, irrespective of the jurisdiction concerned.[196] In that regard, subjecting the model contract to *lex mercatoria* has the unique advantage of situating it in a "free space" – an "autonomous zone" – where national laws do not apply.[197] The parties would, thus, be able to "substract themselves from the application of domestic rules, even mandatory ones".[198] The only limit would be public policy in the jurisdictions in which the arbitral award needs to be recognized: an arbitral award can always be denied recognition if it is contrary to public policy.[199]

Imposing, or strongly encouraging, the choice of *lex mercatoria* as the model contract's governing law might well have offered a solution to the problem of mandatory rules

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57 (2005): « Were the contract to be submitted to an indefinite number of domestic laws, chosen by parties in individual cases, it would be impossible to draft clauses complying with all [rules of law applicable to it] ».

[193] As already underscored, some arbitration scholars have submitted that there could exist a genuinely transnational public order, but it is virtually never used in practice: see *supra* note 163.

[194] *Supra*, text accompanying notes 174-176.

[195] Fabio Bortolotti, *Vers une nouvelle Lex Mercatoria de l'agence commerciale internationale - Le modèle de contrat d'agence de la CCI*, INT'L BUS. L.J. 685 (1995).

[196] Idem, at 688.

[197] Id.

[198] Id., at 689.

[199] Id.

contained in national contract laws. It is certainly the most pressing problem faced by drafters of international model contracts; but, it is not the only one. Contract provisions may be invalidated or otherwise held unenforceable pursuant to a variety of other national laws such as anti-trust or insolvency laws. No advocate of *lex mercatoria* has ever claimed that it could displace such regimes.[200] It is, therefore, no antidote to their application. Drafters of international model contracts must either take such regimes into account or ignore them. The ICC has certainly taken into account anti-trust law when drafting some of its model contracts. The ICC Model Distributorship Contract[201] is a good example. Although it provides for the application of *lex mercatoria*,[202] the potential application of anti-trust law has led the drafters to include options from which the parties must choose depending on whether they are concerned with the application of anti-trust law.[203] What is unclear, however, is whether the options offered by the drafters are meant to ensure that the relevant contract comport with all anti-trust laws or simply with certain ones.[204]

The ICC's decision to promote *lex mercatoria* can, therefore, be explained by its willingness to reduce its model contracts' production costs. Like every other product or service provider, the ICC would like to reduce its production costs for the various products intended for sale. As a seller of international model contracts, it is bound to incur some cost in verifying whether its models are valid and enforceable under applicable mandatory rules. One way to limit those costs is to first provide for the application of a single national law, and to then verify that its contracts comply with the mandatory rules of that particular law. Many trade associations have made precisely that choice, by applying English law to their model contracts.[205] However, the choice of one particular law might not always be acceptable to all commercial parties in a given industry. To address that issue, organizations producing model contracts might opt to incur the costs of verifying the enforceability of their contracts under only a limited number of national laws that correspond to the particular industry's leading centers.[206] But, even an expanded choice of potential national laws might not work for certain norm producers working in broad and far-reaching fields without leading centers. As it is prohibitively expensive to even attempt to verify the enforceability of such an entity's norms against the mandatory rules of hundreds of national laws, the only remaining solution is to avert the problem, by preventing the potential application of such

[200] Compare, however, Hugh Collins, *supra* note 20, who seems genuinely surprised that U.S. insolvency law could displace contractual provisions contained in the ISDA Master Agreement.
[201] *Supra* note 172.
[202] Article 24.1.A.
[203] See, e.g., Article 11 (Resale Prices), Article 12 (Sales outside the territory), Article 16 (Sole Distributorship).
[204] It is unclear, for instance, whether the options offered are meant to be compliant with both US and EU competition laws. Some US lawyers have argued that the focus was, at least for certain model contracts, only European law: see, e.g., Carl E. Zwisler, *Amended ICC Model International Franchise Contract is Problematic for Franchising*, available at http://www.franchise.org/Franchise-Industry-News-Detail.aspx?id=54643 (last visited on Nov. 8th, 2012).
[205] See, e.g., GAFTA's model contracts, *supra* note 15.
[206] This path has been followed in the finance industry. The enforceability of the ISDA Master Agreement (see text accompanying notes 16-25) was verified with respect to several national laws.

mandatory rules. The ICC chose that path, relying on the application of *lex mercatoria* to reach this goal.

