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Content:
The Law Applicable to the Merits of the Dispute

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I. ARBITRAL TRIBUNALS AND INTERNATIONAL CONVENTIONS, RULES AND MODEL LAWS

This chapter deals with the law applicable to the merits of an international commercial dispute before an arbitrator. It treats the rules and practices of arbitral tribunals, mostly those of the Western countries, and the impact, if any, which the UNCITRAL Model Law on International Commercial Arbitration (hereinafter the Model Law)\(^1\) will have on these rules and practices.

A. National and Non-National Arbitral Tribunals

1. Most international cases are taken to national tribunals. The parties, however, are free to choose the seat of the arbitration, and in many cases they agree to bring their dispute before a tribunal of a national arbitration institution. The institution selects the arbitrator or, if the tribunal is to be collegiate, the chairman of the tribunal. The selection is generally made from a panel of domestic arbitrators.\(^2\) The proceedings are conducted under the arbitration rules of the institution and supplemented with the rules of the domestic law of arbitration and civil procedure.\(^3\)

Parties which do not resort to institutional arbitration may establish a national arbitration ad hoc. They appoint the arbitrator or choose a court or other national authority which is to appoint the arbitrator or the chairman of the tribunal. Failing an agreement to the contrary, the tribunal will sit in the country of the arbitrator or Chairman, and the proceedings will be conducted under the rules of procedure of that country.

2. Reference is increasingly being made to non-national arbitration. The parties agree to entrust an international body such as the Court of Arbitration of the International Chamber of Commerce with the choice of the arbitrator or the chairman of the tribunal. The institution or the arbitrator selects the seat of the tribunal. The tribunal applies the arbitration rules of the institution but is not bound to apply the rules of procedure of the place of arbitration. Nor is it obliged to apply its conflict-of-law rules or its rules on the suitability of the dispute for arbitration. The parties may also decide that an ad hoc arbitration be referred to a non-national tribunal. An international institution such as the Permanent Court of Arbitration at the Hague may then be called upon to select the arbitrator. The arbitrator will apply the rules of procedure agreed upon by the parties. These may be the Arbitration Rules of the United Nations Commission an International Trade Law (UNCITRAL).\(^4\)

A non-national arbitration is often chosen because the parties wish to have the case decided by a neutral tribunal. In the absence of such an agreement, the plaintiff will bring an action before a court in the defendant's country. The court is expected to be impartial, however, the case is tried in the defendant's language and according to the procedure of his country. In order to prevent the defendant from having the advantage of "playing at home", the parties may refer their dispute to a court or the national arbitration institution of a "neutral" third country. By doing so, however, they often cannot frame the proceedings as they wish. They submit to proceedings and often to substantive rules which are alien to both of them. Neutrality and freedom may be obtained by selecting a non-national arbitral tribunal.\(^5\)

The situations described are typical cases. It is for the parties to determine the character of the tribunal; they may decide that it shall have some traits of a national and some of a non-national arbitration. Although the arbitrator has been selected from a certain country and the seat of arbitration has been placed in that same country, the parties may want
him to apply an autonomous set of procedural rules or conflict-of-law rules. Arbitral tribunals of the ICC have sometimes acted in some respects as national ones, applying, for instance, the conflict-of-law rules of the forum country.  

Non-national arbitration is not unbound by national law. The parties may request a court of the forum country to take the necessary measures to get the arbitration going, to decide upon an arbitrator's partiality, to terminate his mandate, to replace him, to determine the jurisdiction of an arbitral tribunal, etc. The court will decide these issues in accordance with the law of the forum.

and if the court's ruling is preceded by a ruling of the arbitrator, he will have to take the forum law into consideration.

However, a non-national arbitrator is and should be unbound by all rules of the forum which are not suitable for the conduct of an international arbitration in a neutral country. Thus he should not be chained to the forum's specific choice-of-law rules and substantive law rules.

3. The Model Law

A country which enacts the Model Law will apply its rules to international arbitrations taking place an its territory regardless of whether they are national or non-national. Under the Law the help and supervision of the Courts may be requested in the matters mentioned above and its rules an the setting aside of an award will apply.

At the Same time, the demands of parties who wish the arbitration to be non-national will be satisfied in most respects. The arbitrator will not be tied to the rules of procedure of the forum country unless the parties direct him to follow these rules. He will not be bound by the conflict-of-law rules of the forum. Article 34 (2)(b) of the Model Law Claims obedience to the public policy of the forum; however, this provision will probably be interpreted narrowly. The dispute will be governed by the principles of due process of law and by the basic ethical rules governing the validity of contracts such as legal rules by which contracts obtained by fraud or corruption are void. They belong to the common core of the legal systems which are part of international public policy (see infra, Section IV). The economic and political laws of the forum country which form part of its public policy will, in most cases, not claim to be applied to contracts which have no connection with the forum country.

However, under Article 34 (2)(b)ii), the arbitrator will be bound by the rules of the forum on suitability for arbitration also in cases which have no connection with the forum country. This is a regrettable solution. It would imply, for instance, that the arbitrator would have to abstain from hearing a case involving rules an restrictive trade practices if, under the law of the forum, such disputes are not capable of settlement by arbitration even though they are arbitrable under the laws of the countries connected with the dispute. The parties may, of course, avoid selecting a country as the seat of arbitration if the courts of that country are known to enforce their own laws on suitability for arbitration in such cases. The seat of arbitration, however, is not always chosen by the parties; it is sometimes chosen by an institution which may not be aware of the laws in question. One must hope that the courts will limit the scope of specific rules on suitability for arbitration to disputes which have an appropriate connection with the forum country. On the other hand, the rules on suitability for arbitration of a country will often have to be taken into account if enforcement of the award is likely to be sought in that country or if it has a close connection with the case (see infra, Section IV).

B. Article V11 of the European Convention of 21 April 1961 and its Followers

Many countries, including the United Kingdom, have no statutes dealing with the law to be applied by an arbitrator to the merits of the dispute. In such a case, it is generally understood that the arbitrator will apply the choice-of-law rules of the forum country.

In Europe the most prominent provision on this issue is Article VII of the European Convention on Commercial Arbitration of 21 April 1961, which reads as follows:

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

(2) The arbitrators shall act as amiables compositeurs if the parties so decide and if they may do so under the law applicable to the arbitration.

The European Convention has been ratified by at least seventeen States in East and West.\(^\text{15}\) Article VII has had a considerable impact upon later texts. Article 38 of the Rules of Arbitration of the United Nations Economic Commission for Europe has an identical provision and Article VII (4) (a) of the Arbitration Rules for the Economic Commission for Asia and the Far East embodies an almost identical rule. Article 33 of the Arbitration Rules of the United Nations Commission on International Trade Law (the UNCITRAL Rules)\(^\text{16}\) and Article 13 (3)-(5) of the Arbitration rules (1975) of the International Chamber of Commerce\(^\text{17}\) have very similar texts.

C. The Model Law

The UNCITRAL Model Law provides in Article 28 that:

(1) The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Any designation of the law or legal system of a State shall be construed, unless otherwise expressed, as directly referring to the substantive law of that State and not to its conflict-of-law rules.

(2) Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict-of-law rules which it considers applicable.

(3) The arbitral tribunal shall decide \textit{ex aequo et bono} or as amiable compositeur only if the parties have expressly authorized it to do so.

(4) In all cases the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction.

On the whole, the Conventions, their followers and the Model Law are in agreement: The parties are free to choose the applicable law. In the absence of a choice by the parties the arbitrator applies the law designated by the choice-of-law rules which he considers applicable. The parties may authorise the courts to decide the case \textit{ex aequo et bono}. The arbitration must always obey the terms of the contract and take into account the relevant trade usages.

The major differences between the texts are the following: The Model Law will allow the parties to choose the \textit{rules of law} applicable to the substance of the dispute. They do not have to choose a national legal system. This is a concession to the advocates of the \textit{lex mercatoria} and other non-national sources of law (on this subject, see \textit{infra}, Section III). Furthermore, the texts endorse agreements on \textit{amicable composition} which so far have not been accepted in all countries. The European Convention and the UNCITRAL Rules require that the arbitrator be permitted to act as \textit{amicable compositeur} under the law applicable to the arbitration. The ICC Rules and the Model Law, which is intended to be enacted as a statute, do not contain this requirement.

Arbitration is secret and the awards do not have the authority of precedents. Nevertheless, the manner in which the arbitrators have decided a dispute and used the freedom granted to them is regarded as valuable knowledge. The psychological factors which lend persuasive authority to precedents also operate in the case of arbitral awards. Faced with a problem, one wants to know how others have acted in similar situations, and one tends to copy them.\(^\text{18}\) Thus a number of awards have been published\(^\text{19}\) and some are passed from hand to hand.

The awards which have been published show that the arbitrators of Western countries have made extensive use of their freedom. They have applied a variety of methods and rules when deciding which law to apply to on international contract. These methods will be described in Section II.

