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The Applicable Law in an International Commercial Arbitration: Is It Still a Conflict of Laws Problem?

Introduction

International commercial arbitration has been successful in recent decades among international traders as an alternative to national courts for the settlement of disputes. The needs of parties to international contracts, in particular the need for neutrality and effectiveness, have found in international commercial arbitration a satisfactory answer, which no other system for the settlement of disputes had provided before. Among the several issues that international arbitration poses, that of the "applicable law" plays a very important role. The award is based on the law applied by the arbitrator, and the provisions of that system of law will finally settle the contrasting interests of parties. Therefore parties are very much concerned about the process that leads the arbitrator to the choice of the applicable law.

Why is "the applicable law in an international commercial arbitration" an issue? Every national court, when faced with the question of the applicable law to a contractual dispute, will decide on the ground of national choice of laws rules. International arbitration, on the other hand, developed as an alternative to national judicial systems, does not derive its authority from a nation but from an agreement between two private parties. Should an arbitrator choose the applicable law through a private international law rule? If the answer is positive, what conflict of laws system should he apply? Or should he decide the case on the ground of a non-national system of law (lex mercatoria)? An official report of arbitral awards does not exist, therefore one lacks a coherent development of case law which could give an answer to the previous questions. For this reason

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the doctrine played a more important role than in other fields of law in shaping a guideline to help arbitrators in their process of choosing the law applicable to an international dispute.[1]

I. The Applicable Law in an International Commercial Arbitration: The Theory and the Practice

The first part of this work will ascertain the approach by commentators to the problem through an analysis of the different situations with which an arbitrator can be faced in the determination of the applicable law in an arbitral dispute. The approach will not be completely theoretical because, even though there is not an official report of arbitral awards, each author supports his opinion concerning the applicable law by reference to arbitral decisions.[2]

A. *Determination of the Applicable Law by the Parties*

When an arbitrator has to decide which law to apply for the solution of the dispute, he may find a contractual clause providing an express choice of law: "The validity, construction and performance of this contract shall be governed by and interpreted in accordance with the law of . . . ," or similar

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[1]Carabiber, *L'évolution de l'arbitrage commercial international*, 99 REC. DES COURS, 119 (1960-1); Derains, *Le statut des usages du commerce international dévant les jurisditions arbitrales*, REV. ARB. 122 (1973); Derains, *L'application cumulative par l'arbitre des systèmes de conflit de lois intéressés au litige*, REV. ARB., 99 (1972); Fazzolari, *De l'Arbitrage "marchand" à l'Arbitrage "de droit commun,"* in ESSAIS IN MEMORIAM EUGENIO MINOLI, 163 (1974); Fouchard, *L'Arbitrage Commercial International*, (Dalloz-Paris 1965); Fragistas, *Arbitrage étranger et arbitrage international en droit privé*, 49 REV. CRIT. 1 (1960); Goldman, *Les conflits des lois dans l'arbitrage international de droit privé*, 109 REC. DES COURS 347 (1963-II); HAARDT, *Choice of Law Clauses in Arbitration Agreements*, in ESSAYS ON THE LAW OF INTERNATIONAL TRADE, Festshrift Schmitthoff, 215 (F. Fabricus 1973); Klein, *Considérations sur l'arbitrage en droit international privé*, Heillung & Lichtenhahn (Bale 1955); KOPELMANAS, *International Conventions and Standard Contracts as Means of Escaping from the Application of Municipal Law*, in SOURCES OF THE LAW OF INTERNATIONAL TRADE, 118 (C.M. Schmitthof 1964); Lalive, *Problèmes rélatifs a l'arbitrage international commercial*, 120 REC. DES COURS 569 (1967-I); Lalive, *Les règles de conflit de lois appliquées au fond du litige par l'arbitre international séegeant en Suisse*, REV. ARB. 155 (1976); Lalive, *Le droit applicable au fond du litige en matière d'arbitrage*, 17 RASSEGNA DELL'ARBITRARO, 1 (1977); LEW, APPLICABLE LAW IN INTERNATIONAL COMMERCIAL ARBITRATION. A STUDY IN DECIDED ARBITRATION AWARDS (New York 1978); Mann, *Lex facit arbitrum*, in LIBER AMICORUM FOR MARTIN DOMKE, 157 (The Hague 1967); Panchaud, *Le siège de l'arbitrage international de droit privé*, REV. ARB. 2 (1966); ROBERT, *De la place de la loi dans l'arbitrage*, in LIBER AMOCORUM FOR MARTIN DOMKE, 226 (The Hague 1967); Sanders, *Trends in the Field of International Commercial Arbitration*, 145 REC. DES COURS, 207 (1975-II); TALLON, *The Law Applied by Arbitration Tribunals-II*, in SOURCES OF THE LAW OF INTERNATIONAL TRADE, 154 (Schmitthof 1964); Tommasi di Vignano, *Arbitrato Commerciale Internazionale e Diritto Sostanziale Applicabile*, 17 RASSEGNA DELL'ARBITRATO 117 (1977).

[2]The arbitral awards which will be cited hereafter can be found in the following sources: JOURNAL DU DROIT INTERNATIONAL, Paris; Derains, *L'application . . . , supra* note 1; Fouchard, *supra* note 1; Lalive, *Les règles . . . , supra* note 1; Lalive, Le droit . . . , *supra* note 1; Lew, *supra* n.1; Goldman, *La lex mercatoria dans les contrat et l'arbitrage internationaux: realite et perspectives*, 106 JOURNAL DU DROIT INTERNATIONAL 475 (1979).

provisions.[3] The parties may provide for the application of some national law or for some non-national set of rules (international law—"*ex aequo et bono*"— lex mercatoria). The two possibilities must be considered separately.

1. If the Parties Choose a National Law

In this situation the arbitrator has to deal with the following issue: should he test the autonomy of the parties in choosing the applicable law under a conflict of laws system or should he recognize that freedom without relying on any conflict of laws rule? The problem could be merely theoretical and therefore of little practical relevance for two reasons. First, it might be argued that all private international law systems accept without limitation the doctrine of party autonomy. Second, it can be maintained that even though there are some differences among countries in recognizing the parties' freedom to choose the applicable law, those differences are not relevant because parties to international contracts do not push their choice beyond a standard common to all private international law systems. As will be demonstrated, both assumptions are incorrect and therefore the above-mentioned issue is worthy of discussion.

The principle of party autonomy is widely recognized both in common law and civil law. In England it is normally upheld by courts: "Parties are entitled to agree what is to be the proper law of their contract."[4] Most of the civil law codes recognize as well the choice of law by the parties.[5] The few countries that have not explicitly provided for party autonomy in their codes have introduced that doctrine through case law development.[6]

Since a casual observer would conclude that in fact all private international law systems accept the principle of party autonomy, some authors drew the conclusion that an arbitrator must apply the law chosen by the parties without checking if any conflict of laws rule limits that freedom.[7] But not all countries permit unlimited freedom to the parties to determine the law applicable to their contractual relation. For instance, in the English

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[3]Even though the usual practice in international trade is to specify the applicable law, sometimes parties do not include in their contracts such a clause. The reason for this is not always the failure of the lawyer to ensure that a contract contains a choice of law. Many times the parties cannot agree on such an important issue, and they prefer to postpone the problem to the time that a dispute arises. The arbitrator in this case shall be charged with this burden. *See infra* 1(B).

[4]Whitworth Street Estates (Manchester) Ltd. v. James Miller and Partners Ltd. [1970] A.C. 583, 603 per Lord Reid.

[5]*See, e.g.*, Greece, Civil Code (1940) art. 25; Italy, Disp. Prel. (1942) art. 25; Austria, Allg. BGB. §§ 36-37; Japan, Int. Priv. Law, art. 7.

[6]*See, e.g.*, France, Cass. Civ. (Dec. 5, 1910), American Trading Co. v. Quebec Steamship Co., 5.1911, 1, 129; Germany, BGH (Feb. 1, 1952), 85 Journal du Droit International 225 (1958).

[7]*See, e.g.*, Tommasi di Vignano, *supra* note 1 at 130. It should be emphasized that the author does not have recourse to any conflict of laws rule not because he considers an arbitration "denationalized," but because the private international law system of every country would accept the choice of the law made by the parties.

system a choice of law must be "bona fide and legal" and a merely "eccentric or capricious" choice of law is of no effect.[8] The principle is well formulated by Dicey & Morris in the comment of Rule 145 Sub-rule I:

> No court, it is submitted, will give effect to a choice of law (whether English or foreign) if the parties intended to apply it in order to evade the mandatory provisions of that legal system with which the contract has its most substantial connection and which, for this reason, the court would, in the absence of an express or implied choice of law, have applied.[9]

Thus the English private international law rule does recognize the party autonomy principle with certain qualifications.

As far as the United States conflict of laws system concerns, Restatement of the Law 2nd, by the American Law Institute, provides in Section 186: "Issues in contract are determined by the law chosen by the parties." This language clearly constitutes general acceptance of the party autonomy principle, common to all private international law systems. Section 187 however, subjects parties' freedom to certain limitations.[10] Subsection 2, in particular, confirms that also under United States law parties do not have unlimited freedom to choose the applicable law. Parties for instance cannot endow themselves with contractual capacity or dispense with contractual requirements, which could not be obtained under the law that has the closest relation with the contract, by choosing a different applicable law. This is true if the parties have no other basis for choosing this law.

