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THE NEW LAW MERCHANT RECONSIDERED

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Content:

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More than ten years have passed since an article of mine, The New Law Merchant, was published in Journal of Business Law. At that time I wrote, inter alia: "Notwithstanding the differences in the political, economic and legal system of the world, a new law merchant is rapidly developing in the world of international trade. It is time that recognition be given to the existence of an autonomous commercial law that has grown independent of the national systems of law."

Speaking of the legal factors underlying this development, I said that two legal factors had made this development possible: the optional character of the law relating to international trade, and the ever-growing use of arbitration in commercial disputes. Due to the fact that that branch of law is founded on the autonomy of the parties' will, freedom of contracting enables those engaged in international trade to overcome the historical peculiarities of the various national systems of law. In this way a new, autonomous law is being developed in practice, expressed in model contracts, standard clauses, general terms of delivery, commercial customs and trade usage. The causes for the emergence of an autonomous international commercial law seem to lie in the diversity and inadequacy of many traditional national systems of law in the changed circumstances of modern international trade.

It is beyond doubt that in the arbitral settlement of disputes in international trade the universal recognition and confirmation of the two fundamental principles of freedom of contract and pacta sunt servanda is an accepted fact.

Speaking of the law of international trade it is necessary to define this concept. What we have in mind here is operations of international trade law transacted on the level of private law. This view came to expression in the Report of the Secretary-General of the United Nations on the Progressive Development of the Law of International Trade.

The expression the "Law of International Trade" may be defined as the body of rules governing commercial relationships of a private law nature involving different countries.

In other words, private law relations deal with the microeconomic aspect of international trade, while public law relations deal with the macroeconomic aspect of trade.

It is a fact that trading methods all over the world - regardless of economic structures - are essentially the same. However, this assertion is based on earlier experiences and observations concerning the development of the law of international trade. A number of developments should be specially mentioned since new facts make it possible to reconsider the accuracy of the above views. Among these facts we should like to mention the following:
First, intensive research carried out within the framework of the International Association of Legal Science. Four extremely successful colloquia\(^5\) have contributed to the rapprochement and harmonization of views of eminent scholars from the countries of different socio-economic systems. Many until then unadjusted views have in the meantime proved themselves unjustified, and the Colloquium in Rome constituted the first step in this direction. It is, however, also necessary to emphasize in particular the Colloquium held in London which discussed the basic questions in connection with the genesis, content and development of the law of international trade. As a result, extensive agreement was reached between Eastern and Western scholars regarding the prospects of the law of international trade. Between individual colloquia there were intensive exchanges of view among participants in the colloquia, many studies were published and views expressed at the colloquia, so that a favourable climate has been created for concrete action on the national and international plane.

Secondly, by drawing up the General Conditions of Sale and Standard Forms of Contract the United Nations Economic Commission for Europe, established in 1947, has done very much to facilitate international trade through avoidance or reduction of uncertainty. It should be especially emphasized that since 1955 there has been active participation of experts from a far larger number of countries, including the countries of Eastern Europe. One cannot overlook the effects of the unification of law resulting from the use of the ECE General Conditions of Sale and Standard Forms of Contract. The fact is that the unification of law is gradually being attained by means of the codification of trade usages.\(^5\)

Thirdly, international conventions in commercial matters decreeing uniform law for international transactions contains the draft of a uniform law which can be enacted even for municipal purposes.\(^7\) However, there are not many such conventions and many essential problems have not been solved by means of international legislation.

Fourthly, by arranging meetings from 1958 to 1964, the International Association of Legal Science carried out preparatory work which led to more ambitious cooperation. It was the Hungarian delegation to the United Nations, i.e. a delegation from a socialist country, which in 1965 requested the Secretary-General of the United Nations to place on the agenda of the General Assembly an item concerning the progressive development of the law of international trade; on December 17, 1966, the General Assembly passed a resolution calling for the formation of a United Nations Commission on International Trade Law (UNCITRAL).