II. APPLICATION OF A NATIONAL LEGAL SYSTEM TO THE MERITS OF THE DISPUTE

A. Choice of Law by the Parties

1. Express Choice of Law
Today many contracts contain clauses which expressly submit them to the law of a certain country. The reported cases show that the arbitrators invariably apply the law selected by the parties.\textsuperscript{20} Some do so without reference to any national conflict-of-law rules.\textsuperscript{21} Other awards find an authorisation of the choice of law in the conventions or the conflict-of-law rules of a specific country.\textsuperscript{22} 

No case is known in which an arbitrator has set aside the parties' express choice of law on the ground of lack of connection with the intended legal system.\textsuperscript{23} Several awards uphold the choice of a law unconnected with the contract.\textsuperscript{24} In these cases it appears that the parties often want a neutral or well developed law to apply. Choice-of-law clauses which are made with an evasive intention and by which the parties have committed what the French call “fraude à la loi” have not been found in arbitration cases.\textsuperscript{25}

By giving effect to the parties' choice of law, the arbitrators have acted like the courts of most countries. The parties' freedom to choose the law applicable to their contract is so widely accepted among the nations of the world that it must be said to be "a general principle of law recognized by civilized nations".\textsuperscript{26}

2. Tacit Choice of Law by the Parties

The cases involving an implied choice of law fall into two categories. One is where the intention is "demonstrated with reasonable certainty by the terms of the contract or circumstances of the case".\textsuperscript{27} The parties, for instance, have used a contract formula current in a particular country; they have chosen an arbitration institution located in the same country, which is also the country of the place of performance of the contract. In such cases there is a tacit choice of law. The other category includes cases where the facts do not sustain a tacit choice of law but where the arbitrator, like the courts in some countries, invokes the presumed intention of the parties in support of a choice of law he has made.\textsuperscript{28} This will be dealt with \textit{infra}, under II.

(a) The Choice of an Arbitrator or a Forum as a Tacit Choice of Law

An important and much debated question is whether the fact that the parties have chosen an arbitrator or seat of arbitration in a certain country is to be regarded as a tacit choice of the law of the nationality of the arbitrator or of the seat of arbitration.

(i). Non-national arbitration

Often the parties have chosen neither the country in which arbitration takes place nor the nationality of the arbitrator. Many, if not most, references brought to the ICC Court of Arbitration will not have any allegiance to a certain country. The ICC Court of Arbitration will ask the National Committee of the ICC in a country to which neither party belongs to appoint the arbitrator or the president. The Court also selects a "neutral" country as the place of arbitration. As mentioned above, the selection of a neutral arbitrator and neutral place of arbitration has great advantages in international commercial arbitration. However, the place of arbitration and the nationality of the arbitrator have no connection with the dispute. The same may apply to a non-national arbitration when the parties have chosen the arbitrator and the seat of the tribunal. Imagine a British and a Polish party who have referred their dispute to arbitration under the UNCITRAL Rules. They have chosen an arbitrator from Malmö in Sweden. After his appointment the parties have agreed to conduct the reference in Copenhagen mainly because the city is conveniently located for all persons involved. There is no reason why this reference should be governed by Swedish or Danish law.

(ii). National arbitration

If the case is tried by a national arbitral tribunal, the answer may be different. This is shown by court decisions which have dealt with the effect of the parties' choice of a national tribunal upon the law governing the merits of the dispute. English courts have held that an agreement to submit to arbitration in a particular country is evidence of an intention to apply the law of that country. In most cases this has led to the application of English law.\textsuperscript{29} In two leading cases dating from the end of the nineteenth and the beginning of the twentieth century, submission to arbitration in England led the English court to uphold an arbitration clause which was valid by English law, but invalid according to Scots and Jersey
law, respectively, which would have been applied in the absence of an effective choice of law. However, in 1970 the House of Lords held that a contract made in France between a French shipowner and a Tunisian charterer for the transport of oil from one Tunisian port to another, with payment to be made in France, was governed by French law although the charterparty provided for arbitration in London. The charterparty also contained a clause that it was governed by the law of the flag. This clause, however, was held incapable of application since the ships used for transport of the 350,000 tons of oil were Norwegian, Swedish, French, Liberian and Bulgarian, and all were chartered by the “shipowner”. Apart from the arbitration clause,

the contract had no other connection with England. Their Lordships agreed that even if the parties had failed to make an express choice of law, the proper law of the contract was French law, the law with which the contract had its closest connection. They also agreed that where the parties had made no express choice of law, the inclusion of an arbitration agreement is evidence of an Intention to apply the law of the place of arbitration, but that such an agreement “. . . should not be treated as giving rise to a conclusive or irresistible inference . . .”.31

The French courts have been induced by an arbitration clause to conclude that the parties intended to submit the contract to the law of the chosen forum. In one of the leading cases the court was faced with the problem whether the submission to arbitration and to the courts in England constituted a valid choice of English law with the result that the arbitration was valid, whereas it was invalid according to French law which would have been applied in the absence of a valid choice of law. The court held that the submission constituted a tacit and valid choice of English law and upheld the arbitration clause.33

For a long time the courts in West Germany held that a clause submitting to arbitration in a particular country constituted a tacit choice of the law of that country. Sometimes other connecting elements or other indications of Intention were taken into account as additional evidence of a choice of law.

Some arbitral awards have gone in the same direction; however, an opposite trend is discernible. As mentioned before, parties who choose a neutral place of arbitration may not wish to have the law of the forum applicable to their dispute. This is also true when the parties have selected the national arbitration institution of a neutral country. The tribunal of the institution will not consider the parties’ choice of the institution as a tacit choice of the substantive law of the forum. The leading Swedish textbook on international arbitration in Sweden which reflects the practices of the Arbitration Institute of the Stockholm Chamber of Commerce does not even mention that a Swedish arbitrator might apply the law of the forum.

Arbitrators, however, have often applied the law of the forum as the law designated by the parties when other connecting factors, such as the place of business of one of the parties, have also pointed to the forum country.

(b). The Model Law

The European Convention of 1961 and its followers grant the arbitrator the power to determine the applicable law “failing any indication by the parties as to the applicable law”. The Model Law grants him the same power “failing any designation by the parties”. An indication is more easily ascertained than a designation, and thus the new terminology seems to indicate that greater demands have been placed an providing evidence of the choice of law by the parties. Given the freedom which the Model Law grants the arbitrator to designate the applicable law in the absence of a choice of law by the parties, the new terminology need not have consequences when a national legal system is to be applied. Even when the parties have not “designated” a certain law, the arbitrator may, by virtue of the choice-of-law rules which he considers applicable, rely on what he believes to be a genuine “indication” of the parties to apply that law.

On the other hand, the increased demand that the parties' choice be evident, may become important when the parties have chosen the lex mercatoria (see Section III below).

B. Choice of law by the Arbitrator

Turning to cases where the parties have not indicated the law applicable to the contract, we shall see what the arbitrator is obliged to do under Article VII of the European Convention, Article 28 of the Model Law and other authorities, which law arbitrators have in fact chosen, the reasons for their choices, and finally which choice-of-law rules should apply in the
opinion of the present writer.

1. Must the Arbitrator Apply the Conflict-of-Law Rules of the Forum?

Article VII of the European Convention and Commercial Arbitration and its followers-one of them being Article 28 of the Model Law-authorise the arbitrator to apply the conflict-of-law rules which he deems applicable. He is not bound to apply the choice-of-law rules of the forum country. Article VII applies to disputes between persons and enterprises having their habitual residence in different States which are parties to the Convention (see Article I (a)). As mentioned before, the rule provided in Article VII has been widely adopted in other texts. To our knowledge, most countries will permit the arbitrator to select the choice-of-law rule which he deems applicable if a rule of the arbitration institution, or other rules adopted by the parties, such as the ICC Rules or the UNCITRAL Rules of 1976, authorise him to do so. He may do so even when the dispute is not governed by the European Convention.39

In other cases not governed by the Convention, it is doubtful whether the arbitrator is bound to apply the choice-of-law rules of the forum. Some authors have asserted that an arbitrator whose mandate is based upon the Submission of the parties is unbound by the choice-of-law rules of any specific country. He may choose the conflict-of-law rules he prefers.40 Others maintain that the arbitrator derives his mandate from the authority of the State in which he conducts the arbitration and that he is bound to follow its choice-of-law rules.41 This is correct in so far as a State has the power to direct the arbitrators acting on its territory to apply a specific set of choice-of-law rules. Some States have in fact obliged arbitrators to apply the rules of the forum country.42 In Western countries, however, the view is gaining ground that the arbitrator should not be bound to apply the same choice-of-law rules which bind the courts. This view has been accepted by the Model Law which, if enacted, will let the arbitrator apply the conflict rules which he considers applicable. Sweden, Switzerland and England are not parties to the European Convention. Nevertheless, Swedish authors maintain that international disputes which are to be decided in Sweden are not necessarily governed by Swedish conflict rules.43 In Switzerland some authors have advocated the freedom of the arbitrator to choose the appropriate conflict rules; the authors of the draft Law on Private International Law have decided to leave the question open.44 In England arbitrators are bound to apply English conflict rules to international disputes which are governed by the rules of the specific case.45 In cases not covered by these rules, a choice of law by the arbitrator cannot be challenged.

Before examining the choice-of-law rules which the international arbitrator should consider applicable, we shall first turn to the arbitral awards.