In the civil law tradition, for instance as personified by Mancini, the trend has been to recognize the choice of the applicable law by the parties, with no limitation. More recently, some European countries subjected the freedom of the parties to certain qualifications to be determined by the conflict of laws rule of the lex fori.[11]

It has thus been demonstrated that the principle of party autonomy, even though generally accepted, is subject to certain limitations which are different in the several conflict of laws systems. However, one could argue that

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[8]Vita Food Products, Inc. v. Unus Shipping Co., A.C. 290 (1939).

[9]DICEY & MORRIS, THE CONFLICT OF LAWS, 755-56 (1980 10th ed.).

[10]Section 187 reads:

(1) The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.

(2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either

a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties choice,

or

b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law, i.e., the absence of an effective choice of law by the parties.

[11]*See, e.g.*, VITTA, DIRITTO INTERNAZIONALE PRIVATO, vol. III, 233 (1972).

even though there are different limitations on the principle of party autonomy, this fact is irrelevant because in international practice parties usually do choose the law which has the closest connections with the contract. But this is not always true in international contracts. Sometimes the decision-making process of parties differs from this ideal. International traders from different countries, such as from a developed country and from a developing country, may decide to include an arbitration clause in the contract. Each may think that a foreign court might be partial to the other party as they consider the foreign judicial system not to offer sufficient procedural guaranties. Therefore, they believe that a neutral arbitrator, from a third country, can best handle their disputes. For the same reasons they may decide that the national law of either party could dissatisfy one of them. Therefore, they choose the national law of a third country that does not necessarily have any link with the contract.

Now that it has been established the soundness of the issue whether an arbitrator has to respect the parties' choice of the applicable law without any limitation or he has to ensure that it conforms to the conflict of laws rule of a nation, the various means by which commentators solved this problem will be analyzed.

At the earliest stage, Sauser-Hall at the 1957 Meeting of the Institute of International Law suggested a preliminary solution to the issue. Even though he maintained that arbitration has a mixed nature, its source being contractual but its effect jurisdictional, he emphasized that parties do not have unlimited freedom on the choice of the applicable law but must submit to the conflict of laws system of the lex fori.[12] A decade later Mann stated the same orientation.[13] On the assumption that "every arbitration is necessarily subject to the law of a given state," he expressed the view that nobody has been able to "point to any provision or legal principle which would permit individuals to act outside the confines of a system of municipal law." From this premise he then analyzes the specific issue at hand. Even the party autonomy principle as well as arbitration as a whole, must rely on and derive its existence from a national law system. Every right, power or duty of a person has its root in the law of a nation. In arbitration this national law system is the lex fori itself: the law of the country of the arbitral tribunal. A clause in an international contract providing that "the contract is governed by the law chosen by the parties," is acceptable only if there is a rule of conflict of laws that gives to the parties this freedom. According to Mann the choice of the applicable law is not made by the parties alone, but by the parties by means of the lex fori. A national court and an arbitrator play the same role in a jurisdictional system and they are both subject to national law. If arbitration is set up by agreement of the parties and proceeds according to the will of individuals, this is possible

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[12] SAUSER-HALL, ANNUAIRE DE L'INSTITUT DE DROIT INTERNATIONAL, 394 (1957-II).

[13] *See* Mann, *supra* note 1 at 161-62.

because it accords with the provisions of the lex fori. In conclusion, Mann takes a strict position: he does not recognize the choice of the applicable law by the parties as such. The arbitrator must analyze the party autonomy theory under the conflict of laws rule of the lex fori and he can also disregard the choice of the parties if they did not select the national law with which the contract has its closest connection.

Lalive in two of his major works on international arbitration[14] seemed to agree with Mann. He focuses on the fact that when parties choose the applicable law, this choice does not have effect as such. One has to find a legal ground to justify it. The principle of party autonomy is commonly recognized but with different qualifications and limits in each country. Therefore that choice may be in conflict with some national law provision, and the conflict must be solved by private international law. In contrast with Mann, Lalive does not specify which system of private international law should apply; he merely presents the different solutions available.

However, in his most recent article on this issue,[15] he has adopted a more flexible position. He gives more relevance and weight to the party autonomy principle: in an international contract the arbitrator should respect the will of the parties without trying to substitute their choice of the applicable law with any other law even though it may not seem the most appropriate. But, how does Lalive reconcile this position with his previous and more traditional views? He attempts two solutions. On the one hand he looks to the peculiar nature of international contracts. Sometimes parties choose a neutral law, such as English law or Swiss law, which have developed a highly sophisticated set of rules. In so doing they can find an agreement that they probably could not have reached if they had applied the national law of either party. Those factors make the choice of the parties "appropriate"—meaning that for the above reasons the contract has sufficient connections with that law such as to admit that choice. On the other hand he states that the power of the parties to choose the applicable law, must be exercised within "des limites raisonnables." What Lalive means by that, however, is unclear. He does give an example of a case involving a nonreasonable choice. If the parties make a choice of law that renders the contract void, then the arbitrator would disregard that law. In conclusion Lalive takes on an intermediate position: he still believes that the party autonomy principle should be checked by some conflict of laws system but he makes that operation more flexible than does Mann, taking into consideration the particular characteristics of international contracts.

Haardt[16] deals with the issue from yet another point of view: he does not present a fully theoretical picture but probably his is a more practical approach. He maintains that parties are free to determine the applicable

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[14]*See* Lalive, *Problèmes . . . , supra* note 1 at 680; Lalive, *Les regles . . . , supra* note 1 at 157-58.

[15]*See* Lalive, *Le droit . . . , supra* note 1 at 7.

[16]*See* Haardt, *supra* note 1 at 219-20.

law because "it [the law] might have a reference to the case which at first sight is not apparent." For instance they could have preferred the national law of the arbitrator because he is most familiar with it, or, in a particular field of international trade, that law is deemed the most appropriate by the parties. He then gives another argument that may not be the most correct from a strictly legal point of view, but is nevertheless quite persuasive:

> It is not a question for the arbitrators of finding a justification for the choice of the particular law made by the parties in order to regard that choice as valid, but a question of finding very good reasons why that particular choice was not justified in order to regard the choice of law as invalid in its entirety.

Furthermore, Haardt points out that for certain contracts located in a country and involving fundamental public interests of that country (for instance contracts for the installation of nuclear plants) a nation provides rules that are applicable in any case even though the parties are from different countries. In such cases parties must be aware that if they choose a different law they may not be able to enforce an arbitral award because such enforcement is contrary to the public policy of that country. In this situation an arbitrator will be more willing to disregard the law chosen by the parties.

In contrast, Fouchard[17] maintains a position on the other side of the spectrum. He emphasizes the contractual nature of arbitration. When two parties with an agreement decide to settle their disputes through arbitration, they can also decide which law should be applied by the arbitrator. That choice has an exclusively consensual nature and cannot therefore be disregarded by an arbitrator. The power of an arbitrator does not derive, as in the case of a national court, from a sovereign state, but from the agreement of the parties. Fouchard calls it a process of "internationalisation": the contract and arbitration are not localized in any particular country; the place of seat of arbitration may be purely fortuitous and there is no system of private international law competent to challenge the choice of the applicable law by the parties.

Lew[18] follows the same reasoning as Fouchard, attempting in addition to shape international arbitration as a structure independent of any national law system. He points out the fundamental difference between national courts and international arbitration tribunals in terms of their allegiance and the source of their authority. "The international arbitrator has no duty to any sovereign State of any national law; empowered by the parties his duties are to them and to international trade in general." Both Fouchard and Lew rely on the contractual nature of arbitration, but the latter goes one step further because he not only recognizes the party autonomy doctrine but also fits it into an autonomous legal order. He states that as in international trade there exists a set of rules that do not belong to any particular national legal system (so-called transnational commercial law) so

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[17] *See* Fouchard, *supra* note 1 at 356-57.

[18] *See* Lew, *supra* note 1 at 82-84.

"[e]xtending this idea to the field of conflict of laws, could it not be argued that party autonomy is a transnational conflict of laws rule applicable in all non-national tribunals?" Private parties choose international arbitration as an alternative to the jurisdiction of national courts and to avoid restrictions of any conflict of laws system. The law of international trade as used by the community of international merchants allows per se parties' choice of the applicable law. There is no need to look at any applicable body of private international law to justify that choice.

To gain a more complete perspective on the problem some arbitral awards will be examined.[19]

The first set of arbitral awards to be considered involves situations in which the arbitrator seems to accept the party autonomy principle per se, without considering eventual limits imposed by a private international law system.