The merit of Professor Schmitthoff lies in the fact that with his leading position, and especially with his General Report on the Colloquium held in London on the Law of International Trade, its Growth, Formulation and Operation\(^8\) , he prepared the ground for the decision of the United Nations Secretary-General to entrust him with the preparation of a draft report which the United Nations General-Secretary then submitted to the General Assembly. Professor Kegel therefore rightly observes that "the most modern doctrine" is the "doctrine of Clive M. Schmitthoff and Others\(^9\) , which has rallied a significant group consisting of a large number of reputed authors.\(^10\)

**I. Present Position**

The similarity of the law of international trade is noticeable when the system of common law is compared with those of the civil law.\(^11\)

Furthermore, the similarity of the law of international trade transcends the division of the world into countries of planned and market economy.\(^12\)

Professor Chloros has expressed the view that at least "our law of contract will be similar in form and substance to continental law. The essence of fusion is to retain in the new law the best elements of both systems".\(^13\)

The reasons for the universal similarity of the law of international trade is that this branch of law is based on three fundamental propositions:

(i) The principle of the autonomy of the parties' will;
(ii) That the contract must be faithfully fulfilled (*pacta sunt servanda*);
(iii) The use of arbitration.\(^14\)
Universal similarity lies in the fact that the difference in the social structure and legal system is by no means an unsurmountable obstacle for evolving unified rules. Commodity-money relations are known to have existed under different social systems, namely in the slave-owing, feudal and capitalist societies. The essence lies in the fact that the influence of identical circumstances and needs has resulted in common or similar solutions. The background of such development is the existence of the world market. The law governing trade transactions is neither capitalist nor socialist; it is a means to an end, and therefore, the fact that the beneficiaries of such transactions are different in this or that country is no obstacle to the development of international trade. The law of international trade is based on the general principles accepted in the entire world.

II. Conditions for the Development of the Law of International Trade

In the field of international trade here is a growing volume of original commercial practice which corresponds to the constant reduction of the sphere of application of municipal law. Numerous are the forms in which international practice attempts to escape from the restrictions of municipal law. Three main reasons explain this:

(i) Great differences in the various national laws are a factor unfavourable to the existence of an international market;

(ii) Municipal laws are becoming inadequate for the problems of international trade. Legal rules, as Rabel stated, are only a part of the entire commercial law actually applied; they are supplemented by trade usages, developed further by judge-made interpretations, and as they are of a dispositive nature, they have been widely replaced by the use of contract forms. Characteristic of the modern international law of trade is the great variety and complexity of legal forms. Therefore the General Conditions, Standard forms of Contract and usages of trade, not infrequently depart in substance from the general principles formulated in national laws;

(iii) The insertion of the arbitration clause into international trade contracts is an essential requirement for the existence of the autonomous law of international trade. International legislation in the field of the law of international trade will for a longer time to come not be able to meet the needs of the international business community. International conventions are relatively slowly created, preparations are hindered by difficulties encountered in the harmonization of national legal systems, and once an inter-state agreement is concluded it is slow in being adapted to new needs. True, there are more international conventions in the field where technical progress demands faster harmonization, but relatively little has been achieved in the spheres of international sales, agency in international trade, insurance law, international investment law, and in some other areas.

There have emerged in practice new forms of business, frequently used in international transactions, which are not regulated either by municipal laws or internationally, as for example, engineering, leasing, various transactions in the field of the hotel law, the contract of goods inspection, banking and other kinds of transactions.

Municipal laws are inadequate for the needs of international trade. It cannot be denied that the legislative mechanism of society works combrously and slowly and that it is to a limited extent suitable for directing mercantile development. On the other hand, it is open to discussion how far society can afford and is capable to go towards rendering economic life this services, and whether so much would not be lost in the elasticity and adaptability of economic life that the rapidly expanding development of our time would run the risk of making serious steps backwards. We, as Professor Jørgensen stated, must learn to live with development by which private laying down of rules determined by terms and regulations takes the place of the political legislation.

