

International Chamber of Commerce  
Policy and Business Practices

# DEVELOPING NEUTRAL LEGAL STANDARDS FOR INTERNATIONAL CONTRACTS

A-national rules as the applicable law in international commercial contracts with particular reference to the ICC Model Contracts



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## **DEVELOPING NEUTRAL LEGAL STANDARDS FOR INTERNATIONAL CONTRACTS**

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### **FOREWORD**

*When choosing the applicable law, parties may wish to agree on neutral solutions, instead of submitting the contract to the domestic law of one of the parties. When this is the case they may opt for the law of a third country or they may decide to submit their contract to a-national rules of law, such as "principles of law generally recognized in international trade", "Unidroit Principles on International Commercial Contracts", or other transnational rules.*

*ICC has followed this second approach in several of its model contracts by providing optional choice-of-law clauses referring to "principles of law generally recognized in international trade" in conjunction with the Unidroit Principles.*

*The Task Force which has prepared this study has been created, within the ICC Commission on Commercial Law and Practice, with the purpose of exploring the pro's and con's of choice-of-law clauses based on general principles of law and the Unidroit Principles and of clarifying the practical use that can be made of such solution in order to construe choice of law clauses which may help parties to escape the rigid alternative between "my law" or "your law".*

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## CHAPTER 1 INTRODUCTION

### **1.1 The growing importance of transnational rules in international contracts**

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Parties negotiating international contracts will often feel the need to submit their agreement to neutral rules which do not favor either of the parties.

A traditional compromise solution, which is frequently used in international trade, consists in submitting the contract to the law of a third country, as for instance Swiss law, English law or Swedish law.

This solution is certainly more balanced than the choice of the law of the country of one of the two parties, since it will give neither of them the advantage of having recourse to its own law. In fact, both parties will be in the same condition, i.e. both will need to deal with a law with which they are not familiar.

Since it is rare that parties have a good knowledge of the chosen law of a third country (and since they will typically not have the time to verify whether the contract fully complies with such law), it may emerge later (especially in case of dispute) that some provisions of the contract do not comply with the applicable third-country law or that some of the gaps inevitably left will be filled by provisions which give rise to unexpected results.

Moreover, in case of controversy, both parties will need to retain a lawyer of the third country whose law has been chosen, which will often imply substantial costs and additional complications.

This is why businesspeople and their legal advisors are increasingly interested in transnational rules which can help them to create an alternative neutral legal framework for their international contracts.

In order to obtain this result two different approaches can be taken:

- the first, more traditional, approach is to remain within the framework of domestic laws and to refer, within such framework, to rules designed specially for international transactions, like uniform laws (such as, for instance the UN Convention on Contracts for the International Sale of Goods: CISG) or "private" rules drafted by non-state organizations (such as the Incoterms® rules of the ICC or the Unidroit Principles);
- the second, more "revolutionary", approach is to assume the existence of an autonomous legal system (the so-called *lex mercatoria*) that can govern international contracts instead of domestic laws, and to develop tailor-made solutions within such framework.

We will examine in more detail these two possible approaches in the following paragraphs.



## 1.2 The traditional approach to transnational rules

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The traditional approach consists mainly of referring to rules for international commerce which have been established within the framework of national (domestic) legal systems.

Thus, several international conventions have established uniform rules which can be incorporated into the domestic laws.

The most important example of this approach is the UN Convention on Contracts for the International Sale of Goods (Vienna Convention of 1980), in force in more than 70 countries. Through this solution the uniform rules in the Vienna Convention (which can be considered “transnational” as to their contents) are incorporated into the domestic law of a ratifying country so that all the countries that have adopted the Convention have common (domestic) rules governing international sales.

Through this mechanism parties in states which have ratified the Convention are put in a situation where their international contract is governed by the same rules whichever of the two parties’ domestic laws are applicable (as long as it is of a CISG state party).

The limit of this system is that the few international conventions which have introduced uniform laws (see, in addition to the CISG, the Unidroit conventions on financial leasing and international factoring) cover only a very limited number of contract types and furthermore do not apply to all countries of the world (for example, the 1980 Vienna Convention has not been ratified by the United Kingdom). Moreover, the uniform rules governing a specific type of contract deal mainly with the issues regarding that contract, but do not include all rules on contracts in general. This means that some more general issues (like for instance the validity of penalty clauses in contracts of sale) remain governed by the applicable national law, which can be very different from country to country.

A further important contribution to the creation of transnational rules is that of establishing “private” sets of rules for international transactions which may be incorporated by reference in the parties’ contracts. Examples of this approach are general rules on international contracts such as the Unidroit Principles or the Lando Principles, or rules dealing with more specific issues, such as ICC rules including Incoterms® 2010, UCP 600, etc.

As we will see hereafter, general sets of rules governing contracts (such as the Unidroit Principles) can be applied within the context of a domestic law (*infra*, § 3.3) or autonomously, as “the applicable law” (*infra*, § 2.4) or within the context of the *lex mercatoria* (*infra*, § 2.3).





### 1.3 The theory of *lex mercatoria*

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An alternative response to the demand to have international contracts governed by transnational rules is offered by the theory of *lex mercatoria*.

According to this theory, international contracts can be ruled by an "a-national" system of principles and rules generally accepted in international commerce, the so-called new *lex mercatoria* or law merchant, which can be applied instead of national law systems.

Parties engaged in international commerce can thus refer – according to this theory – to a system of transnational rules, capable of constituting an alternative legal framework for their transactions, closer to their needs and expectations than most domestic laws.

The theory of *lex mercatoria* was developed in the second half of the twentieth century by a number of authors<sup>1</sup> who sustained that this system of transnational rules, which could replace or integrate the domestic laws, was gradually emerging from international business practice. These rules could be found in the uniform practice of contracts and clauses commonly used in international commerce and in the general principles of law developed in international law.

This theory offered arbitrators a means for "delocalizing" international disputes and escaping the narrow limits of domestic laws, by directly applying autonomous rules of international commerce.

And, in fact, in the 1970's we encounter some arbitral awards applying «principes généralement admis»<sup>2</sup> or «principes généraux largement admis régissant le droit commercial international»<sup>3</sup>, followed later by awards which take the further step to formally use the term *lex mercatoria*<sup>4</sup>.

Thanks to this arbitral jurisprudence and to the fact that it resisted the attacks brought against it before the domestic courts (which refused to set aside awards applying the *lex mercatoria*<sup>5</sup>), the principle was gradually established that arbitrators have the right to apply general principles of the *lex mercatoria* instead of a domestic law.

At present in most jurisdictions the decision by arbitrators to apply *lex mercatoria* will not be questioned by national courts. Consequently, recourse to the *lex mercatoria* as the governing law of an international contract is an option which is lawful and effective, at least when any possible disputes are submitted to arbitration (see *infra*, § 3.3).

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<sup>1</sup> See, inter alia, GOLDMAN, *Frontières du droit et «lex mercatoria»*, in *Archives de Philosophie du Droit*, 1964, p. 177 et seq.; *la lex mercatoria dans les contrats et l'arbitrage internationaux*, in *JDI*, 1979, p. 475 ss.); GOLDSTAJN, *The New Law Merchant*, in *J. Bus. L.*, 1961, p. 12 et seq.; SCHMITTHOFF, *The Law of International Trade, its Growth, Formulation and Operation*, in *The Sources of the Law of International Trade*, London, 1964, p. 3 et seq..

<sup>2</sup> ICC award n. 2152 mentioned by DERAIS in his comment to the award 1641/69, in JARVIN, DERAIS, *ICC Awards 1974-1985*, p. 190.

<sup>3</sup> ICC award n. 3267 of 14 June 1979, in JARVIN, DERAIS, *ICC Awards 1974-1985*, p. 376 et seq..