In a contract between Swiss and French corporations a dispute arose over the licensing agreement. When faced with the question of the applicable law the arbitrators held:

> The decision on the substance [of the dispute] must be reached in accordance with the Swiss law which the parties have agreed to make applicable by article XVI of the license contract concluded between them.[20]

In a dispute between a Swedish manufacturer and a Philippine buyer it was held:

> In clause 13 of the contract of January 26, 1963 the parties agreed that disputes arising from the contract should be dealt with according to Swedish law. As from the legal point of view, there is no objection to such an agreement, the arbitrator is bound to apply Swedish law.[21]

Finally, in an arbitration that took place in Switzerland, the Swiss arbitrator initially considered that under the Swiss private international law rule, Swiss law had to apply. However, he then decided that the choice of another applicable law by the parties had to prevail over the conflict of laws rules of the arbitration seat. It was held:

> In the present case, Swiss law would be applicable. However, on several occasions, the parties have invoked the law of Yugoslavia. . . . It would, therefore, not be acceptable to apply Swiss law if the parties themselves want the law of Yugoslavia applied.[22]

A distinction should be made between the first two cases and the third. In the former cases it should be noted that the arbitrator does not even take into account any limitation on parties' choice of the applicable law under any choice of law rule. This fact might be explained in two ways: either the recognition of the party autonomy principle per se, independently from any

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[19]The following abstracts are reported in Lew, *supra* note 1 at 87 passim.
[20]ICC award No. 1103, Doc. No. 410/774, September 28, 1960.
[21]ICC award No. 1315, Doc. No. 410/1316, October 13, 1965.
[22]ICC award No. 893, Doc. No. 410/330, March 10, 1955.

body of conflict of laws, as a transnational conflict of laws rule (this is the way Lew reads the above arbitral awards; he supports the "denationalization" of international commercial arbitration)—or the arbitrator in his analysis found sufficient connection between the contract and the law chosen by the parties, so that every conflict of law system would allow that choice. However, he fails to translate his decisionmaking process explicitly into words, in order to avoid further bases of dispute between the parties. This interpretation is more acceptable to those who maintain that the party autonomy theory must be qualified by a national law system.

In the last case discussed, on the other hand, the arbitrator was clearly faced by a choice between recognition of the law selected by the parties per se and submission to the Swiss private international law rule. He preferred the first selection, even though he did not give a theoretical justification of that choice.

The second set of arbitral awards considers cases where arbitrators applied the law chosen by the parties because that choice was in accordance with the rule of a system of private international law.

In an arbitral award where Lalive was the arbitrator, in a dispute between a German and a Pakistani corporation, it was held:

> The differences which may be observed here between different national systems relate only to the possible limits of the parties' power to choose the applicable law or to certain special questions as to modalities but not to the principle itself, which is universally accepted. . . . The three or four solutions just mentioned with regard to the various systems of private international law to be applied by the Arbitrator would, in the present case, lead to the same practical result in all likelihood.[23]

In this case the arbitrator submitted the choice of the applicable law to a conflict of laws rule, but the case at hand relieved the arbitrator from the heavy burden of selecting one among the several conflict of laws systems connected with the dispute, since they all led to the same conclusion.

The same approach was taken by a Swiss arbitrator in a dispute in connection with a contract of Agency, between a German and an Austrian individual. He pointed out that the parties chose German law as the applicable law, but also justified recognizing that choice:

> First of all, it has to be borne in mind that the dominant opinion in Germany, in Austria and in Switzerland recognizes the right of the parties to choose the applicable law. We are not governed here with determining the simple hypothetical will of the parties as they have clearly expressed their will before the tribunal if not at the time of concluding the contract.[24]

There are no reported cases in which an arbitrator disregarded an express choice by the parties of the applicable law. However this fact should not lead to the conclusion that arbitrators do not consider themselves bound by any conflict of laws rule. Two factors should be considered. First of all, the

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[23]ICC award No. 1512, Doc. No. 410/1935, February 24, 1971.
[24]ICC award No. 1255, Doc. No. 410/1185, March 13, 1964.

number of arbitral awards reported is minimal. It may be that none of those awards that disallowed the selection of the applicable law by the parties has been published. Second, even though under a conflict of laws rule the party autonomy principle is not recognized, it would be inappropriate for the arbitrator not to apply the law agreed upon by both parties. The parties chose arbitration because it is more flexible than national courts. An arbitrator would frustrate the expectations of the parties were he to disregard their choice by applying a conflict of laws rule. Therefore, he would probably seek to find a connection with another private international law system which recognizes the party autonomy principle.

Some conclusions can now be drawn from the above arguments. There is a range of different solutions to the issue of the recognition of the party autonomy principle in both theory and practice. If one accepts the principle that an arbitrator must check the choice of the applicable law made by the parties under some conflict of laws body, we are within the traditional methodology of any national court approaching a conflict of laws problem. This solution, treating arbitration as any other national judicial process, seems to achieve the goals of simplicity and uniformity. However, this is not completely true because it does not consider an objective difference between a national court and an arbitral tribunal: the latter institution does not necessarily have connections with just one country. This means that the arbitrator has to select one system of private international law among the several that have some relation to the dispute. An arbitrator normally faces up to the following choices: the law of the seat of arbitration, the national law of the arbitrator, the national law of the parties, the law of the place where the contract was concluded, the law of the place where the contract must be performed, the "proper law of the contract."[25] This wide spectrum of possibilities causes uncertainty because the solution of an arbitrator is unpredictable and might render parties dissatisfied with the result.

On the other hand, if one agrees that an arbitrator should respect the choice of the applicable law without checking if there is any limit to the parties' autonomy under some conflict of laws rule, arbitration is in some respect "denationalized." Denationalization means detachment, separation from any national law system. However, this process is not complete because as in the above-cited cases, the arbitrator actually applied a national law and not some non-national set of rules like lex mercatoria.

The solution is an intermediate one which will be probably more acceptable if a court had to enforce an arbitral award. Moreover, this approach would better respect the inherent nature of arbitration: a means for the settlement of disputes chosen and based on the will of the parties.

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[25]For a description of the "proper law of the contract" doctrine *see supra* test to n.54.

2. If the Parties Choose a Non-National Set of Rules (Lex Mercatoria)

Instead of a national set of rules, parties might have selected a non-national standard. This has been defined in different ways: international law, international customs or usages, transnational law, supranational law, lex mercatoria. In spite of all these different labels probably the same phenomenon reoccurs: a set of rules developed to regulate international trade in the merchants' community. The question is whether an arbitrator should respect the choice of the parties. In addition to all the problems discussed in the previous section one should note that no rule of conflict of laws of any country permits a "renvoi" to a non-national legal standard such as lex mercatoria.[26] Furthermore, not being a highly developed system, lex mercatoria does not cover all the matters which might be the object of a dispute. Therefore, an arbitrator needs a set of national rules to fill the gaps within lex mercatoria.[27]

B. *Determination of the Applicable Law by the Arbitrator When the Parties Do Not Make a Choice*

It may appear unusual for the parties to a contract not to include such an important clause as that determining the applicable law; however, it happens quite often. This occurrence may derive from the fact that businessmen tend to be more concerned about commercial clauses and to give less consideration to legal aspects like the applicable law. In drafting an agreement they may not be aware of the impossibility to regulate all foreseeable situations and the necessity, therefore, for a national court or an arbitrator to have recourse to some law to implement contractual provisions. Parties may also be advised by incompetent lawyers who do not include in the agreement a clause reflecting the applicable law. However, when a contract does not provide for the applicable law, it should not necessarily be ascribed to the carelessness of parties: sometimes they willingly choose not to embody such a clause in the contract. It may occur that the contracting parties, after a long period of negotiation, finally agree upon all the different clauses of the contract. The agreement is sound but when they reach the stage of selecting the applicable law they face an insurmountable barrier. They come from different countries with divergent economic and

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[26]The exception to this general trend is represented by the new French legislation on International Arbitration. Art. 1496 of the Code of Civil Procedure reads as follows:

> The arbitrator shall settle the dispute in conformity with the rules of law which the parties have chosen; in the absence of such a choice by the parties he will settle the dispute in conformity with the rules which he will deem appropriate.
>
> He shall in every case take into account commercial usages.

French courts liberally interpreted the article, such as to uphold parties' choice of lex mercatoria as the applicable law. *See, e.g.*, Banque du Proche Orient c. Société-Fougerolle Cour d'Appel de PARIS June 12, 1980.

[27]For a discussion of the applicability of lex mercatoria, *see infra*.

political backgrounds and therefore they are not acquainted with and do not confide in the respective national laws. In this situation parties prefer to leave the issue open rather than not to conclude the contract. The arbitrator then has to discharge the difficult task of determining the law applicable to the contract. Why is the determination of the applicable law by the arbitrator a problem in an international commercial arbitration?

If the parties settle the dispute before a national court the issue is prima facie less complicated. The judge is compelled to follow the rules of conflict of laws of the forum. On the other hand, when the dispute is before an arbitral tribunal the mechanical relation between the dispute resolver and a national conflict of laws body is absent. The problem is whether the arbitrator should apply a conflict of laws system at all, and if the answer is positive, which one among the several connected with the dispute. As an alternative, he could select the applicable law directly, independently from any private international law body. The theory and the practice give a range of different solutions to this question. These solutions will be presented in a logical sequence in order to demonstrate the process of denationalization of arbitration.

1. Application of the Conflict of Laws System of the Country Which Would Have Had Jurisdiction in the Absence of an Arbitration Clause

This theory was first promulgated eighty years ago when international arbitration was still in its infancy, by a distinguished Italian scholar, Dionisio Anzilotti.[28] He stated that the conflict of laws system controlling arbitration is that of the country which would have had jurisdiction to settle the dispute between the parties if they had not included the arbitration clause in the contract. That country has been in reality dispossessed of its jurisdictional authority by the arbitration clause and therefore it may reaffirm its control over arbitration in this way.