2. The Awards

(a) There are some awards in which the arbitrator has applied the choice-of-law rule of the forum country. This solution is recommended by several authors and by the Institut de droit international (1957 and 1959).46 Some awards apply the conflict rule of the forum without further reflection, others invoke the Institut or other authorities.47 In a few cases the arbitrator has done so because he would not draw upon any other source for an adequate choice-of-law rule.48 Several arbitrators have used other methods.

(b) Writers and courts generally take it for granted that a legal issue can be governed by one law only, and that the choice-of-law rules of one legal system are to be applied. In accordance with this “legal monism”, most lawyers would hold that only one conflict-of-laws system, be it the rules of a legal System or of another source, can govern an issue before a court of arbitration. Several arbitrators, however, have not followed this monism. Faced with a choice between two laws - for instance the laws of the parties - the arbitrators have shown that the choice-of-law rules of both laws refer to the application of

the substantive rules of one of them. Since they have not disclosed which of the two systems they have applied, one must conclude that both have been applied. Often the arbitrators have also been able to show that the substantive laws of the two systems agreed and that they invoked both.49

Arbitrators who have the freedom to select the choice-of-law rules which they consider applicable cannot be tied to any monism. They must be able to apply two, or more converging conflict-of-laws systems cumulatively. Article VII of the
European Convention and Article 28 of the Model Law do not envisage the cumulative application of two or more substantive laws. Though it may seem repugnant to the legal mind to do so, there are no valid legal or moral grounds for criticising such an approach.

In some awards the "general principles" of private international law have been invoked.50 The arbitrator has alleged that there was unanimity among the private international laws of the world or at least among all the major legal systems on this particular issue. This has sometimes been done with some audacity. In a case from 196751 it was stated that it is "in conformity with the constant theory and case law concerning the conflict of laws (. . . that . . .) preference has to be given to the law of the place where the contract has been made, and subsidiarily, to that of the place of performance". This holds true of some legal systems but by no means of all.

In earlier times the courts of several countries, including the English, French and German, relied on the presumed intention of the parties to decide which law to apply. This led to unpredictable solutions as the courts often, but not always, found that the parties would have chosen the law of the forum if they had made a choice of law. This practice has now become rare. Instead, the courts tend to apply the law of the country to which the contract is most closely connected. Many arbitrators do the same.52

(c) Whereas national conflict-of-laws systems have been invoked in the cases above, in other cases reference has been made to international conventions on private international law. For example, the Hague Convention on the Law Applicable to International Sales of Goods (1955) has been invoked. This has occurred even in instances where none of the States connected with the matter adhered to the Convention.53 Reference to this Convention has also been made by the state courts of countries which were not parties to the Convention.54 State courts have also invoked choice-of-law rules in texts which do not have legally binding character, such as draft conventions and draft laws.55 Article VII of the European Convention on Commercial Arbitration and Article 28 (2) of the Model Law permit the arbitrator to make use of such texts.

(d) In several cases the arbitrator has relied on a conflict rule without disclosing the legal system or other source from which it was derived.56 The arbitrator, for instance, has stated that he chose the law of the country in which the contract was made or was to be performed. In most cases it has been easy to find authorities which support the rule chosen by the arbitrator.

(e) In a number of cases the arbitrator has taken a short cut and gone directly to the substantive law, thus avoiding the intricacies of private international law.57

In some of them the arbitrator has compared the substantive rules of the various countries connected with the dispute and found a satisfactory concurrence, i.e., the rules led him to the same outcome.58 In such cases his short cut has been justifiable. Any conceivable conflict rule would have led him to one of the concurring laws.

In other cases the arbitrator has stated that he applied the substantive law of a certain country,59 however, without giving reasons and without revealing whether the laws of other connected countries would have led to the same result. Such a direct leap to the applicable law is tenable in those cases where it is evident that the law chosen is the proper law of the contract, because all or most of the connecting factors point to that law. Where the proper law is not evident, the arbitrator should reveal the conflict rule which he applies.

(f) Sometimes the arbitrator, in addition to invoking a rule of national law, has supported his finding by reference to the lex mercatoria or to the general principles of law.60

In some cases this means that the international trade usages or the prevailing practices of international trade61 have been applied. This reference is in accordance with Article VII (1) of the European Convention and with Article 28 (4) of the Model Law. In these situations the arbitrator need not search for a proper law of the contract.

In other situations the arbitrator has relied exclusively on non-national law. This is dealt with infra in Section III.

3. Why are the Awards so Diverging?

The awards reveal a variety of approaches. Some arbitrators apply the choice-of-law rules of existing legal systems, some select conflict rules which have not yet been enacted, and some invent such rules. Others simply leap over the choice-of-law question. The picture is colourful and confusing. Yet one could not expect it to be otherwise.
(a) The cases are decided by arbitrators of different nationalities and legal backgrounds. Their decisions reflect the
diversity of approaches to the conflict of laws of contract. Some of the laws provide inflexible and others flexible
rules; some rely exclusively or lay the main stress on the place of contracting, some an the place of performance, and
some an the place of business of the parties or the party providing the characteristic performance.62

(b) The attitude of many arbitrators to the judicial process resembles that of judges. Others have a more open approach.

Some arbitrators view the law as a perfect and stringent system of rules under which a good lawyer can always find the
one and only solution. To apply the law is the same as to apply the theorems of mathematics. In their view this is not only
possible, but also desirable. It produces certainty and predictability for the citizen.

On the other hand, there is another school of arbitrators which contests the absolute predictability advanced by the school
of legalists.63 In their opinion, no legal system provides definite solutions to all problems. Even the best lawyer in the most
highly developed country is often in doubt. Moreover, predictability is only one of several social values. Rules which
create certainty and predictability also bring about rigidity. The legal process is not and can never be a mere syllogism. It
is above all an effort to reach the most fair and appropriate solution. In this process, which is partly inventive, the
arbitrator will have to take the special circumstances of the case into account.64

Although the two schools are contrasted sharply here, when in doubt, even the legalist will seek the equitable and
appropriate rule. A clear statutory provision or precedent may bind the inventor to a solution which he finds unfair or
inappropriate. The two schools reflect two different attitudes to the legal process. The one cultivates the statute and the
precedent. The legalist will always strive to bring the case before him under the proper provision or precedent. The
inventor does not cherish the authorities equally. He views the case from its different aspects, weighs up the opposing
considerations and makes his choice.

In the civil law countries the law requires judges to be legalists; however, when deciding cases concerning the conflict of
laws of contracts, they have often disregarded the rules, and their "disobedience" has frequently been disguised.65 The
freedom which arbitrators have in applying the law has left even more room to the inventors. They have used it and have
not needed to hide their inventiveness.

(c) Furthermore, the very task of the international arbitrator makes his reasoning and decision-making different from that
of the judge.

When giving reasons for the award, the arbitrator has a double concern. As the mandatory of the parties, he must
persuade them, especially the losing party, that the award is just. Moreover, he must make sure that the award is
enforceable in the country or countries where enforcement may be sought.

This leads many arbitrators to justify their conclusions by referring not only to the law which they would deem applicable
to the dispute but also to other laws connected with the parties or the subject-matter of the dispute. The arbitrator will
often refer to the law of the unsuccessful party to show that this law

confirms his findings. As mentioned above, such a cumulation of rules of the legal systems involved is unobjectionable.
On the other hand, it offers little guidance to parties of future disputes and their arbitrators who wish to learn. However,
few arbitrators will see any fault in that; they feel no responsibility for the development of a world law of international
arbitration

4. Should Awards be Harmonised?

The freedom which the European Convention and the Model Law grant the arbitrator to apply the choice-of-law rule which
he considers applicable is beneficial in so far as it frees the international arbitrator from the fetters of the forum law. On
the other hand, if the arbitrators themselves do not make an attempt to harmonise their practices, the diversity will
continue. It is unlikely that parties to international commercial arbitration cherish this. Parties who do not agree on the
application of the lex mercatoria or on awards ex aequo et bono want the arbitrator to take up a legalist attitude to basic
issues of the dispute such as the choice of the proper law of the contract. Books, articles and reviews on international
commercial arbitration provide a world-wide basis for discussion, and so do the increasing number of published awards. The first signs of attempts at co-ordination are already visible\textsuperscript{66} and more will follow. It is to be hoped - and seems likely - that the arbitrators will then follow the trend of modern legislations\textsuperscript{67} and court decisions.\textsuperscript{68} They have the following characteristics:

(a) The law chosen by the parties governs the contract.\textsuperscript{69} Only a choice which appears clear from indications in the contract or from the behaviour of the parties counts as a choice of law. Presumed intention is not considered.\textsuperscript{70}

(b) In the absence of a choice of law by the parties, the law with which the contract has its most significant connection will govern.\textsuperscript{71} This connection is based upon the relevant contracts, notably the place of business or the habitual residence of the parties, and the place of performance.\textsuperscript{72} The parties' choice of the place of arbitration or the nationality of the arbitrator may also carry weight.

(c) It is to be presumed that the contract has its most significant connection with the country where the party who is to effect the performance which is characteristic of the contract has his place of business.\textsuperscript{73} Thus sales of movables are presumed to be governed by the law of the seller's place of business, licence contracts by the law of the licensor's place of business, and agency and distributorship contracts by the law of the agent's and the distributor's place of business.