<sup>4</sup> See for instance: ICC award n. 3131 of 26 October 1979 in the case *Pabalk Ticaret Limited Sirketi c. Norsolor S.A.*, in *Rev. arb.*, 1983, p. 525 ss.; ICC award n. 3540/80, in JARVIN, DERAIS, *ICC Awards 1974-1985*, p. 399 et seq.; ICC award n. 5953 of 1<sup>o</sup> September 1988, *Primary Coal c. Compañía Valenciana de Cementos Portland*, in *Rev. arb.*, 1990, p. 701 et seq.

<sup>5</sup> See *infra*, § 3.3.



This means that opting for this “a-national legal system”, instead of a national law, can constitute a workable legal framework, provided its rather general principles are integrated by additional and more specific rules, such as the Unidroit Principles, as we will see in more detail hereafter (*infra*, § 2.3).

#### 1.4 The increasing acceptance of transnational rules

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In principle, systems of private international law tend to refuse the possibility of applying transnational rules, and in particular the *lex mercatoria*, as the law governing an international contract. According to this view, the applicable rules of law should be those of a domestic legal system; rules which are not part of a domestic legal system may apply, but only within the framework of the applicable domestic law, for example if they have been incorporated by reference into the agreement of the parties or if they can be qualified as a trade usage.

There have been attempts in recent years to soften this approach by recognizing a more important role for transnational rules.

During discussions within the European Union on the revision of the Rome Convention of 1980, which would have become Regulation 593/2008 (Rome I Regulation), the issue whether a “non-state body of law” could be chosen by the parties as the applicable law was debated. The proposal submitted by the European Commission in 2005, stated that:

*«The parties may also choose as the applicable law the principles and rules of the substantive law of contract recognised internationally or in the Community.*

*However, questions relating to matters governed by such principles or rules which are not expressly settled by them shall be governed by the general principles underlying them or, failing such principles, in accordance with the law applicable in the absence of a choice under this Regulation.»*

Nevertheless, at the end this proposal was rejected and the final version of Article 3 “Freedom of choice” clearly states that “a contract shall be governed by the law chosen by the parties”, where the use of the term “law” is normally understood to mean that it must be a state law.

Paragraph 13 of the recitals of the Rome I Regulation says that “*this Regulation does not preclude the parties from incorporating by reference into their contract a non-State body of law or an international convention*”, the notion of incorporation meaning that the non-state law in question would have the value of a contractual clause to be applied and interpreted within the context of the national law applicable to the contract. This confirms that the European rules of private international law applicable to obligations do not in principle recognize *lex mercatoria* and, more generally, transnational rules, as rules that can govern an international contract instead of a specific national law.

A more flexible approach has been taken recently by the draft “Hague Principles on the Choice of Law in International Contracts” approved in November 2012 by the Special





Commission of the Hague Conference on Private International Law.

Article 3 of the draft Hague Principles recognizes the possibility of applying a-national rules under certain conditions by stating the following:

*«In these Principles, a reference to law includes rules of law that are generally accepted on an international, supranational or regional level as a neutral and balanced set of rules, unless the law of the forum provides otherwise.»*

Also the Inter-american Convention on the Law Applicable to International Contracts (Mexico 17 March 1994) considers principles of international commercial law, by stating the following in Article 10:

*« In addition to the provisions in the foregoing articles, the guidelines, customs, and principles of international commercial law as well as commercial usage and practices generally accepted shall apply in order to discharge the requirements of justice and equity in the particular case.»*

Furthermore, several domestic laws on arbitration recognize that arbitrators may apply “rules of law” (see: *infra*, § 4.1 for further details). This implies a recognition of the arbitrators’ right to apply transnational rules instead of a domestic law.

Finally, it may be interesting to mention that the standard conditions of the United Nations for the provisions of goods and services provide in clause 17.2 that possible decisions of the arbitral tribunal shall be based on “general principles of international commercial law”.

All this shows that there is a trend towards a gradual recognition of the possibility of applying transnational rules, particularly within the framework of international arbitration.

## **1.5 The purpose of this study**

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Since the appearance of the *lex mercatoria* theory as a possible alternative to the traditional approach based on application of a specific domestic law, determined by the rules of private international law, many lawyers have shown great scepticism concerning this solution.

We will not discuss here the theoretical foundation of *lex mercatoria*.<sup>6</sup>

It is sufficient to say that this theory has been successful in the sense that it is generally admitted that – provided possible disputes are brought before international arbitrators – the parties can lawfully submit their contracts to “*general rules and principles regarding international commercial contractual obligations enjoying a wide international consensus*”<sup>7</sup> instead of national laws, and that such choice will be effective, i.e., the arbitrators will apply such rules, and the awards applying *lex mercatoria* will normally be recognized by national courts (for further details, see § 3.3).

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<sup>6</sup> For a general overview of the different opinions, see Berger, *The Creeping Codification of the Lex Mercatoria*, 1999, p. 32 et seq.

<sup>7</sup> See arbitral award ICC n. 7110/95, in *ICA Bull.*, 2/1999, p. 40 et seq., p. 53.



In other words, the main purpose of this study is to deal with the issue of the *lex mercatoria* and/or general principles of law as a contractual solution for the choice of the governing law which can be used when no agreement on a domestic law is possible or appropriate. At the same time this study is intended to help users of ICC model contracts (many of which contain this type of solution: see in particular the clauses mentioned in § 2.3, hereunder) to better understand the actual meaning of the *lex mercatoria* approach and to evaluate the pro's and con's of this solution as opposed to the traditional one, consisting in submitting the contract to a national law.



## CHAPTER 2

### THE CONTENTS OF THE LEX MERCATORIA AND ITS COMBINATION WITH THE UNIDROIT PRINCIPLES

#### 2.1 The basic contents of the *lex mercatoria*

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The contents of the *lex mercatoria* are mainly principles of law generally recognized in international trade.

Such principles, which have been applied by international arbitration tribunals and which are generally considered – by the supporters of the *lex mercatoria* theory – to be part of the *lex mercatoria*,<sup>8</sup> include:

- Parties are bound to respect the terms of the contract (*Pacta sunt servanda*), unless there is a significant change of circumstances (*rebus sic stantibus*).
- Parties must perform the contract in good faith.
- Parties may be liable for not respecting good faith during negotiations (*culpa in contrahendo*).
- A contract obtained by bribes is void, or at least unenforceable.
- A party can refuse to perform its obligations if the other has committed a substantial breach (*inadiplenti non est adimplendum*).
- Damages for breach of contract are limited to the foreseeable consequences of the breach and include actual loss and loss of profit.
- A party which has suffered a breach of contract must take reasonable steps to mitigate the damage.

A very exhaustive list of 130 general principles of the New Lex Mercatoria, together with thousands of full text comparative references, the “TransLex-Principles”, is published on “TransLex”, the online platform on transnational commercial law, operated by the Center for Transnational Law (Central) at Cologne University Faculty of Law ([www.trans-lex.org](http://www.trans-lex.org)).

It is undeniable that these very general principles, which may not always answer the specific questions that arise in a dispute, leave much latitude to the discretion of the arbitrators, and may not warrant the foreseeability of the possible outcome of a dispute, which the parties normally expect. At the same time, it should be remembered that the contents of the *lex mercatoria* are gradually becoming more precise<sup>9</sup>.

Many lawyers tend to refuse *a priori* the choice of the *lex mercatoria* as the applicable

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<sup>8</sup> For more details, see LEW, MISTELIS, KRÖLL, *Comparative International Commercial Arbitration*, Kluwer Law International, 2003, p. 458-460. See also the list of 20 principles compiled by Lord Mustill (MUSTILL, *The New Lex Mercatoria: the First Twenty-Five Years*, in 4 *Arbitration International*, 1986, p. 109 et seq.) and the list of 78 principles mentioned by Berger (BERGER, *The Creeping Codification of the Lex Mercatoria*, 1999, p. 210-211).

<sup>9</sup> For more details see the Translex website mentioned above.



law, because of the lack of sufficiently detailed rules.

However, this objection can be overcome by incorporating in the agreement, within the framework of the *lex mercatoria*, a set of rules specially designed for international contracts, such as the Unidroit Principles (or other similar rules), which can warrant a sufficient certainty and predictability, as we will see in the following paragraphs.