The theory has been criticized mainly on two grounds.[29] First of all, one of the major advantages of international arbitration, that is the avoidance of uncertainty and inconveniency related to international conflicts of jurisdiction, would be totally frustrated. An arbitrator, under Anzilloti's theory, has the difficult burden to determine which national court would have had jurisdiction if parties had not submitted to arbitration. Second, this solution is not acceptable because it is circular. An arbitrator has to select a conflict of laws rule to know which country would have had jurisdiction, hence the issue of the applicable private international law system arises again. For both practical and theoretical reasons this position was abandoned many years ago and it is the only one that has not formed the basis of any known arbitral award.

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[28] *See* Anzilotti, Rivista di Diritto Internazionale, 467 (1906).

[29] Klein, *supra* note 1 at 252-55; Lalive, *Les règles . . . , supra* note 1 at 161.

2. Application of the Conflict of Laws System Where the Arbitral Tribunal Has Its Seat

This position has been given authority by Sauser-Hall as rapporteur of the Institute of International Law. As discussed above, Sauser-Hall took an intermediate position in the dispute on the nature of international arbitration. Emphasizing the necessary link between arbitration and the conflict of laws rules of its seat, he focused, however, upon the jurisdictional aspect of arbitration. In his 1952 report to the Commission he maintained that where the parties did not select the law applicable to the contract, the conflict of laws rule of the country where the arbitral tribunal has its seat will apply. This view was adopted in article 11 of the 1957 Amsterdam Resolution.[30]

The advantages claimed by this theory are predictability and uniformity of result. In addition, it has been maintained that the will of parties is respected: they can freely choose the seat of arbitration and therefore indirectly select the applicable conflict of laws rule.

The most recent and authoritative source supporting Sauser-Hall's theory has been Mann. As has already been pointed out,[31] the author opposes any trend toward denationalization of arbitration. According to Mann, an arbitration clause, as any other contract between private parties, cannot be suspended in the air, but must draw its authority from a national law provision. From this assumption he then argues that only one country can control arbitration: the country of the seat of arbitration. This conclusion derives from an understanding of arbitration as a national jurisdictional organ:

> Just as the judge has to apply the private international law of the forum, so the arbitrator has to apply the private international law of the arbitration tribunal's seat, the lex arbitri. Any other solution would involve the conclusion that it is open to the arbitrator to disregard the law.[32]

This viewpoint has been challenged by many authors upon both practical and theoretical grounds.[33]

On one hand, it has been argued that if parties did not select the applicable law and therefore the arbitrator has to determine it by the conflict of laws rule of the seat of arbitration, several practical problems follow. Sometimes contracting parties do not specify in the arbitration clause the country in which the arbitrator will sit. In this case one of the supposed advantages of this criterium, the respect of the will of the parties, fails: the seat of arbitration, and indirectly the applicable conflict of laws system, is determined by the arbitrator and not by the parties. Moreover, it may be

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[30] Annuaire de l'Institut de Droit International, 496 (1957-II).

[31] *See supra*.

[32] Mann, *supra* note 1 at 167.

[33] *See* Goldman, *supra* note 1 at 366; Fouchard, *supra* note 1 at 360; Derains, *L'application . . . , supra* note 1 at 102, Lew, *supra* note 1 at 221; Lalive, *Les règles . . . , supra* note 1 at 160.

impossible to identify the seat of arbitration. For practical reasons the arbitrator can fix the hearings in two or more different countries. For example, if the first hearing was conducted in Paris and the second one in London, because evidence was more accessible in England, the question arises whether the arbitrator should apply the French private international law rule or the English one. The Institute of International law attempted to solve this problem suggesting that the conflict of laws rules of the country where the first hearing was held shall prevail. One can easily see how this solution is arbitrary and scarcely convincing. In addition, arbitration may be conducted by an exchange of letters between the parties and the arbitrator. Where did arbitration take place in this case? Again the Institute of International Law attempted a solution by reference either to the domicile or to the residence of the arbitrator. However, this answer is also unsatisfactory. The previous arguments show that the other supposed advantage of the seat of arbitration theory, predictability and uniformity of result, is a mirage: there are several practicable solutions and it seems improbable that all arbitrators would follow the same rule.

Another criticism of the theory of the arbitration seat, based on practical grounds, maintains that the selection of the seat, either by the parties or by the arbitrator, is merely fortuitous. The choice of the seat might not have any subjective or objective link with the parties or the contract. Two examples will demonstrate the validity of the argument. An international trade agreement between an Italian and a Japanese provides that any dispute shall be settled by arbitration. The contracting parties are located in distant countries, hence for economic reasons, they decide that the arbitrators shall sit halfway in Moscow. In this situation the contract has no connection with, and the parties are not related to, the U.S.S.R. Again, in a contract between a German and a Frenchman, the arbitration clause selects Switzerland as the seat of arbitration, not for economic reasons but because it is a neutral place. In both cases the choice of the seat does not imply a choice of the conflict of laws system of that country. The parties probably do not know and do not desire to be bound by the private international law rule of that jurisdiction. They are inspired by completely different motivations in that choice.

On the other hand, there is a more theoretical reason which demonstrates that the theory of the arbitration seat cannot stand. It is claimed that much as the Court of Appeals of Paris is an arm of the French judicial system exercising the jurisdictional function in the name of a particular country (i.e., France), so is an arbitral tribunal sitting in Paris. It is analogous to the Court of Appeals and therefore should apply French private international law. However, one can immediately recognize that the relation between the Paris Court of Appeals and France is completely different from the relation between an arbitrator sitting in Paris and France. Although this is not the place to list the dissimilarities between a national court and an arbitral tribunal, it should be sufficient to point out that arbitration is set up by an

agreement between private parties which shall regulate its procedural and substantive aspects. Even though a country attempts to control all arbitrations within its borders it fails in this purpose since many ad hoc or institutional arbitrations develop independently of any national scheme.[34]

Even though this position has been widely criticized, there are some early arbitral awards where, lacking a selection of the applicable law by the parties, the arbitrator applied the conflict of laws rule of the seat of arbitration.

For example in a dispute over a sale of goods between a German and a Belgian settled under the auspices of the International Chamber of Commerce, the French arbitrator held:

> It follows from the general principles governing the case that not only the rules of procedure, but also the rules of private international law to be applied by the arbitrator must be drawn from French law. This doctrine has been advocated in particular by the Resolution of the Institut de Droit International of September 16, 1957 the arbitration on private international law, Article II.[35]

In another case between an Italian and a German, the arbitral panel sitting in Switzerland, when faced with the issue of the applicable law stated:

> There where concrete rules of conflict of laws have to be observed, it is advisable to apply the standards of the legal system valid at the place where the arbitration tribunal sits. In the present case, it is thus on the basis of the rules and the practice of Swiss private international law that decisions have to be taken.[36]

Finally, the following opinion is noteworthy because of its clarity. This opinion supports an arbitral award rendered in Paris by a French arbitrator in a dispute between a Canadian corporation and an East German partnership:

> This is an agency contract. Where there is no provision in such a contract the law of the country where the agent or the distributor had his seat normally prevails. This is, however, only a presumption. The parties may decide otherwise, and even if the parties have not provided for this question, there may be special circumstances which give precedence to the law of the country of the manufacturer. This is the point of view of French private international law which this arbitrator sitting in France in a French procedure is obliged to follow.[37]

3. Application of the Conflict of Laws System Connected Either to the Arbitrator or the Parties or the Dispute

Still within the borders of the traditional approach to the issue is the adoption of one conflict of laws system, selected through a rigid "single-

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[34]It should be finally observed but this time in favor of the theory of the arbitration seat, that this theory fits better in arbitral institutions of socialist countries. There the link between arbitral institutions and the country is very strong. Arbitrators are more akin to public officers and there are a number of rules that must be applied even against the will of the parties.

[35]ICC award, No. 1446, Doc. No. 410/1435, July 4, 1966.

[36]ICC award, No. 1592, Doc. No. 410/1914, November 18, 1970.

[37]ICC award, No. 1505, Doc. No. 410/1940, January 13, 1971.

aspect methodology."[38] For example it has been suggested that the conflict of laws rules of the arbitrator should apply. The first question is: what test should be followed: the nationality, the domicile or the residence of the arbitrator? It can be argued that the different relevance of nationality in a single-state country and domicile in a multistate country should cause many problems. The argument in favor of this theory is that an arbitrator has the best knowledge of his personal law. But this has been rebutted.[39] First of all because if the relevant factor is the arbitrator's knowledge of the law, his substantive personal law should be applied, and not his conflict of laws rule; second because it would be an underestimation of international arbitrators' capacities, to consider them unable to understand and correctly apply a foreign conflict of laws system.

A second example is given by the conflict of laws system of the parties. It is very easy to object that in an international commercial arbitration the two parties come from different countries and therefore an arbitrator choosing the law of either party, leaves the other one unsatisfied. However, the idea to take into account the conflict of laws rule of both contracting parties has not been completely abandoned as will be discussed *infra*.

