

LEX MERCATORIA AND THE UNIDROIT PRINCIPLES: A SHOCK OR A NEW CHAPTER OF CONTEMPORARY PRIVATE INTERNATIONAL LAW?

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Thank you Mr. Chairman. Let me thank Istanbul Kemerburgaz University for the invitation, the organizers, and in particular Prof. Cemil Yildırım. And let me greet all the colleagues and students who have conveyed here. My job is to raise some issues concerning *lex mercatoria* and the UNIDROIT Principles and the title I have elected - I hope it will be provocative- is it “a Shock or a New Chapter in Private International Law?” I’m sure that the entire day will bring some answers, if there are definitive answers, to this very complex but very important issue for international business law.

In 1554, Lanfranco da Oriano, one of the first scholars of commercial arbitration in the period of the ancient *lex mercatoria* (law merchant), published in Venice, my town, an essay where he noticed that, let me quote in Latin “*materiam arbitrorum utilem fore et quotidianam a nostrisque doctoribus male explicatam*” which means “the subject of arbitration is of

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a great utility, but it is badly explained by our legal doctors.” And I believe that almost five centuries later, many businessmen would agree with Lanfranco da Oriano, since their perception of the law of international business seems completely different from that of many legal scholars, including their lawyers.

Part I : The New Lex Mercatoria and the UNIDROIT Principles for International Commercial Contracts as a shock for conservative Conflict of Laws Scholars

Now, one might agree or disagree in abstract terms with *lex mercatoria* doctrines, but I think that anybody should accept three simple facts, such as:

First, it is widely recognized that about 80% of international contracts contain an arbitration clause. I know that we could discuss about statistics and we could, perhaps arrive to the conclusion according to which “there are three kind of lies: lies, damned lies and statistics”¹; but let me say that, anyone in the practice of international business law would agree that eight contracts out of ten, bear an arbitration clause.

Second, anybody drafting international business contracts should have a broad understanding of contract law but, it is equally true that, he or she will always be a *principiante* - that’s a word that prof. Ole Lando who was mentioned today has used - when asked about a domestic law other than his own.

Third simple statement: International law is our common legal system and therefore even our common language. Thus, even transnational contracts have to be considered as part of the contemporary international legal system and that is of course the most difficult part of the story². How is that possible? Well, in contemporary international law, reference should be made to the notion of “general principles of law recognizes by civilised nations” ex art.38 of the International Court of Justice Statute. Thus, combining new actors of International Law, such as transnational

¹ Attributed to Benjamin Disraeli in Mark Twain’s *Autobiography* (1924), Vol. 1, 246.

² See D. Carreau, F. Marrella, *Droit international*, XI éd., Paris, Pedone, 2012.

corporations with the expansion of “old sources” of International Law, such as the general principles of law, one should easily look at the UNIDROIT Principles on International Commercial Contracts as a “codification” of such a source, particularly useful for B2B and State Contracts³.

Also for these reasons, legal scholars have tried to solve the Babel of Law dilemma - that’s a word used by another pioneer of the field, René David, coming from Comparative Law -by creating a compilation of principles intended to provide one codified answer to the challenge of unwritten *lex mercatoria*: the UNIDROIT Principles which have discussed this morning, an international restatement of the new *lex mercatoria*.

Then are the UNIDROIT Principles a shock or a challenge for contemporary Private International Law?

Today, the reader of the imposing legal literature on the UNIDROIT Principles, and we have many learned authors present here, is confronted by a phenomenon which has reunited international private and comparative law scholars in common reflections, and has torn down for once the common state-centered partitions of law, at least in continental Europe.

In view of the above, prof.Francesco Galgano, a leading Italian Scholar, has warned in a wonderful booklet on the history of *lex mercatoria* and Commercial Law, that we might face a turning point in the legal thinking of international business law. Let me quote his words. He said that “the effectiveness of this new Digest [and it’s interesting to see the parallel with the Roman Law Digest, another non-binding instrument] relies on the ongoing number of the international arbitral awards that, in resolving disputes by applying *lex mercatoria*, make textual reference to the UNIDROIT Principles, assuming them to be a credited source. The essence of this compilation [the UNIDROIT Principles compilation] resides in the blend of contractual practice with universally accepted general principles of law.”

³ I have developed these views in my “La nuova lex mercatoria. Principi UNIDROIT ed usi dei contratti del commercio internazionale”, in *Trattato di diritto commerciale e di diritto pubblico dell’economia*, Padova, Cedam, 2003. See also F. Galgano, F. Marrella, *Diritto del commercio internazionale*, 3 ed., Padova, Cedam, 2011.