National laws are in a great measure antiquated. There are few laws of a more recent date which strive to meet the needs of international trade to such an extent as the Uniform Commercial Code of the U.S.A. and the Czechoslovak International Trade Code.

As can be seen, international conventions often lack universality. They are, in addition, largely static and are more concerned with general problems than with the problems of individual branches. There is no doubt that more could be achieved by means of conventions in alleviating conflicts of different groups of interests because international legislation presumes confrontation of differing interests. But this is precisely where one of the difficulties in the achievement of international agreements lies.

The last few decades have seen an increasing development of so-called multilateralism. The reasons for this should be
sought in the increasing interconnectedness of the internal development of nations and general progress, particularly economic and technological. The growing interdependence of countries acts towards a continuous expansion of the sphere of international cooperation and organized resolution of problems of common concern. Therefore, it seems to us that the various forms of regionalism will in the future tend to enter the broader domain of multilateralism.

III. Legal Prerequisites for the Development of the Law of International Trade

Professor Schmitthoff has defined with extreme lucidity the sources of the law of international trade. The autonomous law of international trade is derived from two sources, viz. international legislation and international commercial customs. The new law merchant is in addition considered as an autonomous body of law and is in a large measure independent of national systems of law. Founded on the universal practice of international business, on the common sense of business men in all parts of the globe, the new law merchant is common to all countries engaged in international trade.

In economic life there also lives something that is different from what is written in municipal laws, something that takes no account of municipal laws, something that ignores or even negates them. Commercial law is no longer created in parliaments alone, its makers being also those who take part in business, so that views are confronted outside classical agencies and law-creating methods. To this should be added the increasing significance of arbitration which sanctions this law and in its awards transcends the legal conceptions of municipal law.

Several factors have contributed to this development:

(i) The dispositive character of municipal rules;
(ii) The inadequacy of municipal rules;
(iii) A certain similarity of municipal rules pertaining to commercial transactions;
(iv) The positive climate of municipal rules in respect to arbitration;
(v) Economic and sociological factors; and
(vi) The limited effect of ordre public.

Each of these factors deserves a short explanation.

The dispositive character of the municipal law of contract, which is its universal principle, has already been discussed. It will be seen that all legal systems agree, subject to certain limitations, that the parties are at liberty to stipulate expressly the proper law of contract.

Commercial practice has made maximum use of the possibilities deriving from the dispositive character of municipal rules. There are many reasons for this among which we mention the following:

a) Statutes are more difficult to change and thereby more difficult to adjust to the needs of international trade;

b) Municipal rules are too much generalized and traditionally rely on historical concepts both with regard to general principles and the regulation of individual kinds of transaction. International trade has created new forms of transaction; moreover, it has created complex types of contract embracing several contracts known to municipal law, which because of their complexity cannot be easily classified among standard transactions governed by national laws;

c) Domestic legislation does not take international elements into account, whereas the law of international trade must take into account the recognized principles of international law created in business practice.

d) International business practice is to a large extent developing within the framework of individual branches, so that specialization is one of its basic features. The general provisions of the law of contract will no longer be able to meet, not even as general principles, the needs of individual branches which will gradually develop their own legal principles.

On the other hand, municipal laws show a certain similarity in their solutions since, despite all their differences, the laws of contract of individual States show certain similarities in some characteristic features. Societies largely invent their political and administrative systems, but their private law is nearly always taken from others. Professor Graveson notes that we can unify those branches of law in which the similarities are more important than their differences. The possibilities of unification in such fields as commercial law, negotiable instruments, copyright and shipping law are much stronger than in other fields.

Therefore we find justified the statement that within the framework of municipal law the autonomous law of trade can be
negatively defined as the law which does not derive from the law-maker, or, as Professor Jørgensen puts it, a distinction should be made between the "public and private creation of law".  

The objection that such development entails great risks is not without any ground, since the private creation of law is not based on such thorough preparations as is the case with public legislation. In addition, the balancing of interests is not sufficiently controlled.