Employment contracts, however, are presumed to be governed by the law of the place of work,\textsuperscript{74} and contracts relating to immovables by the law of the place where the immovable is situated.\textsuperscript{75} Other special presumptions for specific contracts exist or may come into existence.

As was pointed out, these rules are presumptions. This means that they do not apply if it appears from the circumstances of the case that the contract has its most significant connection with the law of another country.

Special problems concerning mandatory rules will be dealt with in Section IV

III. THE LEX MERCATORIA

A. The Concept

The parties to an international contract sometimes agree not to have their dispute governed by national law. Instead they submit it to the customs and usages of international trade, to the rules of law which are common to all or most of the States engaged in international trade or to those States which are connected with the dispute. Where such common rules are not ascertainable, the arbitrator applies the rule or chooses the solution which appears to him to be the most appropriate and equitable. In doing so, he considers the laws of several legal systems. This judicial process, which is partly an application of legal rules and partly a selective and creative process, is referred to here as application of the \textit{lex mercatoria}.\textsuperscript{76}

In Continental Europe, arbitrators increasingly apply the \textit{lex mercatoria} to international disputes.\textsuperscript{77} Clauses to this effect are often inserted in contracts between a government or government enterprise an the one hand and a private enterprise an the other.\textsuperscript{78} The government does not wish to submit to the laws of a foreign State. A private party will not wish to have the contract governed by the laws of the foreign government since they may be changed to his dis-
and nobody has the disadvantage of seeing it governed by a foreign law.

On the Continent and in the common law countries it is still a matter of controversy whether the parties may agree to have their contract governed by the *lex mercatoria*. This question will be dealt with; however, first the existing elements of the *lex mercatoria* and the judicial process involved when it is applied to the substance of the dispute will be considered.

**B. Existing Elements: The New "Law Merchant"**

In international arbitration the *lex mercatoria* is applied in combination with a national law. Here we shall deal with the case where the *lex mercatoria* is paramount and no single national law governs the contract. Situations are considered where the mandatory rules of the national law must not be applied but its directory rules are applied to fill the gaps left by the law merchant. Although all of the questions raised in such situations are not covered, some of the following observations also cover this combination.

It is not possible to provide an exhaustive list of all elements of the "law merchant".

1. **Public International Law**

This is one important element. The rules of public international law on treaties have been applied to contracts between a government enterprise and a private party. Several provisions of the Vienna Convention on Treaties of 13 May 1969 reflect the common core of legal systems and are thus suitable for international contracts. The World Bank Convention of 18 March 1965, which provides for the settlement of investment disputes between States and nationals of other States, provides in Article 42 that, in the absence of a choice of law by the parties, the arbitral tribunal shall, inter alia, resort to such rules of international law as may be applicable. Rules of public international law may also be applied to disputes between private enterprises.

2. **Uniform Laws**

The uniform laws which have been adopted for international trade are also important. An example is the Uniform Law on the Sale of Goods of 1964 which has been ratified by some European countries. Its successor, the Convention on Contracts for the International Sale of Goods of 1980 is expected to be adopted by a larger number of countries.

Where the courts of those countries connected with the parties or subject-matter of a dispute would be obliged to apply a uniform law, the arbitrator will be bound to do the same. The expressions "bound to" or "obliged to" etc. are used here although the duty of the arbitrator cannot be enforced by the courts. Sometimes the uniform laws may guide the arbitrator as has been the case in several published awards.

3. **General Principles of Law**

The general principles of law recognised by the commercial nations are an important element of the law merchant, for example, the pacta sunt servanda rule and the principle that a party may terminate a contract in the case of a substantial breach by the other party. It is not always easy to ascertain which rules are general principles; however, the possibilities of doing so are improving with the growing volume of literature an comparative law. Arbitrators have been known to make use of the *International Encyclopedia of Comparatiae Law* to find the general principles of the major legal systems of the world. Furthermore, a comparative analysis of the relevant laws will reveal whether the rules of the various legal systems, though differently formulated, produce the same result. An arbitrator who is faced with a general principle or common solution to the issue will generally be obliged to comply with it.

Although some authors have conceived the law merchant as universal law, it need not be the same all over the world. The arbitrator will tend to confine his investigations to those legal systems which are connected with the subject-matter of the dispute. Where they have a common rule or rules leading to the same result, the arbitrator will be obliged to follow the common core of these laws even though other legal systems may provide a different solution.

4. **Rules of International Organisations**

International organisations (the UN, UNCTAD, the OECD, etc.) have adopted
resolutions, recommendations and codes of conduct on matters relating to contracts. These measures, which have a non-binding character, often reflect good faith and fair dealing. Mention should also be made of the more ambitious efforts to unify commercial laws. UNIDROIT and the Commission an European Contract Law are in the process of establishing general principles of contract law, the former for all nations of the world, the latter for the Member States of the European Communities. These principles will be published as non-binding rules which, inter alia, will serve as guidelines for international arbitral tribunals.  

5. Customs and Usages

The customs and usages of international trade make up another very important element of the concept of the law merchant. The customs and usages of some trades apply both to domestic and to international contracts; others apply only to international relationships. In addition, there are the "codified" customs, for instance, the INCOTERMS, the Uniform Customs and Practices for Documentary Credits and the newly adopted force majeure and hardship clauses issued by the ICC. These customs, usages and contract terms only apply when the parties or their organisations have agreed to apply them. They have, however, provided guidance for the courts and for arbitration even when they have not been chosen by the parties.  

6. Standard Form Contracts

Several standard form contracts have gained international popularity. This applies to the General Conditions for the Supply of Plan and Machinery for Export issued by the Economic Commission for Europe in 1953. The same holds true for some standard clauses in contracts which are made individually. The courts have established interpretations of these standard form contracts and clauses and such interpretations can also be found in reported arbitral awards. In cases where the courts of several countries have agreed upon the interpretation of certain clauses, this interpretation will bind the arbitrator. In other cases he may be guided by an interpretation in a particular court decision or in arbitral awards.  

7. Reporting of Arbitral Awards

Most arbitral awards are not published and are kept secret even from the members of the trade. This is to be regretted because the reporting of arbitral awards is an important element of the law merchant. During the last few decades there has been an increasing tendency to publish arbitral awards.  

C. The Lex Mercatoria as a judicial Process

The law merchant is still a diffuse and fragmented body of law. It will develop with the growth of uniform laws, international trade customs and usages, and with the increasing number of reported awards; however, it will never reach the level of the copious and well-organised national legal systems. This has to be admitted. To do so, however, is not to admit that the lex mercatoria cannot be applied.

1. Legalists and Inventors

The imperfect character of the law merchant makes arbitration something more than the mere application of pre-existing rules. The arbitrator must often seek guidance from sources other than the law merchant, notably from national laws. Sometimes he must invent a new solution, thus acting as a "social engineer". The opponents of the law mercatoria argue that it does not derive its binding force from any State authority and does not provide a sufficiently substantial and solid system. It cannot be called a legal order and therefore it is not suitable as a basis for the settlement of legal disputes. Another school of thought (to which the present writer adheres) holds that the binding force of the lex mercatoria does not depend on the fact that it is made and promulgated by State authorities but rather that it is recognised as an autonomous body of rules by State authorities.
The two opposed schools of thought reflect the two different attitudes to the legal process described above.\textsuperscript{97} The legalists oppose the application of the \textit{lex mercatoria}; the inventors favour it.

\textbf{2. The Lex Mercatoria as Invention}

An arbitrator applying the \textit{lex mercatoria} will act as an inventor more often than one who applies national law.\textsuperscript{98} Faced with the restricted legal material which the law merchant offers, he must often seek guidance elsewhere, mainly in the various legal systems. When they conflict, he must make a choice or find a new solution, and thus the \textit{lex mercatoria} often becomes a creative process.

Arbitrators of different nationalities who have applied the \textit{lex mercatoria} in collegiate arbitral tribunals have not experienced great difficulties in reaching consensus. When the law merchant has been silent and the national laws connected with the subject-matter have not led to the same result, few arbitrators have insisted on the solution provided by their own legal system but have sought the most appropriate and equitable solution for the case.

By applying the \textit{lex mercatoria}, arbitrators may take advantage of their freedom to select a better rule of law, something which the courts cannot do. For instance, the Scandinavian Sale of Goods Act provides that the buyer who wishes to invoke a late delivery of the goods must give notice immediately upon delivery. This rule is not suitable for international sales. Non-Scandinavian buyers are not acquainted with it, and for them it may be a trap. The rule in Article 49 (2) of the Convention on the International Sale of Goods of 1980, under which notice must be given within a reasonable time, offers a better solution.

Most arbitrators are led in the same direction by common ethics and notions of how business should be conducted. Often their intuition has told them the outcome before they have reflected upon the reasons. In their attempt to give reasons they sometimes realise that the issue is governed by a rule which still has to be framed. Even courts sometimes face such situations. Instead of invoking rules of law, Scandinavian courts sometimes refer to the facts which led them to their evaluation and conclusion. After stating the facts, they find, for instance, that the defendant's breach of contract was so reckless that he cannot invoke the exemption clause of the contract.\textsuperscript{99} Whether they are relying on a general rule to the effect that liability for reckless breach cannot be validly excluded by contract or whether this only applies to the special circumstances of the case is not revealed. One cannot expect arbitrators to give more scholarly reasons. Such reasoning will often satisfy the parties for whom the award is made.