The third and last example of this trend is the attempt to apply the private international law system of the state where the arbitral award will be enforced. This doctrine has been supported for practical reasons: it could be inconvenient for an arbitrator to apply a substantive law, even though the choice is justifiable on other grounds which would cause the national court to refuse to enforce the arbitral award. The first objection to this theory is the difficulty in foreseeing the forum where the arbitral award will be enforced. Moreover, it may also happen that the award is enforced in more than one country. Secondly, member-states of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards have so far narrowly interpreted article V of the Convention,[40] which allows them to refuse enforcement of an award on public policy grounds. This does not imply that an arbitrator, in order to render the award more effective, shall not examine the substantive law, in particular the public policy principles, of the country where he assumes the award will be enforced.[41]

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[38]For the distinction between single-aspect methodology and multi-aspect methodology, *see* VON MEHREN AND TRAUTMAN, THE LAW OF MULTISTATE PROBLEMS, MULTITHED MATERIALS 12 (2d ed. 1980). This section does not deal with a traditional conflict of laws problem, but with a "conflit au deuxieme dégré" (Lalive, *Problèmes . . . , supra* note 1 at 570). The issue here discussed does not concern the application of different substantive laws, but of different conflict of laws rules. Nevertheless, the distinction suggested by von Mehren is appropriate for the discussion at hand.

[39]*See* Lalive, *Les règles . . . , supra* note 1 at 160.

[40]Art. V of the Convention is reported *supra* note 73.

[41]*See, e.g.*, art. 26 of the ICC Rules.

4. Cumulative Application of the Conflict of Laws Systems Connected with the Dispute

In the process of "denationalization" of arbitration the following discussion describes the first significant step towards it. This theory has been analyzed by several authors,[42] but in particular Derains, former Secretary of the Court of the International Chamber of Commerce, has dedicated an entire piece to it.[43] An arbitrator, instead of applying one of the conflict of laws systems mentioned in the previous sections, looks at all the systems that have any contact with the dispute. From this analysis he might ascertain that these systems lead to the same solution: they all select the same national law as applicable to the contract. Therefore an arbitrator does not need to choose one private international law rule, but can base his decision on this cumulative choice. This process is commonly used by national courts faced with choice of laws problems: when the different laws whose policies are involved lead to the same solution of the dispute, a judge can avoid applying one law, labeling the situation as a "false conflict." The same technique may be followed by an international arbitrator even though it must be noted that the "false conflict" is not among substantive rules, but among conflict of laws rules (so-called conflit au deuxieme dégré). The following decision gives a better idea of the theory. In an award between a West German and a Greek rendered by an arbitrator sitting in Switzerland, it was held:

> To resolve whether the substance of the claim is justified, it is necessary to determine initially the substantive law applicable to the dispute. If the agreement of the parties does not express itself on the subject, it is necessary in the first place to research from where to draw the conflict of laws rules to resolve the question. The answer to the question is sensibly facilitated by the fact that the principles of private international law developed in German law, as well as in Greek law and in Swiss law, lead to the same result.[44]

In this case the jurisdictions presumably connected with the dispute were Greece (where the contract was concluded and had to be performed and where the buyer resided), Germany (where the seller was domiciled), and Switzerland, where the arbitration had its seat. The arbitrator could base his selection on the applicable law on the three conflict of laws rules of these countries since they led to the same result.

The advantages and disadvantages of this theory have to be balanced. On the one hand, as observed by Derains,[45] the cumulative application methodology will be effective in practice. Both parties will be satisfied and any country where the award might be enforced will recognize the applicable law as selected by the arbitrator, since the choice is grounded on all conflict of laws systems that are related to the action. On the other hand

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[42] *See* Lalive, *Les règles . . . , supra* note at 180; Lew, *supra* note 1 at 335.
[43] *See* Derains, *L'application . . . , supra* note 1 at 99.
[44] ICC award No. 953, Doc. No. 410/385, January 18, 1956.
[45] *See* Derains, *L'application . . . , supra* note 1 at 121.

there are two inherent limitations to this theory. Firstly, the situation must be one of "false conflict." If the several countries connected with the dispute have different conflict of laws rules this solution is not available. Secondly, the arbitrator has to decide which countries are connected with the dispute. In this process there is room for discretion for the arbitrator and therefore the conflict of laws rules deemed applicable may be different. For example an arbitrator asserting the jurisdictional nature of arbitration will also apply the private international law rule of the lex fori.[46] An arbitrator claiming the contractual nature of arbitration, on the contrary, will not.

Derains maintains that this possible conflict is of limited relevance because it concerns just the means and not the scope of the cumulative application theory, which constitutes a search for an international (in the sense of widely-accepted) solution to the problem.

5. Application of the Conflict of Laws System Established by the Arbitrator

The next step toward denationalization of arbitration is the application of a conflict of laws system, not on the ground of its own authority, but because it has been chosen by an arbitrator. When parties did not select the applicable law, no one particular conflict of laws system must be followed; the arbitrator has to decide which one is the more appropriate to the case at hand and more in conformity with the necessities of international commerce. What is the theoretical justification for this theory?[47] It is mostly based on the contractual nature of arbitration: as discussed previously, part of the commentators consider arbitration as an institution independent and autonomous from any country. Arbitration is grounded on the will of the parties and the recognition of this autonomy is extended to the arbitrator. Since his authority does not derive from a sovereign nation but from the agreement of the parties, as a logical consequence he should be able to determine the private international law system he considers more appropriate. Further argument to support this thesis, raised by Lew,[48] emphasizes the fact that parties chose arbitration because of its more flexible approach to the dispute than that of a national court. Sometimes the latter applies conflict of laws rules rigidly. This is the reason parties had recourse to arbitration, where a more satisfactory solution may be reached, through the arbitrator's free choice of the most appropriate conflict of laws system.

In an arbitral award under the ICC auspices presumably rendered in France, in a dispute between a Bulgarian state enterprise and a Swiss buyer in a contract concluded by telex and to be performed in Alexandria, Egypt, the Swedish arbitrator held:

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[46] *See, e.g.*, ICC award No. 953 *supra*.

[47] *See* Fouchard, *supra* note 1 at 378; Lew, *supra* note 1 at 300; Lalive, *Les règles . . . , supra* note 1 at 181.

[48] *See* Lew, *supra* note 1 at 299.

> In this matter [the applicable law] the arbitrators consider that it would be proper to apply Swiss private international law.[49]

The contract was related to many countries: France, the seat of arbitration; Bulgaria, the nation of the seller and the place where the contract was concluded; Switzerland, the nation of the buyer; Egypt, the place where the contract was to be performed, and Sweden, the nation of the arbitrator. However the arbitrator decided to apply Swiss private international law, that led to the application of Bulgarian law, because it was the more appropriate for the case at hand. He gave no real explanation of that choice.

6. Application of an International Conflict of Laws System

The last stage before definitely abandoning any conflicts rule is the application of an "international" conflict of laws system.[50] If, as it has been established in the previous section, an arbitrator might be free in the selection of a national private international law system, why should he not be able to create personally a conflict of laws rule with an international character?

The methodology to be followed consists of a comparative analysis of several bodies of private international law from which an international arbitrator could choose a set of general principles of conflict of laws. This solution, representing a compromise among different laws, is similar to von Mehren's theory of choice of laws: "special substantive rules derived from the competing domestic law rules."[51] A comparison, however, can only be made on the methods of the two theories, not on the substance. Professor von Mehren attempts a compromise among different substantive laws; here, on the contrary, the issue concerns different conflict of laws systems. The problem is on another level: "conflit au deuxieme dégré."

One can find several arbitral awards where reference is made to general principles of private international law. For example in a dispute[52] involving a breach of contract a Swiss arbitrator firstly looked at the Swiss choice of law rule. However, immediately after that, he noticed that the Swiss conflicts rule led to the same result than the principles generally recognized in this field by most countries. He then compared the Swiss system with other private international law systems and finally grounded his decision on some generally accepted principles of conflict of laws.

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[49] ICC award No. 1048, Doc. No. 410/802, January 11, 1960.

[50] Arguing in favor of this theory: Goldman, *supra* note 1 at 414; Fouchard, *supra* note 1 at 385.

[51] *See* von Mehren, *Special Substantive Rules for Multistate Problems: Their Role and Significance in Contemporary Choice of Law Methodology*, 88 Harv. L. Rev. 347 (1974).

[52] ICC award, 1959, in Fouchard, *supra* note 1 at 389.