IV Economic and Sociological Factors

In addition to legal factors there are economic and sociological factors which have contributed to the above-described development of the autonomous law of international trade, for which Professor Sundberg admits that it may not only be secundum legem, but also praeter legem and contra legem unless it is jus cogens. Professor Schmitthoff is therefore right when he says that in future the law of international trade will

be largely founded on legal concepts which will be separated from their peculiar national context.

The development of autonomous commercial law, municipal and international, has its economic explanation. Professor Tunc speaks of political and economic factors. The practices of certain business circles were largely due to their intrinsic value, their reasonableness, which made them acceptable to businessmen all over the world. But this was in part due to their strong economic position. This powers-relationship creates problems.

In modern economic development it can be noted that those engaging in international commercial transactions tend to severe traditional ties in order to be governed by a rational law which is less tied to a particular milieu and ensures them more easily a dominant position, bringing them thus together in their wish to pursue their common economic aims. There is professional solidarity within the narrower groupings within individual branches so that rules are imposed in a quasi-sovereign way and are nolens volens adhered to in a particular sphere. States tolerate this conventional situation and avoid to criticize the admissibility of contract formation by their nationals, or else they would be excluded from international transactions. This leads to a kind of "Esperanto of world trade" which makes it possible for the contracting parties to come to agreement transcending all frontiers and paying no attention to differences in legal systems.

A strong economic position is certainly a significant factor in the acceptance of commercial practice. But at the same time it is a fact that Standard Contracts and the General Conditions have often been corrected through competition and therefore constitute rational solutions. Reciprocity in the law of international trade contributes to the harmonization of law and paves the way to the law of coordination.

Since municipal laws cannot give an answer to everyday questions posed by international commercial practice, it seems that those who maintain that the law-creating monopoly in the field of commercial law has to a considerable part disappeared and that the law-creating role is shared by the law-giver and representatives of other interests, are quite right.

Modern commercial law knows the concepts and institutions created directly by international practice. National law-makers have failed to take

over these institutions not only because they are chronically late, but also because they do not wish to regulate institutions which are not their creations, nor do they wish to be compelled continually to legalize foreign practice. Because of this national law-makers tacitly recognize their inability timely to regulate or to regulate at all certain relations. States have tacitly acknowledged the creation of the law of international trade by participants in commercial transactions. Because of the interdependence of national economies and parties in international business transactions, national law-makers realize that their intervention would upset the harmony of interdependence in the flow of international commercial transactions. In other words, States tend to reconcile themselves to this practice and do not try to "nationalize" international trade practice, since this would lead to economic isolation or to too big risks.

To these arguments should be added the fact that the laws of international trade should be uniformly applied and interpreted. Imposing upon them a national framework would hinder uniform interpretation, which is a precondition for legal security.
An interesting illustration in this connection is a phenomenon in Yugoslav law. Since all regulations which had been in force until the Second World War were repealed under a statute passed after the war, it was necessary to adopt uniform rules for commercial contracts for the whole country. For it should be noted that between the two World Wars Yugoslavia did not have a unified legal system, having inherited and retained the legal systems in force in the individual areas from which the new State was formed. Since no rules on contracts were passed after the war, the Supreme Commercial Court adopted in 1954 the General Usages of Trade thus codifying existing trade usages. The General Usages have now been continuously applied for 18 years and have thus autonomously unified commercial contracts. As Professor Schmitthoff rightly observes, the General Usages incorporate INCOTERMS and they are "a well-drafted code of the law of international trade; they are founded on the universally accepted rules of the export trade." From the sociological point of view this example is instructive in that it shows a rational law has autonomously been accepted in an area traditionally reserved for municipal statutes.

In studying the autonomous sources of the law of international trade, one must pose the question of their relation to municipal law. Professor Schmitthoff gave an answer to this question when he said that "the modern law of international trade is different in character from the medieval lex mercatoria because the medieval law merchant was essentially the universally accepted practice and usage . . . of the merchants; . . . the modern law of international trade . . . is not international law in the sense in which that term is used in the law of nations . . ., it is applied in the municipal jurisdiction by authority of the national sovereign but its sources are of international character". This thought is even more clearly expressed in the idea that the modern law of international trade is applied in every national jurisdiction by tolerance of the national sovereign whose public policy may override or qualify a particular rule of that law.