Many arbitrations turn upon the interpretation of a contract. Although continental countries have statutory rules an interpretation\textsuperscript{100} arbitrators seldom invoke them. The interpretation of a contract is generally based upon reason and logic, and they are communal property.

In this way the law merchant is supplemented by the common attitude of arbitrators which furnishes a greater community of understanding. In spite of the common attitude of arbitrators, one would still think that the rich body of a national law would provide more consistent and predictable awards.

In many situations national law will give the parties greater certainty than the \textit{lex mercatoria}, especially where the parties have agreed to have the contract governed by a national law system and the arbitrator is familiar with the chosen law. In many cases, however, the parties have not chosen the law applicable to the contract, and often it is doubtful which law applies. Although the choice-of-law rules for contracts are becoming more uniform, they still create problems.\textsuperscript{101} Such a problem arises when the arbitrator has to apply the rules of a system which is foreign to him. The cases show that his difficulties may be considerable\textsuperscript{102} and that mistakes are not infrequent. The \textit{lex mercatoria} has the advantage that it does away with the choice-of-law process which many lawyers abhor.\textsuperscript{103}

Even when applying a national law well known to him, the arbitrator may run into difficulties which make his decision less predictable. Some national law rules are made exclusively for domestic relationships and thus are not suitable for cases containing foreign elements. Faced with such rules, the arbitrator is sometimes in a dilemma and must choose between law and equity. In such cases the \textit{lex mercatoria} may in fact provide more certainty. Where the arbitrator is to decide whether the aggrieved party gave notice of a late delivery of goods in time, the \textit{lex mercatoria}, as mentioned above, will
give the answer provided by Article 49 (2) of the 1980 International Sale of Goods Convention; if the case is to be decided under Danish law, doubt will arise as to whether the Danish courts have reduced their demands for immediate notice when the buyer is a foreigner. In this respect Danish case law seems to be unsettled.\textsuperscript{104}

Some authors who oppose the parties' right to choose the \textit{lex mercatoria} will permit them to agree an \textit{amiable composition} or decisions based on equity; however, this is an even more uncertain basis than the \textit{lex mercatoria}. In spite of common traits, there is a difference between the \textit{lex mercatoria} and equity. The \textit{lex mercatoria} obliges the arbitrator to base his decision on the law merchant even when equity might lead to another result.\textsuperscript{105}

Rules which cut off the right of the buyer to bring an action for defects in goods delivered after a certain time may be inappropriate for the delivery of durable goods. When a Scandinavian seller has sold such goods to a German buyer, the arbitrator must find for the seller, if the two-year period of notice under Article 39 of the 1980 Convention had elapsed before notice of the defects was given. He must do so even if it would be more equitable to find for the buyer. The cut-off period under the convention is longer than that of the Scandinavian Sale of Goods Act, section 54, and the German Civil Code, 477.\textsuperscript{106}

From the above it follows that the \textit{lex mercatoria} is capable of application even though it is an imperfect system. All national legal systems were once imperfect and many still are. To refuse businessmen the right to select the \textit{lex mercatoria} would be an unwarranted tutelage. As will be pointed out below, the choice of the \textit{lex mercatoria} need not give the parties any opportunity to evade mandatory rules of law.

In the next section the attitude of some specific legal systems to awards based on the \textit{lex mercatoria} will be examined. Firstly, with regard to domestic awards, the question arises as to whether the losing party may have the award set aside if the case is decided according to the \textit{lex mercatoria}. Furthermore, may the successful party have it recognised and enforced? Secondly, we will deal with the arbitrator's duty to consider international public policy and the mandatory provisions of countries closely connected with the subject-matter of the dispute.

\section*{D. National Attitudes to Domestic Arbitral Agreements and Awards}

\subsection*{1. The Laws}

\textbf{(a) The 1961 European Convention}

Eight Western European countries (Belgium, Austria, Denmark, the Federal Republic of Germany, Finland, France, Italy and Spain) and most of the socialist countries of Eastern Europe have ratified the European Convention of 21 April 1961\textsuperscript{107} on International Commercial Arbitration. This Convention applies to international arbitration agreements concluded between persons having their residence in different Contracting States and to arbitral procedures and awards based on such agreements.

Article VII (1) of this Convention provides that:

\begin{quote}
the parties shall be free to determine, by agreement, the law to be applied by the arbitrators to the substance of the dispute. Failing any indication by the parties as to the applicable law, the arbitrators shall apply the proper law under the rule of conflict that the arbitrators deem applicable. In both cases the arbitrators shall take account of the terms of the contract and trade usages.
\end{quote}

This provision presupposes that a national law is to be applied to the substance of the dispute. However, under article VII (2), the arbitrators may act as \textit{amiables composites} if the parties so decide and if they may do so under the law applicable to the arbitration. Since the \textit{lex mercatoria} will tie the arbitrators to legal rules more than a decision made by an \textit{amiable compositeur}, this comes close to saying that arbitrators may decide the case on the basis of the \textit{lex mercatoria} when the parties have so decided and when they are permitted to agree upon an \textit{amiable composition} under the law applicable to the arbitration.

The European Convention was made to facilitate the recognition and enforcement of arbitral agreements and awards. Whereas it set limits on the right of the Member States to refuse recognition and enforcement of such agreements and
awards, it did not prevent Member States from being more liberal, i.e. from going further than the Convention in their recognition and enforcement. This has been done by France.

(b) France

French authors have eloquently advocated the application of the *lex mercatoria*\(^{108}\) and their efforts have been fruitful. A government decree of 12 May 1981 has added new provisions on international arbitration to the Code of Civil Procedure. Under Article 1496, the arbitrator applies to the contract those rules of law which the parties have chosen, and when no choice has been made, those which he considers appropriate ("celles qu'il estime appropriées"). This provision extends recognition to French and foreign awards based upon

the *lex mercatoria* or other non-national sources of law even when the parties have not agreed on a decision based upon these sources.\(^{109}\)

(c) Switzerland and Germany

Swiss and German authors are divided as to whether to allow application of the *lex mercatoria*.\(^{110}\) I have not found reported cases on the issue. Several authors, including some who declare enmity\(^{111}\) against the *lex mercatoria*, agree that an award which has been rendered *ex aequo et bono* may only be set aside if it violates a strong principle of German public policy (*ordre public*). It is not sufficient that it merely violates mandatory provisions of German law.

(d) Austria

In a judgment of 18 November 1982 the Austrian Supreme Court upheld an ICC award made on 26 October 1979 in Vienna on the basis of the *lex mercatoria*.\(^{112}\) The parties had not agreed on the *lex mercatoria* nor had they submitted to *amiable composition*. The case had turned on the question whether the Turkish claimant, who had been the agent of the French defendant and who had marketed the defendant's goods in Turkey, could claim damages for lost commission after having been dismissed by the defendant. The arbitrators could not find themselves able to choose a national law, the application of which was sufficiently compelling, be it Turkish or French. They therefore based their decision on the international *lex mercatoria*. Applying the principle of good faith and fair dealing, they found that the termination of the contract by the defendant had been unjustified and awarded damages to the claimant for an amount of 800,000 French francs. The Supreme Court found that the application of the *lex mercatoria* had been justified. It pointed out that the award did not violate mandatory provisions of either Turkish or French law.

(e) England and Wales

Some English writers assert that arbitrators must always apply the law.\(^{113}\) They will not accept awards based upon "equity and good conscience" or on the *lex mercatoria*. Other authors favour the application of the *lex mercatoria*.\(^{114}\) It seems that the idea of *lex mercatoria* as a genuine system of law is still foreign to English arbitrators. Thus it is doubtful as to how English courts will treat agreements to apply awards based upon the *lex mercatoria*.

In cases where a reasoned award is not required and not given, an English court will not review the legal basis of the award.\(^{115}\)

Before 1978 English courts set aside awards based upon "equity";\(^{116}\) however, in 1978 the Court of Appeal upheld an arbitration clause according to which the arbitrators should "not be bound by the strict rules of law but . . . settle any difference referred to them according to an equitable rather than a strictly legal interpretation of the provisions of this contract". The court found this provision "entirely reasonable". It did not oust the jurisdiction of the courts but only removed "technicalities and strict constructions".\(^{117}\) One might ask whether this judgement would also cover a *lex mercatoria* clause.\(^{118}\)

Furthermore, under the Arbitration Act 1979,\(^{119}\) the parties may by an agreement in writing exclude the right to bring questions of law before the courts. They may always make such an exclusion agreement after the dispute has arisen. The
parties to an international contract may also do so before the dispute has arisen if they expressly agree to have the
dispute governed by a law other than the law of England. It might be asked whether an exclusion agreement would be
equally effective if the parties chose to apply the *lex mercatoria* instead of a foreign law. Would English courts deciding
this question be guided by one of the purposes of the Arbitration Act 1979 which was to limit the review by the English
courts to the arbitrators’ findings of law in international arbitrations?