The ICC's effort to promote *lex mercatoria* in its model contracts is less problematic than its unfortunate decision to allow arbitrators to declare, *sua sponte*, *lex mercatoria* applicable when the parties have not spoken, which creates genuine agency problems threatening the legitimacy of international arbitration as a whole. Model language is only binding on the parties if they choose to incorporate it in their ultimate contract, such that a suggested choice of law clause applying *lex mercatoria* to the contract, will only apply only if accepted and incorporated by the parties in their agreement. Moreover, although the ICC model contract drafters might encourage parties to do so, they still typically offer the parties the option to choose a national law. Parties choosing *lex mercatoria* in their contract, then, do so knowingly and voluntarily, such that one can reasonably presume that such parties have selected their preferred legal regime to govern it. Available data suggests, however, that *lex mercatoria* is not (and never has been) the preferred legal regime of international commercial actors. The ICC model contracts rightly notify parties using them that the *lex mercatoria* clauses will only be enforced by arbitral tribunals; Parties choosing such clauses must, therefore, also include an arbitration clause (which, in all likelihood, will specify ICC arbitration). The ICC data, however, reveals that parties to ICC arbitrations choose non-national law in only 1% of the cases.[207] Clearly, the *lex mercatoria* clauses in the ICC's model contracts do not appeal to the vast majority of commercial parties.

The question as to why those clauses are so unappealing remains to be answered: it may simply represent a distaste for the particular clauses offered in the ICC model contracts, but it may very well reflect a much more fundamental, general hostility to the application of *lex mercatoria* as a non-national legal regime in international contracts. . The most common ICC *lex mercatoria* clauses establish a trio of norm sets to be applied to the contract in the following descending order: the first norm set to be applied is "the rules and principles of law generally recognized in international trade as applicable to international contracts"; the second is to be trade usages, and the third is to be the UNIDROIT Principles, meaning that trade usages and UNIDROIT Principles are to be applied subsidiarily – that is, if, and only if, the dispute cannot otherwise be resolved by applying the first set of norms. Despite the reference to the UNIDROIT Principles, the clause directs the arbitrators to first apply "rules and principles of law generally recognized in international trade", an obvious reference to *lex mercatoria* developed by continental scholars over the last fifty years, with its numerous and complex sources.[208] Given its lack of precision,[209] as well as the broad discretion its application gives to the arbitrators (arguably as broad as the authority to decide *ex aequo et bono*), it is unsurprising that most commercial parties find it unappealing. Moreover, the directive of the provision providing for the application of the three sets of norms in a particular "order" is not as clear as it seems. The most straightforward interpretation would seem to be that usages and UNIDROIT Principles should only be applied subsidiarily, if the dispute cannot be resolved by applying the first set of norms only. However, Professor

[207] See *supra* text accompanying note 91.
[208] See *supra* text accompanying notes 29-49
[209] See *supra* text accompanying notes 67-70.

Bortolotti, who was involved in the drafting of a number of these model contracts, has offered another interpretation.[210] In his opinion, the order of the three sources should be understood as hierarchical.[211] Sources lower in the hierarchy should only be applied if compliant with sources higher in the hierarchy. Trade usages and the UNIDROIT Principles might therefore only be applied if "they conform with general principles (*lex mercatoria*)",[212] and that "arbitrators may thus refuse to apply the provisions of the UNIDROIT Principles that they consider not to be in accordance with the reasonable expectations of business people engaged in international trade".[213] If Professor Bortolotti's interpretation was widely adopted, parties could not even rely on the application of the UNIDROIT Principles, as arbitrators would have the discretion to displace them for alleged non compliance with the general principles of international trade. Such a clause would not provide any legal certainty.

In light of the apparent distaste international commercial actors have for *lex mercatoria* as a non-national legal regime, one cannot help but wonder whether the future of transnational commercial law does not lie instead in detailed and coherent international restatements of contract law. Perhaps if the *lex mercatoria* clauses in the ICC model contracts only applied the UNIDROIT Principles (or, alternatively, ICC could reverse the order of application, such that the UNIDROIT Principles apply first, and the other norm sets would thereafter apply only if the dispute could not be resolved using the UNIDROIT Principles), commercial parties might worry less about legal uncertainty and more readily enjoy the cost savings associated with not having to verify that their contract comports with the mandatory rules of the relevant national law. The present clause does refer to the UNIDROIT Principles, but only as a subsidiary solution available to supplement "rules and principles generally recognized in international trade". Given the limited success of the ICC's current clause, the ICC should change its policy and include clauses referring to a single, clear, and detailed transnational commercial law regime, either as the sole option, or as the first set of norms to be applied, with any subsidiary norm sets (like trade usage or *lex mercatoria*) applied only if the first set of norms cannot resolve the dispute.

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[210] Fabio Bortolotti, *supra* note 192, at 62.
[211] Id.
[212] Id.
[213] Id.