V. Ordre Public

I have noted with satisfaction that Professor Schmitthoff agrees with me that "in the application of the rules of international trade internal order is sufficiently protected by ordre public and there is, therefore, no need for restriction of the scope of their application by postulating the requirement of bilateral application." This view was accepted in the Report of the Secretary-General of the United Nations.

The application of ordre public to transactions of the law of international trade has its own peculiar features. According to Professor Goldman, in French law a tendency has lately been noted for ordre public to begin to play an increasing role as an international legal instrument. He points out that compulsory rules are not all a matter of ordre public international. This view is shared by Professor Berman who says that "in the international sphere the powers of the State cannot be exercised with the same facility as an other internal level. The State must take into account the reactions of other countries as well as those of the international commercial community". It is "impracticable in the modern world", as Cheshire observes, "for nations by sheltering behind the principle of territorial sovereignty to disregard foreign rules of law merely because they happened to be at variance with their internal system of law. It is no derogation to take account of foreign law."  

Ordre public économique comes particularly to expression in foreign commercial transactions, so that ordre public économique is said to be a law of compromise. The contract is subject to the judgment of the administration, which sometimes proceeds from what it deems to be opportune.

The application of ordre public, although being a matter of national jurisdictions, cannot be divorced from the character of international commercial disputes. Professor Sanders rightly observes that in theory in any case involving international arbitration, some national law will have to be found and will be applicable to the substance of the dispute. In practice, parties to an international contract do not think in terms of national law, but on international lines. What counts for them are the terms of the contract and the customs of international trade. Professor Mentschikoff therefore pointed out that "emphasis in these groups - trade associations - is on the utilization of norms and standards of trade for deciding without regard to their similarity to or difference from the norms or standards that would be imposed by substantive rules of law."
International arbitration is one of the essential instruments for the recreation of the *lex mercatoria*. The arbiter is not the "guardian of a national order". He has a greater freedom to evade State rules which cannot be adapted and to combine various laws, and to seek in actual application a general commercial law which should be accepted by the contracting parties of various nationalities. Lagergren therefore speaks of a liberal and international approach noticeable in many arbitration tribunals, while I myself had earlier observed that arbitration tribunals did not always apply strict rules of municipal law.

Professor Honnold therefore speaks of the unpleasant picture of antiquated statutes unsuited to modern commerce, adding that any assumption that trade depends primarily on legal sanctions would be quickly dislodged by working with a foreign trader, "for trade does not move, in vast quantity, and under circumstances where legal sanctions are unnecessary or unworkable".

### VII. Conclusion - The Applicable to International Commercial Transactions

Professor Kegel has expressed certain criticism by saying that if and to the extent that the law of international trade is customary law, it is within a State its own domestic law in the sense of toleration and possibility of change. This can lead to differences based on different judicial decisions or different ways of legal thinking in individual States, although these differences could be small. This observation is justified if we proceed from the formal sources of law and from the presumption that international commercial disputes will be decided by State courts. However, this poses the question of whether or not the law of international trade within a State is only its own domestic law. A significant feature of the law of international trade is that it is not applied exclusively within one State even though it is applied within States. The fact that international transactions are involved makes it necessary to take an international approach and to take account of reciprocity. International law is increasingly permeating the life of individuals, so that in this field municipal legislation tends to become conditioned by international law.

In view of the foregoing we have arrived at the conclusion that a distinction should be made in respect of the following:

(i) The autonomous law of international trade;
(ii) Self-regulatory contracts;
(iii) The law applicable to international commercial transactions.