The United Kingdom has adhered to the Convention of 18 March 1965 on the Settlement of Investment disputes between
States and Nationals of Other States. Such disputes are to be settled by arbitration. Under Article 42 (1) of the
Convention, the arbitral tribunal has to decide disputes in accordance with such rules of law as may be agreed by the
parties. The parties are entitled to agree on a non-national law. Article 42 (1) also provides that, in the absence of such
an agreement, the tribunal shall apply the law of the contracting state which is a party to the dispute (including its rules an
the conflict of laws) and such rules of international law as may be applicable. It seems to be generally agreed that the
rules of international law refer not only to the rules of public international law but also to what is referred to here as the law
merchant. Furthermore, it has now been established by an arbitral award rendered under the Convention that, in the
case of a conflict between the law of a Contracting State and “the rules of international law” the latter rules may be given

(f) The United States

In the United States the federal courts and most state courts are reluctant to set aside arbitral awards on legal grounds.
The Supreme Court of the United States in a dictum that “the interpretation of the law by the arbitrators in contrast to
manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation”. Cases where a
federal court has set aside an award for manifest disregard of law are not known. Although the *lex mercatoria* is foreign
also to American arbitrators, it seems unlikely that an agreement by the parties to apply the *lex mercatoria* or an award
based on such an agreement would be challenged by an American court.

(g) The Nordic Countries

The Nordic realist school of jurisprudence has taught that even the most developed legal system is imperfect in so far as
it does not provide a predictable answer to many legal questions. From that it must follow that one cannot refuse to
apply a system of law such as the *lex mercatoria* on grounds of principle simply because of its lower degree of perfection.
Although the issue does not seem to have been decided, it is unlikely that Scandinavian courts would set aside an
arbitration agreement to apply the *lex mercatoria* or an award based on such an agreement. A Scandinavian court would
probably follow the will of the parties who knew about the merits and demerits of the *lex mercatoria* when they chose it.

If, however, the parties or their counsels have argued the case on the assumption that a particular legal system would be
applied, the arbitrator is bound to apply that national law. If, as in the Austrian award mentioned above, the arbitrator
applies the *lex mercatoria* where both parties have sought the application of national law, he will not have conducted the
proceedings in accordance with the agreement of the parties. Under section 7 of the Danish Arbitration Act 1972 this may
be a ground for setting aside the award.

Scandinavian courts would probably also accept an award in which, following an agreement on *amicable composition*, the
*lex mercatoria* had been applied. In international arbitration the *lex mercatoria* might be an appropriate basis for an award
which is to be made according to equity.

(h) The UNCITRAL Model Law

Article 28 of the Model Law recognises the freedom of the parties to choose the rules of law applicable to the substance
of the dispute. The words "rules of law" indicate that the parties may select either a national legal system or other rules of
law such as the *lex mercatoria*. However, as we shall see, this freedom is given only to the parties. Failing a designation
by the parties of the law or the rules of law, the arbitrator does not have the power to apply the *lex mercatoria*. He must
apply a law, i.e. a national legal system.
2. Comment

From the above it follows that the courts of most of the countries mentioned will not set aside an agreement by the parties to apply the lex mercatoria or an award which, relying upon such an agreement, has been based upon the lex mercatoria. French legislation has expressly permitted its use and the Austrian Supreme Court, although with a qualification, has accepted an award in which it is applied. French law even permits the arbitrator to resort to the lex mercatoria when the parties have not agreed upon its application. The Model Law will not permit the arbitrator to apply the lex mercatoria in such cases.

This has been criticised. The rule is alleged to be in conflict with existing practices in several countries. It prevents the arbitrator from using an appropriate means of solving international commercial disputes. Thus the question arises as to whether this criticism is justified.

An arbitrator who relies solely on the general principles of law is often unable to find principles which are truly "general" in the sense that they belong to the common core of all legal systems or even the laws connected with the dispute. He will therefore, as mentioned above, have to use his creativity to a large extent and act as inventor.

If the parties direct the arbitrator to apply the lex mercatoria, they will know its merits and demerits, one of which is the scarcity of "authority" on which the arbitrator can base his decision. They will know that the arbitrator cannot make scientific investigations to ascertain the "common core" of many legal systems and that he will often have to use his bon sens.

The lex mercatoria may be applied even if the parties have not mentioned it by name but have invoked the common core of the legal systems, the rules of public international law, international trade usages or other international sources mentioned above at Section II.

The situation is different when both parties have pleaded for the application of a national legal system. Such pleadings show that the parties want the arbitrator to take a legalist attitude - to the extent that this is possible - and to apply a national legal system.

If, in such cases, the arbitrator applies non-national rules of law such as

those of the lex mercatoria, he will be acting in excess of his powers. In some countries this may not be a ground for setting aside the award, but this fact alone does not justify his act.

There are, however, a few situations where the application of the lex mercatoria would be justified even when the parties have not pleaded its application.

An agreement by the parties to have the case decided by amiable composition will also allow the arbitrator to apply the lex mercatoria. Whereas a selection of the lex mercatoria cannot be regarded as an agreement on amiable composition, the elements of the lex mercatoria - international usages, general principles of law, arbitral case law - are appropriate bases for the decisions of an amiable composition in an international dispute.

Furthermore, a non-national arbitral tribunal is often selected in an effort to "denationalize" the arbitration. Therefore, such a tribunal should be permitted to apply the lex mercatoria to cases where the tribunal finds that the contents of the applicable law have not been ascertained. In these situations national arbitral tribunals would act as the courts do and apply the lex fori. Non-national tribunals, however, have no real forum. Instead of applying the law of the casual seat of the tribunal, an appropriate way out of the difficulty is to apply the lex mercatoria. As regards the Model Law, it is doubtful whether it will permit the arbitrator to apply the lex mercatoria in such a case.

IV. APPLICATION OF MANDATORY PROVISIONS

An important question related to references governed by national law or by the lex mercatoria is the extent to which public policy and mandatory provisions must be applied by the arbitrator.

A. Mandatory Provisions and the Courts
In international cases before the courts, the choice-of-law rules of the forum country will determine which law shall govern the contract as its proper law. In general, the courts apply both the directory and the mandatory rules of the proper law. The application of a foreign law, however, will be refused if it is incompatible with a strong principle of public policy in the forum country.

The EEC Convention of 19 June 1980 an the Law Applicable to Contractual Obligations follows this pattern. The mandatory rules of the proper law apply to the contract. Under Article 16, the application of a foreign law may be refused if such application is manifestly incompatible with the public policy (ordre public) of the forum; the public policy of the forum may also impose the mandatory application of a rule of law irrespective of the applicable law. Such a rule is called a directly applicable rule of the forum. Thus an antitrust rule of the forum country may be applied even when the law of the forum is not the proper law of the contract. Furthermore, the courts of those Contracting States which have enacted Article 7 (1) of the Convention may give effect to the mandatory rules of a country other than that of the forum or that of the proper law. They will do so if the situation has a close connection with the other country, and if and so far, under the law of the latter country, those rules must be applied regardless of the law applicable to the contract. In considering whether to give effect to these directly applicable mandatory rules, regard shall be had to their nature and purpose and to the consequences of their application or non-application. Under this provision foreign public law rules such as antitrust rules may be applied even if the contract is governed by the law of another country.

**B. National Arbitrators Applying National Law**

An arbitrator of a national arbitral tribunal who applies national law is in a situation similar to that of a judge. He will have to observe the public policy of the forum State and give effect to its directly applicable mandatory rules. It may be questionable whether he will also have to apply the mandatory rules - be they directly applicable or not - of the foreign proper law of the contract which the parties have chosen or which he has determined to be applicable under Article VII of the European Convention and Article 28 of the Model Law. It may be argued that these very indulgent rules do not oblige him to apply all the provisions of the proper law. It is submitted, however, that the arbitrator can only disregard such mandatory rules to the extent that a judge of the forum State could do so.

Whether the arbitrator will also have to apply the directly applicable rules of a foreign country which is not the country whose laws are applicable to the contract will also depend upon what a judge sitting in his country would and could do.

**C. Mandatory Provisions and the Lex Mercatoria**

The arbitrator who applies the *lex mercatoria* is in a different situation from that of a court. He is not applying a national law as the proper law of the contract. This holds true both of arbitrations governed by national law and of stateless arbitrations.

**1. Arbitrations Governed by National Law**

In cases before national arbitral tribunals and non-national tribunals governed by national law, the arbitrator must give effect to the public policy of the law governing the arbitration, including its directly applicable rules. If the law governing the arbitration includes Article 7 (1) of the Rome Convention, the directly applicable rules of other laws may also be applied. Article 7 (1) deals with provisions of a law other than the proper law of the contract. Contracts governed by the *lex mercatoria* have no proper law. The principle laid down in Article 7 (1) must therefore be given an extended application and should cover mandatory provisions of the law which would have been the proper law of the contract. Even if the law governing the arbitration has not adopted Article 7 (1), it is submitted that the arbitrator should be guided by similar considerations.

**2. Non-National Arbitrations**

An arbitral tribunal conducting a non-national arbitration is not subject to the public policy or the directly applicable rules of a single legal system. Parties who have submitted to a non-national arbitration should not be laid in the Procrustean bed of the incidental forum country and be made subject to its particular public policy. This, however, does not mean that the...
The arbitrator may disregard all mandatory rules.