In other words, what is proposed here is to use the *lex mercatoria* theory for establishing a general alternative framework to be integrated by further transnational rules (like the Unidroit Principles) with the purpose of setting up a system of rules which are independent from the domestic laws and at the same time sufficiently structured to answer the parties' need for certainty and foreseeability.

## 2.2 The Unidroit Principles

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The Principles of International Commercial Contracts (hereafter “Unidroit Principles”) were published by Unidroit in 1994. A third edition, which covers several new issues was published in 2010.

The comment to the preamble,<sup>10</sup> states that the Unidroit Principles

*« ... represent a system of principles and rules of contract law which are common to existing national systems or best adapted to the special requirements of international commercial transactions. »*

### 2.2.1 General characteristics

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The Principles deal with most legal issues of a general nature concerning contracts (such as formation, validity, performance, non-performance, damages, etc.). By submitting a contract to the Principles, parties can establish a neutral legal framework which is, at the same time, certain and adapted to the needs of international trade.

The Principles are proposed to the business world mainly as a set of “private” rules that parties may incorporate by reference into their contract. The preamble<sup>11</sup> states that:

*“ ... they shall be applied when the parties have agreed that their contract be governed by them.”*

The “normal” situation in which the Principles are to be applied is, therefore, when the parties have expressly submitted their contract to them, by an express reference in the contract itself.

However, the Principles may also be applied, absent a choice by the parties to incorporate them into their contract, as part of the general principles of law within *lex mercatoria*.

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<sup>10</sup> UNIDROIT, *Unidroit Principles of International Commercial Contracts*, Unidroit, Rome 2010, p. 3.

<sup>11</sup> UNIDROIT, *Unidroit Principles of International Commercial Contracts*, Unidroit, Rome 2010, p. 1.



For example in the ICC case 7110<sup>12</sup> concerning several contracts, which made reference to “natural justice”, the arbitrators came to the conclusion that the parties intended to have their contracts governed by rules other than their respective domestic laws, and thus by general rules and principles:

*“... which, though not necessarily enshrined in any specific national legal system, are specially adapted to the needs of international transactions like the Contracts and enjoy wide international consensus.”*

And thereafter the arbitrators came to the conclusion that these rules could be found in the Unidroit Principles, by stating that:

*“...this Tribunal finds that general legal rules and principles enjoying wide international consensus, applicable to international contractual obligations and relevant to the Contracts, are primarily reflected by the Principles of International Commercial Contracts adopted by Unidroit [...]. In consequence, without prejudice to taking into account the provisions of the Contracts and relevant trade usages, this Tribunal finds that the Contracts are governed by, and shall be interpreted in accordance [with], the Unidroit Principles with respect to all matters falling within the scope of such principles, and for all other matters, by such other general legal rules and principles applicable to international contractual obligations enjoying wide international consensus, which would be found relevant for deciding controverted issues falling under the present arbitration.”*

In other cases, arbitrators have applied the Unidroit Principles as trade usages<sup>13</sup>, considering them to be “the latest codification of international commercial trade usages”.<sup>14</sup>

It can therefore be said that the choice of *lex mercatoria* as the applicable law may by itself include the Unidroit Principles and consequently make it possible to overcome the lack of certainty of the general principles of the *lex mercatoria*.

However, since the automatic inclusion of the Unidroit Principles in the *lex mercatoria* is a theory which may or may not be followed in a specific case, it is safer for the parties to expressly incorporate the Unidroit Principles in their agreement, within the framework of the *lex mercatoria* as the applicable law, as we will see later in more detail in § 2.3.

### **2.2.2 Precautions to be taken when incorporating the Unidroit Principles**

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The Unidroit Principles have been worked out with the purpose of producing a “restate-ment” of the law of international commercial contracts and should therefore be in line with the standards generally accepted by business people engaged in international trade.

<sup>12</sup> Three partial awards in 1995, 1998 and 1999, published in *ICA Bull.* 2/1999, p. 40.

<sup>13</sup> See, for instance: ICC Award n. 10021 of 2000 published in [www.unilex.info](http://www.unilex.info); ICC award 9479 of 1999, in *ICA Bull.* 2001/2, p. 67 et seq.

<sup>14</sup> ICC award n. 10022, in *ICA Bull.*, 2001/2, p. 100.





However, this does not mean that the Principles reflect the “common core” of the various national systems. In fact, the intention of the drafters was not to choose the solutions which prevail in most legal systems, but to select those which had the most persuasive value and/or appeared to be particularly well-suited for cross-border transactions. In other words, the drafters of the Principles, although taking into account the prevailing rules and practice, made a choice in favor of what they considered to be the “best” rules for cross-border contracts, particularly as concerns the need to protect parties against unfairness.<sup>15</sup>

The result of this approach is that there may be, in certain cases, a substantial gap between the Unidroit Principles and the rules or general principles that companies engaged in international trade would consider to be the appropriate rules to govern their contracts.

Let us take, for instance, Article 3.2.7(1) of the Unidroit Principles 2010 (Article 3.10 in the previous version of the Principles) on gross disparity, according to which:

*“ ... a party may avoid the contract or an individual term of it if, at the time of the conclusion of the contract, the contract or term unjustifiably gave the other party an excessive advantage. Regard is to be had, among other factors, to*

- (a) the fact that the other party has taken unfair advantage of the first party’s dependence, economic distress or urgent needs, or of its improvidence, ignorance, inexperience or lack of bargaining skill; and*
- (b) the nature and the purpose of the contract.”*

While the basic principle that a contract can be avoided in extreme cases – where a party has taken an unfair advantage of the other party’s dependence, economic distress or urgent need – can be considered to be generally acceptable, no businessperson engaged in international trade would accept the idea that its counterpart may put forward its own “improvidence, ignorance, inexperience or lack of bargaining skill” as a reason for requesting the avoidance of the contract.<sup>16</sup>

In fact, unless engaged in negotiation with a counterpart having an extraordinary high level of fairness, no responsible lawyer would take the risk that a counterpart may use its pretended ignorance, inexperience or lack of bargaining skill for the purpose of avoiding a contract (or even a contract clause)<sup>17</sup> it dislikes. One may, of course, object that Article 3.2.7 requires an excessive and unfair advantage, which would normally prevent the above principle from being applied too widely. However, even admitting that an experienced arbitrator would not take too seriously the position of a businessperson who claims to have made a bad deal because of inexperience or lack of bargaining skill,<sup>18</sup> the simple fact that the rule exists and that the counterpart can

<sup>15</sup> See BONELL, *“Policing” the Contract Against Unfairness under the Unidroit Principles for International Commercial Contracts*, in *Dir. comm. intern.*, 1994, p. 251 et seq..

<sup>16</sup> See for example HILL, *A Businessman’s View of the UNIDROIT Principles*, in *Journ. Int’l Arb.*, 1996, p. 163, 165-166.

<sup>17</sup> Which is, of course, far more dangerous, since it gives the counterpart the possibility of requesting the avoidance of the part of the contract it dislikes, while maintaining the rest of it.

<sup>18</sup> Also on the basis of the generally recognized principle that business people must know what they do and cannot claim inexperience. In considering all of this, it is difficult to understand how the drafters of the Unidroit



invoke it, remains a danger and makes Article 3.2.7 in its present wording unacceptable for international trade. In order to overcome this problem, it would be sufficient to exclude the words “or of its improvidence, ignorance, inexperience or lack of bargaining skill” in the last sentence of Article 3.2.7(1)(a).

Another example of rules that go beyond the solutions normally accepted in international trade are the provisions on hardship contained in Articles 6.2.1–6.2.3. These rules state that where the occurrence of events which fundamentally alter the equilibrium of the contract (and provided such events become known after the conclusion of the contract, are unforeseeable, are out of the control of the disadvantaged party, and the disadvantaged party did not assume their risk), the disadvantaged party may request renegotiation of the contract and, if renegotiation fails, resort to the court, which may terminate the contract or adapt it with a view to restoring its equilibrium.