7. Application of a Substantive National Law without Having Recourse to any Conflict of Laws System

At this stage the process of "denationalization" of arbitration is almost completed: the arbitrator does not deem it necessary to apply any private international law system, whether national or international. He settles the dispute between the parties by directly applying a set of substantive rules of a country, without going through the cumbersome process of conflict of laws analysis. This solution has been followed in two different types of situations that will be considered separately.

a. When There Is a False Conflict of Laws[53]

If the substance of the conflicting laws does not differ, because the final result of the dispute is the same, an arbitrator does not have to ground his decision on any conflict of laws rule, but simply on that substantive provision. For example, in a contract for the sale of goods between a German and a Swiss individual, the arbitrator did not apply any conflicts rule, but grounded his decision on a substantive provision common to German and Swiss law:

> It is necessary to underline from the outset that the question of the law applicable is only of interest if there exists between the systems of law to which the parties are submitted a true conflict of laws. As German and Swiss laws impose similar solutions in matters of the law of obligations and of commercial law, one may thus, as a general rule abandon the research for the applicable law.[54]

b. When There Is a True Conflict of Laws

The substantive conflicting laws may contain different provisions, hence leading to dissimilar solutions of the dispute: this is a so-called true conflict of laws situation. In this context a national court would usually apply its private international law rule. In contrast, it has been maintained that an arbitrator can decide to apply a national law directly, without having recourse to any conflicts rule. The law so selected is called the proper law

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[53]It is now necessary to determine the different ways in which the expression "false conflict" may be used. It has been adopted, by analogy, *supra* at 33, to identify the situation where different conflict of laws systems lead to the application of the same national law. In that case it can be defined as a "false conflict" "au deuxieme dégré." On the other hand, when a national court is faced with a choice of laws issue, a false conflict arises:

— either when one of the jurisdictions involved does not have a real interest in the application of its law (its policies do not apply to the case)

— or the substantive laws connected with the dispute solve the legal issue in the same manner.

In this section "false conflict" must be interpreted to mean the latter, as described by Leflar, American Conflicts Law, 239 (New York 1968):

> if the laws of both states relevant to the set of facts are the same or would produce the same decision in the lawsuit, there is no real conflict of laws and the case ought to be decided under the law that is common to both states. Some of the strongest decisions with some of the lengthiest and most convoluted opinions in the books could have been handled simply and easily if this false conflict analysis had been accepted and employed.

[54]ICC award, No. 2172, Doc. No. 410/2384, 1974.

of the contract. This theory was invented in the nineteenth century by an English scholar, Westlake. It represented an alternative to traditional solutions (*lex loci contractus* and *lex loci solutionis*) in choice of laws in the field of contracts. Its development in the English tradition, may be summarized in the definition given by Dicey & Morris of the proper law of a contract:

> When the intention of the parties to a contract with regard to the law governing it is not expressed and cannot be inferred from the circumstances, the contract is governed by the system of law with which the transaction has its closest and most real connection.[55]

The same theory has been adopted also in American private international law. Section 188 of the RESTATEMENT OF CONFLICT OF LAWS, SECOND, by the American Law Institute states:

> The rights and duties of the parties with respect to an issue in contract are determined by the local law of the State which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 5.

This methodology fits also in an international commercial arbitration. An arbitrator can in this way reach the most appropriate solution. He selects the applicable law through his wisdom and his experience in international trade and not through a rule of conflict of laws that may be too rigid. The solution will better fulfill the expectations of the parties and the exigencies of international commerce.

One can find several arbitral awards, where the applicable law has been determined directly by the arbitrator as the proper law of the contract, and not through a choice of laws process. In a licensing agreement between an American and a French individual it was held:

> As the agreement is in the first place to be executed in France and differences between the parties have to be decided by arbitration in Paris, the proper law of the contract is French law.[56]

The arbitrator pointed out that the contract had its closest connection with France, and therefore applied French substantive law.

A better application of this method can be found in an award for a dispute between a Yugoslavian seller and an Iranian buyer in a contract concluded in Iran. The arbitrator stated that there are several elements which must be taken into account to determine the system of law which has the closest relation to the contract, like the place where the contract was concluded, the place where the contract was performed and residence of parties. The arbitrator, after an analysis of those and other elements, concluded, without considering any conflicts rule, that the contract had its closest and most real connection with Iran.[57]

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[55] DICEY & MORRIS, *supra* note 9, Rule 145 sub-rule 3 at 769.
[56] ICC award, June 16, 1960.
[57] ICC award, No. 1717, 1972.

8. Application of a Non-National Standard

The other side of the spectrum is finally reached: the arbitrator not only does not take into consideration any conflict of laws rule, but also does not apply a national law: the dispute will be settled by a set of rules that do not have their origin in any national law. The process of denationalization is now complete. These are rules of private law truly international, designed to regulate an international contract. As already mentioned,[58] this phenomenon has been labeled in several ways: for convenience it will be referred to here after as "lex mercatoria."[59]

The theory of lex mercatoria, intended as a set of rules to regulate international commerce, is not new. It has its origins in the "*ius gentium*" of Roman law, developed in the mediaeval merchants community in Italy, and reached its zenith between the eighteenth and the nineteenth century in England. It has had a strong revival in past decades, even though the current trend of statism does not leave much room for any theory attempting to develop legal provisions outside a national legal order.

The uncontroversial departure point is the existence of several customary rules regulating international commerce, which developed outside national laws. People trading across the world realized that national commercial legislation was insufficient to control a different and wider phenomenon. For example the sale of goods across the ocean presents some problems that would never arise in a sale between persons in Milan and Rome or in New York and Boston.

International merchants started including in their contracts provisions regulating these new exigencies. The repetition of these contractual provisions transformed them into a custom and usage by which international traders felt bound. In the development of lex mercatoria arbitration played, and still plays, a determinant role. A national court in its very nature has a nationalistic view toward an international problem. This means that a national judge is probably less willing to apply lex mercatoria because it developed outside the national legal system; moreover, any attempt by him to apply it would involve a national approach to lex mercatoria that does not suit the exigencies of the parties. From here the growth of arbitration as an alternative forum where lex mercatoria can find a better understanding from an arbitrator which has been chosen by the parties because of his expertise in the international field. The link between lex mercatoria and international arbitration is a very strong one: the former guaranteed the

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[58] *See supra* at 19.

[59] In some international arbitral awards the process of denationalization took another path. Customary public international law or general principles of law (as in art. 38 of the ICJ statute) were selected. However, it must be noted that these disputes were related to contracts between an individual or private corporation on the one hand and a nation or a governmental agency on the other hand. (*See, e.g., Lena Goldfield* case, *Abu Dhabi* case, *Aramco* case, *Sapphire* case, *Texaco* case). The presence of a sovereign state and the consequent "internationalization" of the dispute raise new and different issues that would require a separate study.

development and success of the latter and vice-versa. An arbitrator, in upholding parties' choice of lex mercatoria as the applicable law or in selecting it to regulate the dispute, if they did not make any choice, fulfills their expectations.

Though nobody contests that international usages regulate trade across boundaries and that international arbitrators support their application, only some commentators developed further. It has been maintained[60] that lex mercatoria is the substantive law of an independent legal order, separate from any national law, that is the international merchants society. International traders with common interests must be able to organize a community with its own legal system that does not derive its authority from a nation. The organs of this society, implementing its aims, are international arbitrators and arbitral institutions. When an arbitrator applies lex mercatoria, he is fulfilling the same function as a national court applying national law. Goldman noted[61] that as a national judge faced by a dispute without any foreign elements applies national law, so does an arbitrator dealing with an international contract by simply applying lex mercatoria. When parties to an international contract have selected a national law, an arbitrator can always supplement these provisions with lex mercatoria: this is like a national court that, even though it has decided to apply a foreign law, will fill the gaps of that law with the lex fori.

Once the subjects and the organs of this legal order have been delineated, one has to establish the sources of lex mercatoria. There are at least three of them. First, there is a set of rules, developed as has been shown *supra*, called international custom, usage or practice. These rules are sometimes included in contractual clauses, but in any case an arbitrator can apply them since they are supposedly binding on international traders. Second, there is the so-called "international legislation."[62] This includes International Conventions and Uniform Laws: The Convention on International Sale of Goods 1966, revised in 1980; the Convention on the Carriage of Goods by Sea 1968; the Convention on the Contract for the International Carriage of Goods by Road 1956; the Uniform Law for Bills of Exchange and Promissory Notes 1930; the Convention for the Unification of Certain Rules Relating to International Carriage by Air 1929, revised in 1955 and several others.[63]

If one attempts to weigh the two primary sources of lex mercatoria, at first glance international custom seems to be superior. It is set up by the international trading community itself and it may be adapted to the need of international commerce in a flexible manner. On the other hand international conventions are drafted mainly by scholars and lay down provisions

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[60] *See* Goldman, *supra* note 2; Fouchard, *supra* note 1 at 401; Sanders, *supra* note 1 at 442.

[61] *See* Goldman, *supra* note 2 at 483.

[62] *See* CLIVE M. SCHMITTHOFF, *The Law of International Trade, Its Growth, Formulation and Operation*, in THE SOURCES OF THE LAW OF INTERNATIONAL TRADE, 16 (New York 1964).

[63] *See* CLIVE M. SCHMITTHOFF, EXPORT TRADE, XXXV (London 7th ed. 1980).

representing a compromise among different national legal traditions. By definition a legislative piece is static and requires a long time to be amended. For example the 1966 Convention on Sale of Goods, even though it was already outdated soon after it came into force, required a new international conference to amend it, which took sixteen years in preparation. However, it must be noted that in certain fields, traditionally within the exclusive domain of a country, such as import-export and fiscal regulations, banking laws or insurance law, international legislation seems to be more appropriate. International custom would hardly be effective in these highly regulated fields.