(a) International Public Policy

There is a public policy common to all commercial nations. In an ICC reference subject to the *lex mercatoria*, the arbitrator, Gunnar Lagergren, set aside a contract which had been obtained through the bribery of governmental officials. He said:

> . . . it cannot be contested that there exists a general principle of law recognised by civilised nations that contracts which seriously violate *bonos mores* or international public policy are invalid or at least unenforceable and that they cannot be sanctioned by courts or arbitrators. This principle is especially apt for use before international arbitration tribunals that lack a "law of the forum" in the ordinary sense of the term.\(^\text{139}\)

Within the international public policy referred to by Lagergren is also the principle that unconscionable contracts and contract clauses are unenforceable. This principle is now embodied in the laws of several countries and is adhered to more or less covertly by the courts of other countries.\(^\text{140}\)

(b) Mandatory Rules of Countries Closely Connected with the Contract

The arbitrator must also give effect to mandatory rules of a country closely connected with the contract. For such a rule to be considered, it must claim application to the issue either expressly or by way of statutory construction. The arbitrator, however, should not give effect to every mandatory rule which requires such application. Two legal systems may collide with each other in the sense that one orders what the other prohibits. In 1982 the United States Government prohibited the subsidiaries of and enterprises licensed by American corporations abroad to perform contracts for the supply of equipment planned to connect gas supplies from Siberia to Europe. The UK and French Governments ordered such companies and licensees domiciled in their countries to perform the contracts.\(^\text{141}\)

When considering whether to give effect to a mandatory provision, the arbitrator should pay regard to the likelihood of the award being enforced by the courts of the enacting country. Courts will refuse enforcement if the award violates their public policy, including their directly applicable rules. The arbitrator must therefore pay special attention to the public policy of the country where enforcement of the award is likely to be requested.\(^\text{142}\) The arbitrator should also consider whether the contract has such a connection with the economy of the enacting country that it would be fair and reasonable to give effect to the mandatory rule in question. He should give effect to such rules even though the prospects that the authorities of that country might interfere with his award are small, for instance, when its enforcement will most likely be sought in another country.

Although the arbitrator derives his authority to decide the case from the will of the parties, he cannot have regard to their interests only. Like the courts of law which he replaces, he must consider any strong principle of public policy of a country closely connected with the contract. To apply the *lex mercatoria* is to base the decision an legal considerations having regard to both private and public interests. To disregard the public interests of the communities involved would be to make a blinkered award.

Furthermore every arbitrator has to consider the importance of preserving commercial arbitration as an instrument for settling international disputes. Today commercial arbitration is highly regarded in most countries. Governments have not interfered with its operation and indeed, have encouraged its establishment in their countries. If, however, arbitration is used as a means of evading the relevant policies of countries which have an interest in the subject-matter of the dispute, the reputation of arbitration will suffer. Arbitration can thrive only as long as it is supported by governments. The business world has an interest in keeping arbitration free of government intervention.

It is not possible to lay down exact rules as to when the arbitrator should give effect to the mandatory rules of a country. There are cases where he may disregard such rules even though they are enacted in a country where enforcement of the award may be sought. For instance, an Italian enterprise undertakes to build a waterworks for a Ruritanian city corporation. The parties agree to submit disputes arising out of the contract to a non-national arbitration tribunal and to have them governed by the *lex mercatoria*. The Ruritanian city later fails to honour payment of certificates and the
enterprise institutes arbitration proceedings. The defendant now invokes a Ruritanian statute preventing public corporations from submitting to arbitration. The statute is in force but on several occasions has not been invoked by Ruritanian public bodies in arbitration cases. In such a case the arbitrator would not be obliged to give effect to the statute and might go on with the reference.

In other cases the mandatory provisions of a State should be given effect, although an award in which they were disregarded could be enforced in another State where the courts would not apply the mandatory rules. For instance, a clause in an agreement between a Japanese licensor and a Swedish licensee provides that the annual royalties, which are calculated on the basis of each unit sold, shall be paid even when the secret knowledge assigned to the licensee falls into the public domain. A part of the royalties is to be paid for products made and sold by the licensee's subsidiaries operating within the Common Market. After the knowledge has become publicly known, the licensee refuses to pay further royalties. He invokes the position of the EEC Commission which has ordered the clause to be struck from the agreement as being in violation of Article 85 of the EEC Treaty. The licensor, however, can show that the clause is valid and enforceable under Japanese and Swedish law.

An arbitrator who has to decide upon a reference brought by the licensor against the licensee should give effect to the EEC rules of competition so far as the royalties payable for sale of the products in Common Market countries is concerned. He should do so even though a Swedish court faced with a request for enforcement of his award would not refuse enforcement, even if he disregards the EEC rules.

Article 7 (1) of the Rome Convention is expressive of international solidarity. States should help each other in the enforcement of relevant governmental policies. The arbitrator should contribute to this solidarity by giving effect to mandatory provisions claiming application, provided that those rules are enacted by a State having a close relationship with the contract and that it is fair and reasonable to give effect to them. In fact, arbitrators have done so in several awards.

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2 See Stockholm Chamber of Commerce, An Introduction to International Arbitration in Sweden (Stockholm, 1982), p. 7: "So far most arbitrators appointed by the Institute have been of Swedish nationality . . . .  
3 Ibid.  
6 See Part II of this chapter.  
7 Article 1(2).  
8 Article 6.  
9 Article 34.  
10 Article 19.  
11 Article 28.  
12 Article 34(2)(b)(ii).  
13 UNCITRAL Report No. 296.  
14 See UNCITRAL Report No. 291 on Article 34(2)(b)(i).  
15 The countries are Austria, Belgium, Bulgaria, Cuba, Czechoslovakia, Denmark, Federal Republic of Germany, France, German Democratic Republic, Hungary, Italy, Yugoslavia, Poland, Rumania, Soviet Union, Spain, Upper Volta.  
16 *(1) The arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law determined by the conflict-of-law rules which it considers applicable. (2) The arbitral tribunal shall decide as amiable compositeur or ex aequo et bono only if the
parties have expressly authorized the arbitral tribunal to do so and if the law applicable to the arbitral procedure permits such arbitration. (3) In all cases the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction."

17 "(1) The parties shall be free to determine the law to be applied by the arbitrator to the merits of the dispute. In the absence of any indication by the parties as to the applicable law, the arbitrator shall apply the law designated as the proper law by the rule of conflict which he deems appropriate. (2) The arbitrator shall assume the powers of an amiable compositeur if the parties have agreed to give him such powers. (3) In all cases the arbitrator shall take account of the provisions of the contract and the relevant trade usages."

18 See Y. Derains, 109 Clunet (1982), p. 967 on the arbitrators’ inclination to cite published awards.

19 See cases published in P. Sanders (ed.), Yearbook (1976- ) and in Rev. Arb. (France) and reports, especially by Y. Derains, 101 Clunet (1974- ). Lew also gives very comprehensive reports.


22 E.g. ICC 893/1955, reported by Lew, supra n. 20, No. 106.


24 J. D. M. Lew, supra n. 20, at p. 106 (No. 128).

25 Ibid.

26 O. Lando, supra n. 23 at Nos. 25-60.


28 On the courts, see O. Lando, supra n. 23, at Nos. 115-120 and 122-129.


30 Hamlyn v. Talisker and Spurrier v. La Cloche, supra; F. Russell, supra n. 29, at p. 63. In some cases the selection of an English arbitral tribunal is at the same time the selection of an English court because a party may bring legal questions before the court (special case).


32 Cass. civ. 19 Feb. 1930 S. 1933.1.41. In a later case the Cour de Paris (26 Oct. 1962) maintained that "the clause by which the contracting parties have agreed to submit disputes arising out of their contact to the decision by arbitrators of a certain country is one of the most significant indications that the contract, as they have conceived it, is localised in the country thus designated". Rev. Crit. (1965), p. 535.

33 Cass. civ. 19 Feb. 1930, supra n. 32.


35 See J. D. M. Lew supra n. 20, at p. 218 (Nos. 190 et seq.).

36 The contrary has been held by the English Court of Appeal in Tzortze v. Monark Line AV (supra n. 29) where the choice of arbitration in London by a Greek and a Swedish party was considered to be a choice of English law. This, however, was later criticised in the House of Lords in Compagnie d’Armement Maritime S.A. v. Compagnie Tunisienne de Navigation S.A., supra n. 31; See also J. D. M. Lew, supra n. 20, at Nos. 179 et seq.

37 Stockhom Chamber of Commerce, supra n. 2.

38 See J. D. M. Lew, supra n. 20, at p. 218 (Nos. 190 et seq.).


40 On these theories, see P. Schlosser, Recht der internationalen privaten Schiedsgerichtsbarkeit, vol. 1 (Tübingen, 1975), Nos. 164 et seq.

41 Ibid.


43 Stockhom Chamber of Commerce supra n. 2, at p. 46.

44 Message concernant une loi fédérale sur de droit internationale privé (loi DIP) du 10 nov. 1982, p. 195; P Lalivie, "Les Régles... ", supra n. 5.

45 Arbitration Act 1979 (c. 42) sections 3-4; see M. H. Mustill and S. C. Boyd, supra n. 42, at pp. 316 et seq.

46 47 II Annuaire, 394 (195) and 48 II ibid. 264 (1959); See J. D. M. Lew, supra n. 20, at p. 277 (No. 227).