Now, this solution is much broader (in protecting the disadvantaged party) than most domestic laws existing in this field<sup>19</sup> and does not at all correspond with contractual practice. In fact, hardship clauses are normally not drafted in general terms, but tend to limit their operation to specific situations and to provide specific solutions (which almost never imply adaptation by a third party) in case of the occurrence of hardship.

The reason for this caution is obvious: traders perceive the adaptation of the contract terms by a third party to be a great danger, and are not willing, except in very exceptional circumstances, to accept such a risk. This is why the model hardship clause established by ICC (ICC Hardship Clause 2003<sup>20</sup>) does not provide, in case of failure of the renegotiation, for the adaptation of the contract, but only for its termination. This result can be obtained by incorporating in the contract the model ICC Hardship Clause or by deleting letter (b) of Article 6.2.3(4) of the Unidroit Principles.

We can therefore conclude that, when choosing the Unidroit Principles as applicable rules, it is recommended to add some words to the clause that incorporate the Unidroit Principles by reference, in order to expressly exclude the incorporation of some specific articles which may not correspond to the expectations of parties engaged in international trade.

The parties should also check whether the limitation periods provided for in Chapter 10 of the Principles are suitable for them or if they prefer to shorten or to extend these periods.

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Principles could include in a set of rules made for business-to-business trade a rule that would have been more appropriate for consumer contracts.

<sup>19</sup> In fact, many national systems do not consider hardship at all (but only situations more close to impossibility of performance, such as force majeure or frustration).

<sup>20</sup> The ICC Hardship Clause is available for download free of charge from the ICC Business Bookstore at: <http://store.iccwbo.org/t/ICC%20Force%20Majeure%20Hardship%20Clause>



### 2.3 The combination of *lex mercatoria* and Unidroit Principles

For those who wish to submit their contract to transnational rules in order to avoid the problems of conflicting domestic laws, and at the same time to establish a reasonably predictable legal framework for their contract, the choice of submitting the contract to the *lex mercatoria* together with the Unidroit Principles should be seriously considered.

This kind of solution has been provided for in several ICC models.

The first model contract containing an express reference to the Unidroit Principles was the ICC Model International Franchising Contract (ICC Publication No. 557, now replaced by a new version published as Publication No. 712<sup>21</sup>), which, in Article 32 A, contained the following clause as an alternative to the choice of a domestic law provided for in Article 32

#### **Clause 1 – ICC Franchising Model (*lex mercatoria* + Unidroit Principles)**

This Agreement is governed by the rules and principles of law generally recognized in international trade together with the UNIDROIT principles on International Commercial Contracts.

A more complex clause was subsequently drawn up and included in several models published in the following years.<sup>22</sup> In the second edition of the Model Distributorship Contract<sup>23</sup>, for example, the following clause is found in Article 24 as an alternative to the clause containing the choice of a domestic law:

#### **Clause 2 – ICC Distributorship Model (*lex mercatoria* + Unidroit Principles)**

“Any questions relating to this Agreement which are not expressly or implicitly settled by the provisions contained in this Agreement shall be governed, in the following order:

- 1) by the principles of law generally recognized in international trade as applicable to international distributorship contracts,
- 2) by the relevant trade usages, and
- 3) by the Unidroit Principles of International Commercial Contracts, with the exclusion – subject to Article 18.2. hereunder – of national laws.”

The above clause aims to create the following hierarchy of rules: first, the contract clauses; second, the general principles; third, the trade usages and finally the Unidroit Principles, with the aim of clarifying that the Unidroit Principles will apply only to the extent they conform to the general principles (*lex mercatoria*) and the trade usages. The main reason for this solution is to give arbitrators the possibility of excluding the application of rules contained in the Unidroit Principles which they may consider not to be in accordance with the reasonable expectations of business, such as those mentioned above in § 2.2.2.

<sup>21</sup> The ICC Model International Franchising Contract is available for sale from the ICC Business Bookstore at: <http://store.iccwbo.org/icc-model-international-franchising-contract>

<sup>22</sup> ICC Model Agency Contract, 2nd ed. (ICC Publication 644); ICC Model Distributorship Contract (sole importer-distributor), 2nd ed. (ICC Publication 646); ICC Model M&A Contract I: Share Purchase Agreement (ICC Publication 656); ICC Model Selective Distributorship Contract (ICC Publication 657); ICC Model Contract for the Turnkey Supply of an Industrial Plant (ICC Publication 653). The wording of the clause is slightly different in the latter model.

<sup>23</sup> The ICC Model Distributorship Contract is available for sale from the ICC Business Bookstore at: <http://www.iccbooks.com/Product/ProductInfo.aspx?id=430>



Another possible solution is to expressly mention the Articles of the Unidroit Principles that should be excluded.

**Clause 3 – Choice of law: *lex mercatoria* and Unidroit Principles**

This contract is governed by general principles of law generally recognized in international trade (*lex mercatoria*) together with the Unidroit Principles of International Commercial Contracts (except for Articles 2.20, 3.2.7 and 6.2.1).

**2.4 The choice of the Unidroit Principles as the governing law: the Unidroit Model Clauses**

Another possible option, which has been proposed in the Model Clauses for the use of the Unidroit Principles, published by Unidroit<sup>24</sup>, consists of submitting a contract directly to the Unidroit Principles, as provided in the following model clause, proposed by Unidroit.

**Clause 4 – Unidroit Model Clause 1.1(a)**

This contract shall be governed by the Unidroit Principles of International Commercial Contracts (2010)

This clause expressly indicates the Unidroit Principles as the applicable law, without any reference to general principles of law or *lex mercatoria*.

The difference with respect to the approach followed in the ICC models is that there is no reference to a system of law (be it the alternative system of the *lex mercatoria* or a domestic law): the Unidroit Principles standing alone are the applicable law.

This may cause some problems if one needs to fill possible gaps. In fact, if in case of dispute issues arise which are not covered by the Unidroit Principles, it is likely that arbitrators will have to refer to the applicable domestic law, while under the ICC model clauses it is clear that one must refer to the general principles of law generally recognized in that particular trade<sup>25</sup>.

In any case, this issue has been taken into account in the Unidroit Model clauses, which provide, with respect to issues not covered by the Principles, the possibility to refer to a domestic law (clause 5) or to general principles of law (clause 6).

**Clause 5 – Unidroit Model Clause 1.2(a)**

This contract shall be governed by the Unidroit Principles of International Commercial Contracts (2010) and, with respect to issues not covered by such Principles, by the law of [State X]

<sup>24</sup> Unidroit, *Model Clauses for the Use of the Unidroit Principles of International Commercial Contracts*, Unidroit, Rome, 2013.

<sup>25</sup> Another advantage of the reference to general principles and usages as provided in the ICC standard clause (Clause 2) is that the arbitrators will be led to give greater consideration to contractual practice developed within certain types of contracts, for instance when it comes to interpret clauses which have a precise meaning in that type of contract.

**Clause 6 – Unidroit Model Clause 1.3(a)**

This contract shall be governed by the Unidroit Principles of International Commercial Contracts (2010) and, with respect to issues not covered by such Principles, by generally accepted principles of international commercial law.

Actually, this last model clause is very similar to the clauses of the ICC model contracts, the main difference being that in the ICC clauses the principles generally recognized in international trade prevail over the Unidroit Principles and not vice-versa.

**2.5 Conclusion: choice-of-law clauses referring to a-national rules can provide an adequate legal framework**

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One of the main objections to choice-of-law clauses which refer to a-national rules is that they do not offer sufficient certainty and foreseeability and that consequently, the choice of a national law as the governing law is always a more appropriate solution.

This study does not intend to show that "a-national" solutions are better than the choice of a domestic law. On the contrary, in many cases the latter solution may be preferable.

What we want to clarify is simply that the option to submit the contract to an a-national system of rules (whatever its name: *lex mercatoria*, general principles, principles of natural justice, etc.) should be considered with an open mind as one of the possible alternatives that an experienced negotiator may consider.