In keeping with the definition of Professor Schmitthoff according to which the sources of the autonomous law of international trade are international legislation and international custom, we come to the conclusion that the sources of international commercial law are not the only sources applied to international commercial transactions, because they will not always be able to provide solutions for individual situations. In addition, *ordre public* should be taken into account.

Although commercial transactions are economic operations which make up single wholes, they are governed by

1. International trade usages;
2. International legislations;
3. Awards of international arbitration tribunals; and
4. Municipal law
   a) Through *ordre public*, and
   b) As regulations filling gaps in contracts.

Professor Tallon rightly observes that national laws do not recognize such party autonomy when pushed to extreme. In law it remains necessary to refer to a national law if only to justify the principle of party autonomy and define its limits.

International commercial transactions will for a long time to come be regulated by both international sources of law and national laws. Therefore in international commercial practice the contracting parties provide in their contracts the law of a particular country as the proper law of the contract. The solution therefore lies in arbitration. Legal solutions of municipal legislation and national jurisdictions which protect national *ordre public* should be permeated with an international spirit and therefore implemented and interpreted accordingly.

Similarities in the legal technique of international trade have found visible expression in the movement towards the unification of the law of international trade on the regional and global basis. The advantage of such unifications lies in the
finding of common solutions acceptable to all on a just basis. This is particularly true of those areas of autonomous law which transcend the framework of legal techniques. Efforts to create and adopt international conventions, and the work of the United Nations Commission for Europe on the formulation of Standard Contracts and the General Conditions like the work of the International chamber of commerce are examples of the creation of the new law merchant. The work of other formulating agencies has shown that it is possible to overcome difficulties created as a result of the disintegration of the medieval lex mercatoria, by removing the barriers created by the codification on a national plane. This indicates the strength of commercial custom: where international legislation hesitates, international customs forges ahead.  

In the sense the Uniform Law on the International Sales of Goods provides that the parties shall be free to exclude the application of the present law either entirely or partially; 

Furthermore, that the parties shall be bound by usages which reasonable persons in the same situation as the parties consider to be applicable to their contract. In the event of conflict with the present law, the usage shall prevail unless otherwise agreed. This rule is a synthesized principle accepted by municipal laws (p. 20 A). 

The same idea is accepted in Geneva European Convention on International Commercial Arbitration of 21 April 1961. According to Article VII concerning the applicable law, para 1. provides that the parties shall be free to determine, by agreement, the law to be applied by 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 contract and trade usages. 

Practice has shown that Luitthlen is right in saying that autonomous law no longer supplements State laws in various special areas, but that State statutes only supplement the existing order where there are still gaps to be filled in. 

Mutatis mutandi, all this holds true of self-regulatory contracts which no matter how much they tend to become independent of any municipal law, can nevertheless not prevent resort to municipal law where gaps have remained or when it is necessary to secure enforcement through recognition of arbitral awards. 

Professor Usenko has observed that the international division of labour is a form of internationalization of the productive forces of human society. Because of this, the international division of labour transcends the frameworks of national boundaries. The productive forces of individual national economies, mutually connected by the world market, thus become an organic part of the world economic system. Efforts to create a law of international trade on the level of micro-economic relations should therefore be subordinate to this requirement of the macro-economies of individual countries. 

3 Ibid. p. 17. 
11 Schmitthoff, C. M.: The Law of International Trade, its Growth, Formulation and Operation, in - see No. 8, p. 3. 
12 Ibid. 
14 See No. 4, para. 23. 
Goldštajn, A.: see No. 16, p. 111.
Ibid. 152.
See No. 4, para. 24.
Loussouarn, Y. and Bredin, J. D., No. 30, pp. 44-45.
Kegel, G. op. cit. No. 9, pp. 260-263.
Schmitthoff, C. M. op. cit. No. 38, p. 20.
Article 3.
Article 9, para. 2 Regelung, Berlin 1966, pp. 24-25.
Luithlen, W.: Einheitliches Kaufrecht und autonomes Handelsrecht, Freiburg (Schweiz) 1956, p. 57.

Referring Principles:
IV.1.2 - Sanctity of contracts