As a secondary source of lex mercatoria, codes of practice, uniform rules, standard clauses and contract-types should be mentioned. These are collections of international customs prepared by international organizations, which are not binding per se. However, parties can insert them in the contract so that they are binding, or international arbitrators can resort to them in order to ascertain the existence of an international custom. For example the ICC prepared the INCOTERMS, a codification of international customs regulating carriage of goods by sea. Under the ICC auspices is also the "Uniform Customs and Practice for Documentary Credits and "Uniform Rules for a Combined Transport Document." Several trade associations codified similar rules of practice and standard conditions.[64]

There are several arbitral awards where the dispute has been settled on the ground of lex mercatoria. The following examples are significant because of the type of justification that has been given for its application. Lex mercatoria seemingly can play a secondary role, when the arbitrator uses it to fill the gaps within the national law selected:

> Whereas in this case, the contract being signed in Paris, it is appropriate to make application of French domestic law, completed, if need be, to a supplementary degree, by the rules and usages of an international character, regulating international contracts.[65]

In another arbitral award, where the parties did not choose any applicable law and the arbitrator decided not to apply a national law on the ground of a conflict of laws rule, lex mercatoria was selected per se. The arbitrator held that, since the parties did not provide a choice of law, because of its international nature, the contract should not be regulated by any national law. On the contrary, the principles generally recognized in the merchants society should apply.[66]

In a similar situation the arbitrator textually referred to "lex mercatoria."[67] More often arbitrators call it "usages du commerce international."[68]

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[64] *See* CLIVE M. SCHMITTHOFF, *supra* note 63 at 45-56.
[65] ICC award No. 1472, Doc. No. 410/1636, May 8, 1968.
[66] *See* ICC award No. 2152, 1972.
[67] *See* ICC award No. 2291, 1975.
[68] *See* ICC award No. 2583, 1976.

Finally, in the following award, an even stronger determination of lex mercatoria as the applicable law was made. The contract was silent on the applicable law and each party pleaded his national law. The arbitrator, without taking into consideration any conflict of laws principle, ruled that the nature of the contract did not permit the application of a national law and that lex mercatoria was thus applicable:

> The parties have not reached an agreement on a law which they assert, in the silence of the contract, be applied to regulate the difficulty of performance which has arisen out of the contract . . . but on the contrary, they requested the application of their national law.
>
> The contract had to be executed in three different countries. The fixing, for its application, of a particular law would present some difficulties. The parties have however manifestly agreed to refer to the general principles and to the usages of international commerce in the case in question.[69]

At this point, one can question whether the problem of the applicable law in international commercial arbitration is really the same both where the parties made a choice and where the arbitrator has to select the applicable law. The question is particularly relevant with respect to the applicability of lex mercatoria: are there any arguments which would justify a broader or narrower freedom to the parties than to an arbitrator in the application of a non-national set of rules without taking into account any conflict of laws rule? If one assumes that an arbitrator, when parties did not make an express choice of the applicable law, will apply lex mercatoria on the grounds of an implied choice, then an arbitrator still relies on the principle of party autonomy. In this case there would be no reason to maintain that the choice of lex mercatoria is more or less acceptable whether the parties or the arbitrator selects it. However, from an analysis of arbitral awards, it appears that arbitrators who apply lex mercatoria do not necessarily rely on the doctrine of an implied choice.

The issue can first be approached from a theoretical viewpoint, considering the distinction between the contractual and the jurisdictional nature of arbitration. If one accepts the first theory, then lex mercatoria should have a broader recognition when chosen by the parties. The second theory, on the other hand, would accept the applicability of international usages, only within the limitations determined by the arbitrator on the basis of the law of the seat of arbitration.

The problem could also be analyzed from another point of view: are there any practical reasons or any policy considerations which suggest a different relevance of lex mercatoria whether it has been selected by the parties or by the arbitrator? The fundamental policies underlying a private ordering in conflict of laws are two: facilitate individual decision taking and give effect to justifiable expectations.[70] If one looks at the popularity of

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[69]ICC award No. 1859, 1973.

[70]*See* VON MEHREN AND TRAUTMAN, THE LAW OF MULTISTATE PROBLEMS, 247 (Boston-Toronto 1965).

international arbitration among traders because of its simplicity and speed in settling disputes among private parties, one realizes that these policies are particularly relevant in an arbitration contest. It would be inappropriate for an arbitrator to disregard the decision of the parties to submit their contract to international usages. Their expectations would be frustrated. From this perspective the choice by the parties of lex mercatoria as the applicable law, seems to have more cogency.

However, one may look at arbitration as a truly international, possibly supranational, institution, separate from any national jurisdictional system, that represents the jurisdictional aspect of an independent legal order. An arbitrator is then charged to formulate lex mercatoria as the substantive law of this new legal order as well as a national court in common law systems. From this perspective an arbitrator, because of his experience and his role, should be allowed more easily to select lex mercatoria than a private party.

Therefore one can conclude that the question is sound, even though there are different answers depending upon which viewpoint the issue is approached from.

II. International Conventions' Provisions and Arbitral Institutions' Rules on the Applicable Law

A. *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958*

The New York Convention's purpose is to render compulsory among contracting parties the enforcement of arbitral awards. Therefore the specific subject of the Convention does not interfere with the issue at hand: the applicable law in an international commercial arbitration. However, one could argue that article V of the Convention deals implicitly with the subject reading the article "*a contrariis*." Article V[71] lists five exclusive

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[71] Art. V of the New York Convention reads:

1. Recognition and enforcement of the award may be refused at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:

a) The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or

b) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or

c) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or

d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the lack of the country where the arbitration took place; or

grounds upon which a national court may refuse recognition and enforcement of an arbitral award. Among these grounds there is no mention of the decisionmaking process that led the arbitrator to determine the applicable law. This means that a national court must enforce a foreign award even though the arbitrator, in upholding the choice of the applicable law made by the parties, did not ascertain whether under any conflicts rule the party autonomy was limited. The same conclusion can be argued in the case where the parties did not choose any applicable law. The award must be enforced whether the arbitrator selects the law on the ground of a private international law system or applies an international conflict of laws rule or settles the dispute directly through lex mercatoria. This is only an "*argumentum a contrariis*"; however, it seems in accordance with the rest of the Convention to exclude a reanalysis of the arbitral award.

The only provision in the Convention that has some connection with the issue at hand is probably article V(1).[72] The provision is dealing exclusively with the arbitration agreement and not with the whole contract. It is undisputed today that the two issues, the validity of the arbitration agreement and the validity of the contract, are separate and therefore the law applicable to the former is not necessarily the same one applicable to the latter. Consequently a national court could refuse enforcement of the award if the arbitration clause was invalid under either law of article V(1)a, but it could not if any other substantive provision of the contract was invalid under that law.

It has to be pointed out, however, that the provision recognizes the principle of party autonomy, and only when parties failed to give any indication of intent, the law of the seat of arbitration will pass on the validity of the arbitration agreement. The international legislator wanted a simple and clear rule to be applied by national courts. The choice of the law of the country where the award was made was probably decided upon by considering the jurisdictional nature of the issue.

B. *European Convention on International Commercial Arbitration, April 21, 1961*

In contrast with the New York Convention, article VII of the European Convention specifically deals with the issue of the applicable law in an

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e) The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or

b) The recognition or enforcement of the award would be contrary to the public policy of that country.

[72] *See supra* note 75.

international commercial arbitration.[73] The Convention is particularly important because it attempts to shape a common framework of arbitration for parties coming from East and West Europe.

Article VII contains three provisions of interest: the first one considers the situation when parties chose the applicable law, the second one addresses the situation where parties failed to give any indication of the applicable law, the third one examines the role played by trade usages.

1. "The parties shall be free to determine the law to be applied by the arbitrators." This is a general recognition of the principle of party autonomy, enunciated without any qualifications. An arbitrator seems to be obliged to accept any choice made by the parties. When they select a national law, that law has to be applied without determining whether there was any limit to the parties' autonomy under a conflict of laws rule. When they decide that the contract is to be governed by lex mercatoria, the arbitrator does not seem to have any alternative but to apply international customs and usages.

2. "Failing any indication the arbitrators shall apply the rule of conflict that [they] deem applicable."[74] The provision has been interpreted in different ways by commentators, as a result of the intrinsic uncertainty of the rule: no precise criterion is laid down. A discretionary power is left to the arbitrator. Each arbitrator may emphasize different aspects of the dispute and therefore the process for determining the conflicts rule "deemed applicable" may vary each time.

Kopelmanas, one of the drafters of the Convention, in an attempt to explain the meaning of article VII affirmed that the provision was a compromise resulting from the impossibility of determining one conflict of laws rule.[75]

If the purpose of the provision is just to bestow on an arbitrator the widest discretion in selecting the proper law of the contract, why should this be done through the cumbersome process of a conflict of laws rule? The answer is probably that twenty years ago, even though the international legislator realized that arbitration needed this type of evolution, he did not have the power to make a drastic break with the tradition. It should be also recalled that just four years before, Sauser-Hall made an opposite proposal at the 1957 Section of the Institute of International law.

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[73]Art. VII of the Convention reads:

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

[74]The original text of art. VII, in French, is probably more clear. It states: "la règle de conflit appropriée dans l'espèce." This language emphasized the wide discretion left to the arbitrator in selecting the conflicts rule.

[75]Kopelmanas, *Quelques problemes recents de l'arbitrage commercial international*, REVUE TRIMESTRALE DE DROIT COMMERCIAL, 895 (1957).