It is also important to stress that we are not proposing the option of simply submitting a contract to general principles of law (or *lex mercatoria*). What we are suggesting in the ICC model contracts is to use the *lex mercatoria* as an alternative legal framework and to include, within this framework, a set of rules on contracts, such as the Unidroit Principles, together with a very precise set of contractual provisions provided in the specific model contract.

In doing so, it is possible to create a rather precise and foreseeable legal framework which may guarantee in many cases as much certainty and predictability as a national law.

In fact, the assumption that a domestic law is always the best solution, which many lawyers uncritically accept as indisputable dogma, is not always true.

First, those who support the absolute superiority of domestic laws almost always have in mind their own national law, which – of course – appears to them to be the clearest and most predictable legal framework. However, they forget that, in many cases, the outcome of a negotiation may be the acceptance of a foreign law, the contents of which, although in theory predictable, will normally be difficult to determine.

Experienced lawyers know how difficult it is to really understand a foreign law (even when it is easy to access its sources, which is not always the case). Therefore, when the outcome is to have a foreign law as the governing law of the contract, this is not necessarily the better alternative. This is particularly the case for companies in developing countries and, more generally, for small and medium-sized companies which may not have the necessary resources for specialized advice on a foreign law.





Second, in most domestic laws a number of contracts commonly used in international trade (distribution agreements, licensing agreements, franchising, joint ventures, transfer of technology agreements, only to mention some examples) are not governed by specific rules, but only by principles – if any – established by the courts, which may not be easy to determine. This means that for many widely used contracts, international practice – as reflected for instance in the ICC model contracts – can give at least as much guidance as the rules of a national legal system.

Third, in many cases the domestic rules on specific contracts are not appropriate for international relations, because they are meant to govern other types of situations. Let us imagine, for example, what can happen if a contract with an occasional intermediary engaged in international trade must comply with domestic laws on brokers (e.g., rules enacted with real estate brokers in mind).

Finally, the reference to “principles generally recognized in international trade” may induce the arbitrators to remain close to commercial reality and to give consideration to the current practice in international trade, for instance with respect to the interpretation and application of contractual provisions. This may be very important where certain terms and/or clauses have acquired a specific meaning in a given business or for a specific type of agreement.

It can therefore be concluded that the recourse to *lex mercatoria* in connection with the Unidroit Principles or similar rules, should be taken into serious consideration as a possible alternative, particularly in cases where the choice of a domestic law appears to be inappropriate or difficult to agree upon. It is on the basis of this assumption that it has been decided to propose in most ICC model contracts the *lex mercatoria* together with the Unidroit Principles as an alternative solution to the traditional choice of a national law.



### CHAPTER 3

#### **LEX MERCATORIA AND NATIONAL (DOMESTIC) COURTS**

As regards the relation between *lex mercatoria* and national courts there are mainly two issues to be considered.

The first one is whether a domestic court would accept the idea that a contract can be governed by transnational rules instead of a national legal system; the second issue is whether a national court should refuse to recognize and enforce an international award which applied *lex mercatoria* instead of a national law.

We will examine these two aspects in the following paragraphs.

#### **3.1 National courts do not in principle recognize *lex mercatoria* as a possible “applicable law”**

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National courts determine the applicable law (and the lawfulness of a possible choice made by the parties) on the basis of their own rules of private international law, i.e. by applying the conflict of laws rules of the forum.

Now, since at present almost all systems of private international law only recognize state laws as possible rules governing a contract, it is very unlikely that a national court may accept a choice of law clause in favor of the *lex mercatoria*.

A possible reference to general principles of law is likely to be understood by a national court as a reference to transnational rules to be applied within the framework of the domestic law and not as an alternative legal system which governs the contract instead of a domestic law.

In other words, the state judge will normally be unable to consider a possible choice of “general principles of international trade law”, “transnational rules”, or “*lex mercatoria*” as a choice of the applicable law, since the applicable rules of private international law normally only admit the choice of a domestic legal system.

Thus, for example, we have seen in § 1.4 that EC Regulation no. 593/2008 of 23<sup>rd</sup> June 2008 regarding the law applicable to contractual obligations (Rome I regulation), and its predecessor, the Rome Convention of 19<sup>th</sup> June 1980, do not consider the *lex mercatoria* as a possible “applicable law”.

#### **3.2 *Lex mercatoria* is not an appropriate solution when disputes are to be submitted to domestic courts**

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Considering what has been said above, it appears clearly that a possible reference to *lex mercatoria* or general principles of law as the law governing the contract would not be considered by a domestic court as a valid choice of the applicable law, but would be viewed as only a reference to rules to be applied within the legal system applicable on the basis of the private international law rules of the forum.



This is why the possible option of submitting the contract to the *lex mercatoria* instead of a domestic law is not recommended when the parties wish to have their disputes decided by national courts.

When possible disputes must be decided by domestic courts, and the parties wish to have recourse to transnational rules, the only way is to incorporate such rules by reference and remain within the framework of a national law, as shown in the next paragraph.

### 3.3 The possible application of transnational rules within the context of a national law

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If a dispute is to be decided by national courts, the only way to warrant a more “transnational” framework is to incorporate transnational rules, such as the Unidroit Principles or the ICC force majeure or confidentiality clauses<sup>26</sup>, by reference into the contract. In this case the above rules will be considered as contractual clauses to be applied and interpreted according to the applicable (domestic) law.

This implies two main differences with respect to the situation where the transnational rules are to be applied within the framework of the *lex mercatoria* instead of the framework of domestic law.

First, if the contract is governed by a domestic law, its provisions (including possible sets of rules incorporated by reference) must conform to the mandatory rules of the applicable domestic law. In case of conflict, the mandatory provisions of the governing law will prevail.

Second, the transnational rules incorporated by reference into the contract must be coordinated with those of the applicable law. Now, if we take a set of rules on contracts, such as the Unidroit Principles, such coordination may not always be easy, since the two sets of rules tend to treat the same (or partially overlapping) issues in different ways, for instance with respect to force majeure.

This being said, the possible option of referring to the Unidroit Principles within the context of the choice of a national law should not be disregarded, especially when the application of a given domestic law is a non-negotiable issue.

Leaving aside the solution mentioned in clause 5 (where the Unidroit Principles are the governing law, but a domestic law applies to issues not covered by the Principles), it is possible to simply incorporate the Unidroit Principles into the contract, as proposed in clause 3 of the Unidroit Model Clauses.

#### **Clause 7 – Unidroit Model Clause 3**

The Unidroit Principles of International Commercial Contracts (2010) are incorporated in this contract to the extent that they are not inconsistent with the other terms of the contract.

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<sup>26</sup> The ICC Model Force Majeure Clause is available for free download on the ICC Business Bookstore at: <http://store.iccwbo.org/t/ICC%20Force%20Majeure%20Hardship%20Clause>, and the ICC Model Confidentiality Agreement and Clause are available for sale through the ICC Business Bookstore at: <http://www.iccbooks.com/Product/ProductInfo.aspx?id=442>



By choosing this option the provisions of the contract will prevail over the Unidroit Principles (even with respect to clauses which are mandatory under the Principles) and the applicable law (chosen by the parties or determined by the adjudicating body in absence of such a choice) will govern the contract. This means that mandatory rules of the governing law will prevail over the Unidroit Principles.

An even "softer" approach could be that of referring to the Unidroit Principles as a means for interpreting and supplementing the applicable domestic law, which option is proposed in the Unidroit Model clauses under n. 4, which states the following.

#### Clause 8 – Unidroit Model Clause 4

This contract shall be governed by the law of [State X] interpreted and supplemented by the Unidroit Principles of International Commercial Contracts (2010).

### 3.4 Domestic courts will normally recognize and enforce arbitral awards which apply *lex mercatoria*

The fact that domestic courts do not recognize *lex mercatoria* as a system of rules which may govern a contractual relationship does not mean that they will not recognize and enforce arbitral awards which apply *lex mercatoria* or general principles of law. In fact, when a domestic court is called to give effect to a foreign arbitral award, such court is not entitled to judge the merits of the case and can refuse recognition only in the presence of the strict conditions stated in Article V of the New York Convention of 15<sup>th</sup> June 1958<sup>27</sup>.