47 J. D. M. Lew, supra n. 20, at p. 277 (No. 227).

48 Ibid., p. 256 (No. 235) where Lew cites ICC Award No. 1455/67.

49 On this approach see Y. Derains, "L'Application cumulative par l'arbitre des systèmes de conflit de lois intéressées au


50 ICC 1404/1967, reported by J. D. M. Lew, supra n. 20, at p. 332 (No. 285).

51 ICC 1404/1967, reported by J. D. M. Lew, supra n. 20, at p. 332 (No. 285).


54 O.Lando supra n. 23, at No. 120 (on the Netherlands).

55 E.g. the German BGH an 19 Sept. 1973, IPRspr. (1973), No. 11.

56 ICC 2735/1976, reported by Y. Derains, 104 Clunet (1977), p. 947. See also the two cases cited at p. 949 and ICC 2870/1978 (not reported).

57 J. D. M. Lew, supra n. 20, at Nos. 302 et seq.


59 ICC 1422/1966, reported by J. D. M. Lew, supra n. 20, at No. 270.


62 O. Lando, supra n. 23, at Nos. 104-142.

63 This viewpoint resembles that of the common lawyer. See J. H. Merryman, The Civil Law Tradition (Stanford, 1969), pp. 50 et seq.


68 See O. Lando, supra n. 23, at Nos. 115-142.


70 A. V. Dicey and J. H. C. Morris, supra n. 29, Rule 145, sub-rules 1 and 2 at pp. 753 et seq.; Restatement, Second, supra n. 69, at § 187, Comment a, vol. 1, at p. 561; Rome Convention, Article 3(1), Austrian Conflicts Law § 35(1); Swiss Draft, Article 113(2).

71 A. V. Dicey and J. H. C. Morris supra n. 29, Rule 145, sub-rule 3 at p. 769; Restatement, Second, supra n. 69 at § 188; Rome Convention, Article 4(1); Swiss Draft, § 188(2).

72 A. V. Dicey and J. H. C. Morris, supra n. 29, at pp. 769 et seq.; Restatement, Second, supra n. 69, at § 188(2).

73 Rome Convention, Article 4(2); Austrian Conflicts Law, § 36; Swiss Draft, Article 114.

74 A. V. Dicey and J. H. C. Morris, supra n. 29, Rule 161, at pp. 870 et seq.; Restatement, Second, supra n. 69, at § 196; Rome Convention, Article 6; Austrian Conflicts Law, § 44; Swiss Draft, Article 118.

75 A. V. Dicey and J. H. C. Morris, supra n. 29, Rule 153, at p. 829; Restatement, Second, supra n. 69, at §§ 189 and 190; Rome Convention, Article 4(3); Austrian Conflicts Law, § 42; Swiss Draft, Article 116.


78 J. D. M. Lew, supra n. 20, at pp. 367, 372, No. 139.


80 On the theories, see O. Lando, "Den ikke-nationale handelsvoldgift", Liber Amicorum in Honour of Alf Ross (1969); pp. 295, 302 et seq.

81 Some authors treat the rules common to the international business community - the new law merchant - together with
the rules of a national system; see B. Goldman, supra n. 76, at p. 214; Article 42(1) of the Convention on the Settlement of Investment Disputes of 1965 provides for such a combined approach to the subject see infra n. 123. This raises inter alia, the following questions of hierarchy: May the arbitrator apply the rules of the law merchant when they are in conflict with the mandatory rules of the national law? May he replace the directory rules of the national law with rules or solutions which, though not yet to be found in the law merchant, are better suited to international contracts?


85 See Part IV of this paper.


89 See the illustration, infra n. 106.


93 UNECE Doc. No. 1953 (188).


95 See J. D. M. Lew, supra n. 20, passim; O. Lando, supra n. 66, at p. 157.


97 See II. B.3(b) of this paper.


100 See K. Zweigert and H. Kötz, Einführung in die Rechtsvergleichung, 2nd edn. (Tübingen, 1984), vol. 2, sect. 7.

101 See O. Lando, supra na. 23, at Nos. 4, 142.

102 On the difficulties of ascertaining a foreign law see Materialien zum ausländischen und internationalen Privatrecht, vol. 10: "Die Anwendung ausländischen Rechts im internationalen Privatrecht" (1968), passim and p. 184, where Kegel refers to it as the "Secret King" of the conflict of laws; see also E. Rabel, Conflict of Laws (Ann Arbor, 1958), vol. 4, pp. 473 et seq.

103 The published awards show several instances of a preference of the; lex mercatoria for the intricacies of private international law; see e.g. the ICC award of 26 Oct. 1979, reported infra at n. 112; also the Ad hoc Award of 23 July 1981, Yearbook, vol. 8 (1983), pp. 89, 91.

104 See Ugarskrift for Restvaesen (Supreme Court) 1952 A, 969, 1957 A, 358.


106 This solution, however, would have been less compelling upon the arbitrator if one of the legal systems involved had not provided for any cut-off period.

107 See J. D. M. Lew, supra n. 20, at Nos. 252 et seq.

108 E.g. B. Goldman in several of his writings; see e.g. "Frontières du droit et lex mercatoria", 177 Archives de philosophie du droit (1984); P. Fouchard, L'Arbitrage commercial international (Paris, 1960), pp. 401-456.


111 F. Schlosser, supra n. 40, at No. 623.

112 Fabalk Ticaret v. Norsolor IPRax (1984), p. 97; see B. von Hoffmann, supra n. 110, at p. 106. As regards the request of the Turkish party for enforcement in France, the French Cour de cassation held that recognition and enforcement would not be carried out in France if it would be contrary to "international public order" under Article 1502 (5) of the Code
of Civil Procedure; however, this was not the case here: (1985) XXIV I.I.M. 360.


118 According to M. J. Mustill and S. C. Boyd, an agreement to apply the lex mercatoria is on equal footing with an "equity" clause; see supra n. 42, at pp. 605, 611.

119 1979, c. 42; see M. J. Mustill and S. C. Boyd, supra n. 42, at pp. 525 et seq.

120 Arbitration (International Investment Disputes) Act 1965 (c. 41). The International Centre for the Settlement of Investment Disputes (ICSID) was established by virtue of the Washington Convention of 18 Mar. 1965.


122 J. D. M. Lew, supra n. 20, at No. 345; G. R. Delaume, supra n. 121, at p. 828.


124 See San Marine Compania de Navegacion SA v. Saguenay Terminals, Ltd 293 F2d 796 (1961) referring to Wilko v. Swam, 346 US 427, 436, and Bernhardt v. Polygraphic Co., 350 US 198, 203. In the last decision it was said obiter that "a manifest disregard of the law might be present when the arbitrators understand and correctly state the law that proceed to disregard the same". See also M. Domke, The Law and Practice of Commercial Arbitration (Mundelein, 1968), pp. 245 et seq.

125 The Scandinavian philosopher Alf Ross asserted that the postulate that a proposed rule is a rule of law is only more or less probable. From this must follow that, although the number of "highly probable" rules may be considerably higher in one legal system than in another, this difference of degree cannot lead to a rejection of the latter as a legal system; see A. Ross, Ret og rettaerdiighed (1953), pp. 51 et seq.

126 See B. Hjejle, supra n. 98, at pp. 82, 181; B. Gomard, Voldgift i Danmark (Arbitration in Denmark) (1979), p. 43.

127 See B. Hjejle, supra n. 98, at pp. 125 et seq.

128 See B. Goldman, supra n. 76, at p. 215.


132 Upholding an ICC award made in Germany, the Oberlandesgericht Frankfurt assumes "that the award is not based upon a world trade law which rests on customs and which is unbound by national law, the so-called lex mercatoria". This obiter dictum expresses the view that German courts would consider it a violation of the German Code of Civil Procedure (§ 1041 (1) No. 1) on infringement of due process (unzulässiges Verfahren) if an arbitrator applied the lex mercatoria to a case where the parties pleaded the application of national law. Reference is made to K. H. Schwab, supra n. 126.

133 Here it is stated that in such a case a decision ex aequo et bono would violate due process. See decision of 21 Dec. 1983, IPRspr. (1983), No. 197.

134 See A. V. Dicey arid J. H. C. Morris, supra n. 29, at p. 748; O. Lando, supra n. 23, at Nos. 177-231.


136 Article 10.

137 Article 7(2). On English law see A. V. Dicey and J. H. C. Morris, supra n. 29, at p. 801, Rule 149, Exception 2.

138 Article 22 of the Convention grants the Contracting States the right not to apply Article 7(1). On English law see A. V. Dicey and J. H. C. Morris, supra n. 29, at p. 789, Rules 149 and 792, Rule 149, Exception 1.

139 ICC Award 1110 of 15 Jan. 1963; see J. D. M. Lew, supra n. 20, at No. 423.


142 See the ICC Rules of Arbitration 1976, Article 26 reads as follows: "In all matters not expressly provided for in these Rules, the Court of Arbitration and the arbitrator shall act in the spirit of these Rules, and shall make every effort to make sure that the award is enforceable at law."

Referring Principles:

VI.2 - Deadline for notice of defects