Finally, some authors[76] looked at this provision as an open door toward "denationalization" of arbitration. Since the Convention does not specify that the rule of conflict deemed applicable must be a national rule of private international law, the arbitrator may create an international conflict of laws rule. The next logical step, the application of lex mercatoria, is then easy.

3. "In both cases the arbitrators shall take account of the terms of the contract and trade usages." The inclusion of lex mercatoria in the article, is a confirmation of its importance in international arbitration. By "[i]n both cases" the provision means that an arbitrator may refer to lex mercatoria not only when the parties so provide in the contract, but also when a national law is applied. Lex mercatoria is the most appropriate to regulate international trade and therefore an arbitrator must resort to international usages even though parties selected a national law.

The words "take account of" are not helpful where a national provision is in conflict with lex mercatoria. If one thinks in traditional terms, the national law will always prevail. However, it has been maintained[77] that article VII should be interpreted so that national law must yield to lex mercatoria, since the European Convention is innovative in the field of international commercial arbitration.

C. *Rules of Arbitral Institutions on the Applicable Law*

The International Chamber of Commerce, the UNCITRAL, the UNECAFE and the UNECE Arbitration Rules, contain specific provisions dealing with the law applicable in an international commercial arbitration.[78]

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[76] *See* Fourchard, *supra* note 1 at 384-85; Goldman, *supra* note 1 at 380.

[77] *See* BENJAMIN, THE EUROPEAN CONVENTION ON INTERNATIONAL COMMERCIAL ARBITRATION, THE BRITISH YEAR BOOK OF INTERNATIONAL LAW, 492 (1961).

[78] ICC Arbitration Rules: art. 13(3)-(5)

> The parties shall be free to determine the law to be applied by the arbitrator to the merits of the dispute. In the absence of any indication by the parties as to the applicable law, the arbitrator shall apply the law designated as the proper law by the rule of conflict which he deems appropriate.
>
> In all cases the arbitrator shall take account of the provisions of the contract and the relevant trade usages.

UNCITRAL Arbitration Rules: art. 33.

> The arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.
>
> In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction.

UNECAFE (United Nations Economic Commission for Asia and the Far East) and UNECE (United Nations Economic Commission for Europe) Arbitration Rules:

> The award shall be based upon the law determined by the parties to be applicable to the substance of the dispute. Failing any indication by the parties as to the applicable law, the arbitrator shall apply the law he considers applicable in accordance with the rules of conflict

All three provisions follow the pattern of the 1961 European Convention: recognition of the principle of party autonomy, the rule of conflicts which the arbitrator deems applicable and the relevant trade usages. One can find some stylistic differences among the three rules, but they probably do not differ in the substance.

Some observations should finally be drawn from a comparison between the doctrine and arbitral awards on the one hand and international conventions and arbitral institutions' provisions on the other. It can be noticed that international conventions and arbitral institutions' provisions fit in the process of denationalization above-described at an advanced point. None of the provisions mentioned supports the traditional view of Sauser-Hall or Mann. The principle of party autonomy is definitely accepted. However, there is no clear recognition of the supremacy of lex mercatoria without having recourse to any conflict of laws rule. The provisions dealing with the conflicts rule deemed applicable when the parties failed to give any indication of intent and on trade usages are both ambiguous. They are like an empty box ready to be filled with an interpretation upholding a new conception of international commercial arbitration.

Conclusion

From the analysis of section I, one can see how the theory is essentially divided in two sides, even though there are some intermediate positions. Some authors support lex mercatoria, "denationalization" of arbitration and the idea that an arbitration should not be necessarily bound by any national conflict of laws rule. Another part of the doctrine, as authoritative as this, argues against lex mercatoria and any attempt to detach arbitration from any national law system. In this section reasons for the nonrecognition of the theory of lex mercatoria will be hypothesized. Finally, a demonstration supporting the theory of lex mercatoria will be attempted.

1. As a starting point, in the effort to understand why the arguments in favor of lex mercatoria never completely prevailed, one could quote from Mann:

> No one has ever or anywhere been able to point to any provision or legal principle which could permit individuals to act outside the confines of a system of municipal law.[79]

This proposition is probably correct: Goldman, Fouchard, Lew and the other authors supporting lex mercatoria as a system of law did not question its existence or authority. They furnished several valid and practical arguments in its favor, but without giving a theoretical framework and justification for this hypothetical new legal order. It is important to stress that international commerce needs a "denationalization" of arbitration and that

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of laws. In both cases the arbitrator shall take account of the terms of the contract and trade usages.

[79]Mann, *supra* note 1 at 160.

international merchants look at an arbitration as disconnected from any national law system. However, it is not enough. One has to demonstrate how this new legal order, in which international arbitration plays such an important role, can subsist theoretically.

On the other hand, one must observe that even the authors who disfavor lex mercatoria assume that arbitration is necessarily linked to a national law system, without challenging in theory the possible existence of a different legal order.

The matter thus becomes one of "burden of proof." Every provision of law or institution that does not belong to international law must therefore belong, *a fortiori*, to national law. As a logical consequence, since international commercial arbitration is not within the borders of the public international law system, Mann is correct in maintaining that the legal basis of arbitration, like any other national institution, is based on a national system. It is not the burden of Mann and the other authors who do not favor lex mercatoria to demonstrate its existence since it represents a change in the status quo. Rather, it is that of Goldman, Fouchard and Lew to show that it belongs neither to a national nor an international legal system, but may be fitted in a new legal order, a "*tertium genus*."

2. From this premise one has to investigate whether it is possible to fill the gaps in the doctrine supporting lex mercatoria. An attempt thus will be made to give a theoretical demonstration that a new legal order in which lex mercatoria is the substantive law and arbitration represents the judicial mechanism exists. It must be emphasized that this discussion represents merely a starting point for further and deeper analysis.

The methodology that will be used in the effort to demonstrate the existence of lex mercatoria consists of a comparison between the system of public international law and the newly posted legal order. The basic assumption is that public international law is the only non-national legal order generally recognized. It therefore follows that if one wants to demonstrate the existence of a third legal order, independent from national law, he has to compare it with public international law as the only non-national legal order whose reality is not disputed.

In the comparison of the constituent elements of international society with those of merchants' society, one can draw several analogies. The limits and weaknesses of lex mercatoria and of a "denationalized" arbitration are often similar to those of public international law. Therefore it can be argued that from a legal point of view there is no fundamental theoretical opposition to the existence of lex mercatoria. It exists in the same way that international law exists. The difficulties and limits that lex mercatoria and international arbitration encounter in practice, due to the power and effectiveness of national law, are the same ones encountered by public international law. However, they should not be considered to deny the existence of lex mercatoria. If this premise is correct one could deduce that the grounds

for the challenge to the existence of lex mercatoria are also applicable to public international law.

3. The next step consists of outlining the constituent elements of the merchants' society and its analogies to the system of public international law.

A. *Subjects*

The individuals who are involved in international commerce—legal persons and arbitral institutions—are the subjects of this new legal order. There is no precise line of demarcation in identifying the subjects of the merchants' society. However, this fact should not be dispositive in refuting the existence of lex mercatoria. Also with regard to public international law it has always been disputed whether individuals, international organizations and microstates are members of international society.

B. *Sources*

It has been established (*supra* at section I) that lex mercatoria developed from agreements between private parties (international trade contracts and arbitration clauses) that over time became the customs and usages of international trade. The analogy to public international law is prima facie evident. International conventions and treaties (agreements between states) have also created customary international law rules. The two constituent elements of "custom," practice and *opinio iuris*, are the same in both legal orders.

C. *Judicial Resolution of Disputes and Enforcement of Arbitral Awards*

It is argued that the existence of a judicial body to settle disputes arising between subjects and the capacity to enforce the judgments of this court are the fundamental bases of a society. Moreover, the effectiveness of a legal order in large part depends upon a compulsory system for settling disputes and its ability to enforce its decisions.

One of the main criticisms of lex mercatoria is that one cannot maintain the existence of a legal order without a forum in which lex mercatoria is supreme and applies as the lex fori. Moreover, this new legal order does not have a forum in which international traders can, as of right, address themselves when another member of this society has broken a rule of the law of international trade. In defense of lex mercatoria one could argue that international arbitration represents the natural forum where parties to an international transaction can settle their disputes. It must be admitted, however, that the merchants' society does not provide a system of compulsory jurisdiction. The establishment of an arbitral tribunal is based upon the agreement of the parties.

Once again, however, there is a parallel to public international law. The International Court of Justice derives its authority from a treaty based upon the consent of nations. Article 36 of the ICJ statute, providing for compulsory jurisdiction, is only an optional provision. Not all states accepted article 36 and some of them accepted it with a reservation. The result of these reservations is to limit the binding effect of the court's obligatory jurisdiction.

A second criticism of lex mercatoria concerns the lack of a special executive body in charge of the enforcement of arbitral awards. It has been argued that the respect given to the decision of an arbitrator depends on the good will of the parties. The merchants' society does not provide an autonomous system for the enforcement of arbitral awards. One can reply, however, that in this respect lex mercatoria is even more effective than public international law for at least two reasons. The first factor is the existence of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Secondly, lex mercatoria is made effective through possible economic action that the Traders' community can take in retaliation against the violation of their customary practices by one of its members.

The above arguments represent hypothetical foundations for a theory that to be fully maintained would require a more detailed analysis.