In other words, the fact that the arbitrators have applied transnational rules instead of a domestic law which would have been otherwise applicable is not a reason for refusing to recognize the award, unless it is shown that this amounts to a violation of the public order of the country where enforcement is requested or in case of a violation of other conditions of Article V of the New York Convention.

Now, it is true that with respect to the first cases in which the *lex mercatoria* was applied by arbitrators, the objection was raised that this would have implied that the arbitrators decided the dispute *ex aequo et bono* (instead of applying rules of law) without having been authorized by the parties to do so. However, this objection was rejected by the courts, because it was considered that, by applying general principles of the *lex mercatoria*, the arbitrators in fact applied rules of law<sup>28</sup>.

Thereafter, in most cases where the question of the lawfulness of arbitral awards which applied the *lex mercatoria* instead of a domestic legal system has been brought before national courts, the courts have upheld the arbitral award<sup>29</sup>.

<sup>27</sup> [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html)

<sup>28</sup> See: Cassation (France), 9 December 1981, *Fougerolle*, in *Rev. arb.* 1982. p. 183; Cassation (France), 9 October 1984, *Norsolor*, in *Rev. arb.* 1985. p. 431; Cassation (France), 22 October 1991, *Valenciana*, in *Rev. arb.* 1992. p. 457; Oberster Gerichtshof (Austria) 18 November 1982, *Norsolor c. Pabalk*, in *Rev. arb.* 1983. p. 513.

<sup>29</sup> See, for instance, Tribunal de Grande Instance of Paris, 4 March 1981, *Norsolor v. Pabalk Tikaret*, in *Rev. arb.*, 1983, p. 469; Cass. (France), 9 December 1981, *S.N.C.T. Fougerolle v. Banque du Proche Orient S.A.I.*, in *Rev. arb.*,



We can therefore conclude that the choice of the *lex mercatoria* or general principles of law as the applicable law by the contracting or disputing parties will normally be effective: the arbitral tribunal will respect this choice and the award delivered in accordance with such transnational rules shall be recognized and enforced by the national courts<sup>30</sup>.

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1982, p. 183. Cass. (France) 22 October 1991, *Compañía Valenciana de Cementos Portland v. Primary Coal Inc.*, in *Rev. arb.* 1990, p. 663; Court of Appeal (England), 24 March 1987, *Deutsche Schachtbau- und Tiefbohrgesellschaft mbH c. Ras Al Khaimah National Oil*, in *Yearbook*, XIII-1988, p. 522; US District Court, S.D. California, 7 December 1998, *Ministry of Defense of the Islamic Republic of Iran v. Cubic Defense Systems*, in *Uniform Law Review*, 1999, p. 799.

<sup>30</sup> Of course, this does not exclude that a court wishing to find a pretext for not enforcing a foreign award might use the choice of the *lex mercatoria* (as well as any other argument implying a review on the merits) as a reason for refusing enforcement, but this is another, and more general, problem.





## CHAPTER 4 LEX MERCATORIA AND ARBITRATION

We will now examine the position taken by arbitral tribunals with respect to a possible application of the *lex mercatoria* as the law governing the contract in dispute.

### 4.1 Arbitral tribunals will normally respect a decision of the parties to submit the contract to *lex mercatoria*

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Cases where the parties have expressly chosen the *lex mercatoria* as the applicable law are rather exceptional<sup>31</sup>, such choice being made more frequently in the course of the arbitration proceedings<sup>32</sup>.

Where the parties have made an express choice of the *lex mercatoria* or general principles of law, this choice will in principle be respected by the arbitrators<sup>33</sup>.

In fact, while private international law rules tend to exclude a possible choice of transnational rules as the applicable law, national rules governing arbitration tend to recognize the freedom of the parties to have their disputes decided in accordance with general principles of law.

See for example, Article 1511 of the French Code of civil procedure (Decree No. 2011-48 of 13 January 2011):

*«Le tribunal arbitral tranche le litige conformément aux règles de droit que les parties ont choisies ou, à défaut, conformément à celles qu'il estime appropriées»*

where the reference to “rules of law” means that the arbitrators may apply non-state law.

See also: Article 187 § 1 Federal Statute on Private International Law (Switzerland); Article 28 § 1 of the UNCITRAL model law.

Furthermore, the rules of arbitration of the major arbitration institutions also recognize that arbitrators can apply “rules of law”. Thus, for example, Article 21(1) of the ICC arbitration rules states the following:

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<sup>31</sup> See, for instance the arbitral award of 5 November of the «International Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation» (summarized in [www.unilex.info](http://www.unilex.info)), concerning a contract between a Russian and a German company providing that possible disputes should be decided in conformity with the *lex mercatoria* while providing in another clause the application of German and Russian law; arbitral award of 22 December 2004 of the «Tribunal of International Commercial Arbitration at the Ukrainian Chamber of Commerce and Trade» (summarized in [www.unilex.info](http://www.unilex.info)), concerning a sales contract, submitted to the Vienna convention on the international sale of goods, the *lex mercatoria* and the Unidroit Principles.

<sup>32</sup> See, for instance, ICC award 4761/85, in JARVIN, DERAIS, ARNALDEZ, *ICC Awards 1986-1990*, p. 302; ICC award 5904/89, in JARVIN, DERAIS, ARNALDEZ, *ICC Awards 1986-1990*, p. 387 et seq.; ICC award 8264/97, in *ICC ICArb. Bull.*, 2/1999, p. 63 et seq..

<sup>33</sup> To our knowledge, only in the case decided by the «Tribunal of International Commercial Arbitration at the Ukrainian Chamber of Commerce and Trade», mentioned above in footnote 26, the arbitral tribunal disregarded the choice made by the parties and applied Ukrainian law.



### *Applicable rules of law*

*The parties shall be free to agree upon the rules of law to be applied by the arbitral tribunal to the merits of the dispute. In the absence of any such agreement, the arbitral tribunal shall apply the rules of law which it determines to be appropriate.*

#### **4.2 Arbitral tribunals will not apply *lex mercatoria* if the parties have expressly chosen a domestic (national) law**

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If the parties expressly choose to submit their agreement to a national law, arbitrators will have to apply that law, even if such law appears to be inappropriate in the case of an international transaction.

There is nevertheless some space for "correcting" or "integrating" inadequate domestic laws through the reference to general principles, Unidroit Principles, trade usages, but only to the extent this is admissible under the applicable domestic law.

If the parties have chosen a domestic law as the applicable law together with transnational rules (such as, for instance, the Unidroit Principles), arbitrators will in principle face the same problems described above in § 3.3. However, since arbitrators are not bound to respect a specific system of private international law, they will have a greater discretion when deciding on possible conflicts between the transnational rules and the applicable law.

#### **4.3 Arbitrators may, in exceptional cases, apply the *lex mercatoria* instead of a domestic law when the parties have made no choice of the applicable law**

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If the parties have made no choice, the arbitrators will in most cases apply a domestic law determined on the basis of the principles of private international law or by a direct choice.

Only in rather exceptional cases have arbitrators applied the *lex mercatoria* in the absence of a choice by the parties in favor of this solution.

A very famous case of this kind is the Norsolor case<sup>34</sup>, where the arbitrators applied the *lex mercatoria* in a dispute regarding the termination of a contract between a French principal and a Turkish agent. The agent claimed to be indemnified for the goodwill developed during the contract, but the right to receive this type of indemnification was recognized only by French law (and not by Turkish law). The arbitrators argued that, in the case in question, the conflict of law rules did not warrant an unequivocal solution and consequently decided as follows:

*«Faced with the difficulty of choosing a national law the application of which is sufficiently compelling, the Tribunal considered that it was appropriate, given the international nature of the agreement, to leave aside any compelling reference to a specific legislation, be it Turkish or French, and to apply the international *lex mercatoria*.»*

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<sup>34</sup> ICC arbitral award 3131/1979, *Pabalk Tikaret Limited Sirketi c. Norsolor S.A.*, in JARVIN, DERAIS, *ICC Awards 1974-1985*, p. 122 et seq.



In the context of the *lex mercatoria* the tribunal applied the principle of good faith and awarded on this basis damages to the agent.

In several other cases the arbitrators applied *lex mercatoria* or general principles of law (including in certain cases the Unidroit Principles as part of the *lex mercatoria*) when it appeared that neither party wanted to apply the other party's law<sup>35</sup> or when the parties expressed the desire to have the dispute decided on the basis of non-state rules, for instance through a reference to international law<sup>36</sup>, or «according to the laws of natural justice»<sup>37</sup>.

Another interesting example is the Arthur Andersen case<sup>38</sup>, where the arbitration clause provided, with respect to the applicable law, the following:

*« The arbitrator shall decide in accordance with the terms of this Agreement and of the Articles and Bylaws of Andersen S.C. In interpreting the provisions of this Agreement, the arbitrator shall not be bound to apply the substantive law of any jurisdiction but shall be guided by the policies and considerations set forth in the Preamble of this Agreement and the Articles and Bylaws of Andersen, S.C., taking into account general principles of equity [...]».*

The sole arbitrator decided to apply «*the general principles of law and the general principles of equity commonly accepted by the legal systems of most countries*», and in particular the Unidroit Principles, qualified as a «*reliable source of international commercial law in international arbitration*».

<sup>35</sup> See for instance the *Valenciana* case (partial award on the applicable law of 1 September 1988, *Primary Coal c. Compañía Valenciana de Cementos Portland*, in *Rev. arb.*, 1990, p. 701 et seq.; ICC award 7375 of 5 June 1996 in *The Ministry of Defence and Support for Armed Forces of the Islamic Republic of Iran c. Westinghouse Electric Corporation*, in *Mealey's International Arbitration Report*, vol. 11, 12/1996, A-1 et seq.; ICC award in case 10422/2001, in *JDI* 2003, p. 1142 et seq.

<sup>36</sup> See, for instance ICC award 8365/96 (in *JDI*, 1997, p. 1078) where, with reference to a guarantee, the parties agreed that « ... cette garantie est régie par le droit international». The arbitral tribunal decided that «les parties ont fait un choix implicite de la loi applicable, à savoir les usages du commerce international et les principes généraux du droit (*lex mercatoria*)». See also ICC award 12111 del 6 gennaio 2003 (in [www.unilex.info](http://www.unilex.info)), concerning a clause according to which «This contract is governed by international law (...)».

<sup>37</sup> ICC case 7110, which has resulted in several partial awards in 1995, 1998 e 1999, published in *ICC IC Arb. Bull.*, 2/1999, p. 40 et seq. The dispute concerned several connected contracts which made reference to the principles of *natural justice*: the arbitral tribunal decided to apply general principles of law, including the Unidroit Principles..

<sup>38</sup> ICC award 9797 of 28 July 2000 in the dispute between the *Andersen Consulting Business Unit Member Firms* on one side, and the *Arthur Andersen Business Unit Member Firm* and the *Andersen Worldwide Société coopérative*, on the other side, in *Dir. comm. int.*, 2001, p. 211 ss.



## CHAPTER 5

### RECOMMENDATIONS AND CONCLUSIONS

#### 5.1 In what circumstances is the choice of *lex mercatoria* + Unidroit Principles appropriate?

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Choosing *lex mercatoria* (in conjunction with the Unidroit Principles) may be appropriate in the following situations:

1. Where there is no space for choosing a national law which the negotiating party considers appropriate, in particular when the other party insists on the choice of a national law which is not acceptable (e.g., because it is impossible or difficult to have sufficient knowledge of that law).
2. Where the type of contract is not regulated by national laws, and a common drafting practice has been developed in business, as for example with respect to joint venture or licensing agreements. In this case a well drafted contract submitted to general principles of law and the Unidroit Principles may often offer a better legal framework than a national law. Moreover, when applying general principles recognized in the specific trade, arbitrators will have more space for filling possible gaps with solutions taken from the practice commonly followed within such type of contract. Of course, this implies the need to have possible disputes decided by arbitrators having specific experience in that type of contract.
3. When the parties need to use a standard contract in several jurisdictions and there is no space for submitting it to their own national law. In this case *lex mercatoria* may be a good compromise solution.

#### 5.2 In what circumstances should *lex mercatoria* not be chosen?

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*Lex mercatoria* is not an appropriate solution when possible disputes are to be decided by state courts, because national courts will in principle not recognize such a choice (see, *supra*, Chapter 3, § 3.3).

Thus, contracts of sale where each individual transaction is for a limited amount of money will normally not provide for arbitration for possible disputes, and in this case *lex mercatoria* is not an appropriate solution.

The parties may of course refer to transnational rules within the framework of a national law, as we have seen in § 3.3.

The choice of a domestic legal system as the applicable law will also be preferable when the parties can agree on a national law which is acceptable to both of them. This will be in particular the case where a party is able to negotiate the choice of its own law, or where the parties can agree on a law of a third country which they consider appropriate.



### **5.3 In case of choice of the *lex mercatoria*, should the parties incorporate the Unidroit Principles in their contract?**

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In principle yes, since the principles of law commonly considered to be part of the *lex mercatoria* are too vague and general and do not offer enough guidance and foreseeability in case of dispute.

When incorporating the Unidroit Principles, parties should check whether certain provisions should be excluded: see above § 2.2.2.

### **5.4 How should the clause be worded?**

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See the examples of clauses in Chapter 6.

### **5.5 If the parties submit their contract to the *lex mercatoria*, can the arbitrators refuse to follow such indication ?**

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Arbitrators are in principle bound to respect the choice made by the parties.

If the clause which submits the contract to *lex mercatoria* is clear, there is in principle no reason to fear that arbitrators will not follow the choice made by the parties.

If the clause is unclear, arbitrators may consider the choice non-effective and apply a domestic law, but this outcome is unlikely, especially where it appears that the parties did not want any domestic laws to apply.

### **5.6 Is there a risk that arbitrators will make unforeseeable decisions under the *lex mercatoria*?**

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It should be said at the outset that such a risk exists before any court or arbitral tribunal, whatever the applicable rules of law.

This risk can be minimized by choosing competent and independent arbitrators and by submitting the contract to specific rules, thus limiting their discretion.

By choosing *lex mercatoria* in conjunction with the Unidroit Principles, the parties establish a reasonably complete and foreseeable legal framework with respect to the general contract issues (formation, validity, interpretation, performance, non performance, limitation periods, etc.).

However, when choosing this option there will be no specific rules on the particular type of contract in question, as are found in several national laws with respect to "named" contracts, like sales, agency, lease, etc. This means that for certain contracts a domestic law containing detailed provisions and case law may warrant greater foreseeability (although the parties may overcome, at least in part, this problem by providing detailed rules in the contract itself).

With respect to "unnamed" contracts, as are used in most transactions in international trade (e.g., distribution, franchising, joint venture agreements, trademark and patent licenses, know-how contracts, transfer of technology, turnkey contracts, etc.), most domestic laws do not contain specific rules.





In these cases general principles together with the Unidroit Principles and a detailed contract may in most cases give as much certainty and foreseeability as a national law.

### **5.7 Does the choice of *lex mercatoria* exclude the application of domestic laws?**

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This depends first of all on the wording of the clause. If the reference to general principles and/or to the Unidroit Principles is worded in such a way that no intention to replace national laws appears, the clause may be interpreted to mean that the parties wished to apply transnational rules within the framework of a domestic law (expressly chosen by the parties or determined on the basis of the rules of private international law).

This situation may in particular arise where the parties choose general principles or Unidroit Principles together with an express reference to a national law.

It is therefore recommended that the parties, once they decide to apply the *lex mercatoria*, make a clear choice in this direction by expressly excluding the application of domestic legal systems.

### **5.8 To what extent will the exclusion of national laws be effective?**

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It is generally recognized that by submitting a contract to the *lex mercatoria* or general principles of law, with the exclusion of national laws, possible mandatory rules of domestic laws are excluded.

However, this principle only applies to "simply" mandatory rules.

As regards "internationally" mandatory rules (also called "overriding provisions", "lois de police", "norme di applicazione necessaria": see Article 9, Regulation 593/2008 on the law applicable to contractual obligations - Rome I), such rules will in principle prevail over the *lex mercatoria*, to the extent the arbitrators consider them to be applicable to the dispute<sup>39</sup>.

This means also that an arbitral award based on *lex mercatoria* which does not comply with internationally mandatory rules of the country where recognition is sought, may not be recognized by the courts of such country.

### **5.9 Is there a risk that a domestic court will refuse recognition and enforcement of an award which applies *lex mercatoria* ?**

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In the past the objection has been raised that by applying general principles of law, arbitrators would actually have decided *ex aequo et bono*, and that recognition of the award should be refused if the parties had not given the arbitrators such power.

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<sup>39</sup> See for instance ICC award n. 6500/1992, in ARNALDEZ, DERAIS, HASCHER, *ICC Awards 1991-1995*, p. 452 et seq. where it is said (page 454) ..« ... lorsque la *lex mercatoria* est applicable – comme toute autre "proper law" du contrat – le juge ou l'arbitre devrait tenir compte d'une norme d'application immédiate ou d'ordre public appartenant à un autre système, lorsqu'il y a de bonnes et justes raisons de le faire ...». See also BERGER, *The Creeping Codification of the Lex Mercatoria*, 1999, p. 75-78.





However this theory has been rejected and it has been recognized that, by applying the *lex mercatoria*, arbitrators are in any case applying "rules of law". This means that a national court will recognize arbitral awards which apply *lex mercatoria*, even where such court would not itself respect such choice.

To our knowledge, there are no cases where courts have denied recognition to foreign awards because such awards applied *lex mercatoria*.

Of course this does not exclude that recognition and enforcement may be denied for other reasons, e.g., because the award which applied *lex mercatoria* did not comply with internationally mandatory rules of the country where recognition is sought.



## CHAPTER 6

### EXAMPLES OF CLAUSES

#### 6.1 *Lex mercatoria* + Unidroit Principles

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##### Clause 6.1

“Any questions relating to this Agreement which are not expressly or implicitly settled by the provisions contained in this Agreement shall be governed, in the following order:

- 1) by the principles of law generally recognized in international trade as applicable to international [type of contract: e.g., distributorship, licence] contracts,
- 2) by the relevant trade usages, and
- 3) by the Unidroit Principles of International Commercial Contracts, with the exclusion of national laws.”

This clause, which is the most frequently used clause within the ICC model contracts, states that the contract shall be governed by the *lex mercatoria* and the Unidroit Principles and provides at the same time the following hierarchical order:

1. Contract provisions,
2. general principles of law applicable to the particular type of contract in question,
3. trade usages,
4. Unidroit Principles.

First of all, the clause expressly states that the contract is submitted to an alternative legal system, with the exclusion of national laws. This clarification may be important in order to avoid any possible overlapping with a domestic legal system.

Furthermore, the clause makes clear that the Unidroit Principles apply only to the extent that they do not contradict the contract provisions, general principles of law and trade usages. The purpose of this wording is to give arbitrators the possibility of disregarding rules contained in the Unidroit Principles which are contrary to the contractual provisions agreed by the parties and/or which may contradict the reasonable expectations of parties engaged in a given trade (such as, for instance, the rule on gross disparity: see above, § 2.2.2).

#### 6.2 *Lex mercatoria* + Unidroit Principles (with exclusions)

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##### Clause 6.2

This contract is governed by general principles of law generally recognized in international trade (*lex mercatoria*) together with the Unidroit Principles of International Commercial Contracts [2010] (except for Articles 2.20, 3.2.7 and 6.2.1.) with the exclusion of national laws.

This clause places the general principles and the Unidroit Principles at the same level, but at the same time expressly excludes the application of a number of provisions contained in the Principles which the parties consider not to be appropriate.



Of course, the choice of the Articles which are to be excluded is left to the discretion of the negotiators: one could for instance, maintain the Article on gross disparity and cancel only the words "or of its improvidence, ignorance, inexperience or lack of bargaining skill". Also with respect to the provisions on hardship, it would be sufficient to delete Article 6.2.3(4)(b) which gives the court the right to "adapt the contract with a view to restoring its equilibrium" and to leave only the possibility of contract termination. One could also incorporate by reference the ICC Hardship Clause 2003, which does not provide, in case of failure of the renegotiation, for the adaptation of the contract, but only for its termination.

### 6.3 Unidroit Principles (with exclusions) + *Lex mercatoria*

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#### Clause 6.3

"Any questions relating to this Agreement which are not expressly or implicitly settled by the provisions contained in this Agreement shall be governed, in the following order:

- 1) by the Unidroit Principles of International Commercial Contracts [2010] (except for Articles 2.20, 3.2.7 and 6.2.1.),
- 2) by the principles of law generally recognized in international trade as applicable to international [type of contract: e.g., distributorship, licence] contracts,
- 3) by the relevant trade usages, and  
with the exclusion of national laws."

This clause expressly excludes a number of provisions of the Principles, as in clause 6.2 hereabove. However, while clause 6.2 puts the the *lex mercatoria* and the Unidroit principles at the same level, this clause puts the Unidroit Principles in the first place after the contract clauses and before the *lex mercatoria* and trade usages.

This clause has the advantage over clause 6.2 of clearly providing a hierarchy of the various sources of law.

### 6.4 Unidroit Principles (without exclusions) + *lex mercatoria*

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#### Clause 6.4

This contract shall be governed by the Unidroit Principles of International Commercial Contracts (2010) and, with respect to issues not covered by such Principles, by generally accepted principles of international commercial law.

This clause, (clause 1.3(a) of the Unidroit Model Clauses), puts the Principles in the first place and invokes the general principles (*lex mercatoria*) only for filling the gaps. Since it does not mention the contractual provisions, the issue whether the contract clauses prevail over the Unidroit Principles<sup>40</sup> is not expressly answered.

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<sup>40</sup> In fact, since the Principles are incorporated by contractual agreement between the parties, it may be disputed whether they can prevail over contractual provisions which contradict the Principles.



## 6.5 Unidroit Principles as the applicable law

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### Clause 6.5

This contract shall be governed by the Unidroit Principles of International Commercial Contracts (2010)

This clause (clause 1.1(a) of the Unidroit Model Clauses) consists in choosing the Unidroit Principles as the rules of law governing the contract without reference to any other legal sources.

The clause does not expressly answer the question whether the principles should apply as the applicable law (instead of the otherwise applicable domestic law), or if they should apply together with the applicable national law; and, in the second case, if they should be considered as rules of law or as contractual provisions.

## 6.6 Unidroit Principles + domestic law

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### Clause 6.6

This contract shall be governed by the Unidroit Principles of International Commercial Contracts (2010) and, with respect to issues not covered by such Principles, by the law of [State X]

This clause (clause 1.2(a) of the Unidroit Model Clauses) consists in choosing the Unidroit Principles as the governing law of the contract together with a national law chosen by the parties, which is to rule on all issues not dealt with in the Unidroit Principles.

This means that all issues regarding the specific contract in question will be governed by the domestic law indicated by the parties and that mandatory rules of such law will prevail over the contractual stipulations of the parties.

## 6.7 Unidroit Principles as a means for interpreting and supplementing the applicable law

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### Clause 6.7

This contract shall be governed by the law of [State X] interpreted and supplemented by the Unidroit Principles of International Commercial Contracts (2010).

The purpose of this clause is much more limited than the clauses examined above: it simply intends to ensure that interpretation and supplementation of the applicable domestic law will be in accordance with the internationally accepted principles and rules set forth in the Unidroit Principles.

Such a clause can be useful when there is no way to avoid the application of the law of one of the parties, by choosing a more neutral solution, and the other party would like to make sure that, when applying such law, internationally accepted principles will be given due consideration.