We may certainly discuss later, whether or not *all* the UNIDROIT Principles can qualify as “general principles of law shared by civilized nations” in the formula of Article 38 of the ICJ Statute. But here, it’s useful to point out that the political mediation of competing interests peculiar to the Law created by Nation States, is now replaced by the UNIDROIT Principles - just like in the ancient times of the *lex mercatoria* - a product of the cultural mediation of the legal scholars.

To make a long story short, today the entire debate is still on mainly, if not only, among conflict of laws scholars, most of which cannot accept to qualify as “law” for conflict of laws purposes, a system of rules of a-national origin. International lawyers as well as pure scholars of Commercial Law have placed less drama on our discussions but all that, exploded, if I may use this word, during the transformation of the Rome Convention 1980 on the Law Applicable to Contractual Obligations into the famous and so-called the Regulation Rome I. Let me just recall two points related to the drafting history of the new Regulation Rome I which is now in force for all the EU Member States.

First of all, in the Green Paper initially presented by the European Commission, it was noted that the practice of *lex mercatoria* in the choice of non-state rules was certainly a keypoint to keep into account for the transformation of famous Article 3 of the 1980 Rome Convention. You may remember that, during the drafting of the 1980 Rome Convention, the drafters were aware about the new *lex mercatoria*, the UNIDROIT Principles did not exist, but the phenomenon was less visible. Accordingly they decided simply not to consider it as a valid choice of law, in terms of direct choice.

But at the dawn of the third millennium, the same issue became much more important. Hence, in the draft European Commission Regulation of the 15th December 2005, the European Commission, after having heard a number of experts in the field, noticed that it is common practice in international trade for the parties to refer *not* to the law of one or other State but directly to the rules of an international convention as the Vienna Convention of the CISG, the customs of international trade,

the general principles of law, the *lex mercatoria* or recent private codifications, such as the UNIDROIT Principles of International Commercial Contracts.

Unfortunately, this resulted in a cultural shock for the small realm of conservative conflict of laws scholars, and this modern clause was simply killed during the legislative process, the navette between the EU Council and the Parliament.

The final text of art.3 of Regulation Rome I contains just a little trace of the debate we are addressing today, at recital number 13 where it is written that: “This Regulation [the Rome I Regulation] does not preclude parties from incorporating by reference into their contract a non-State body of law or an international convention.”

As a matter of fact, the result of all that is a sort of *zombie*, a legal frankenstein if you like. Because what happens today is that under Regulation Rome I, the parties may choose *lex mercatoria* but that will work only as *materiellrechtliche Verweisung*, in other words, just as a contractual reception, and not certainly as a valid choice of law, as a *kollisionrechtliche Verweisung*.

This classic approach is changing in other parts of the world. One reference may be found in the official comments to the United States’ Uniform Commercial Code, precisely Comment 2. And more interestingly, in the Hague Principles on Choice of Law in International Commercial Contracts which are currently under preparation at the Hague Conference on the Private International Law, it is specified under Article 3 that rules that are “generally accepted on an international, supranational or regional level” are admitted as a choice of law⁴. So the world is

⁴ See http://www.hcch.net/upload/wop/princ_com.pdf. The Commentary provides that “Article 3 broadens the scope of the party autonomy provided for in Article 2(1) by providing that the parties’ choice may designate not only State law but also rules of law. The expression “rules of law” comes from existing arbitration sources, including national arbitration legislation, model arbitration laws and private institutional arbitration rules (see Art. 28(1) UNCITRAL Model Law; Art. 21(1) International Chamber of Commerce Rules of Arbitration 2012 (“ICC Rules”)). It refers to rules that are not drawn from formal State sources of law. 3.2 The criteria for rules of law provided in

changing and we may also hope that Regulation Rome I will also change, since such a Regulation is subject to a revision in the near future.

Part II : the contribution of Lex Mercatoria and the UNIDRO-IT Principles to traditional Private International Law

Does this debate contribute to classical Private international law doctrines?

Of course my answer is YES.

Let's start with the choice of law process: you can read in the Preamble of the UNIDROIT Principles 2010 that they are intended to be applied when the parties have specifically chosen them. The wording is "they shall be applied" but we know that the UNIDROIT Principles are *per se* non-binding, unless the parties – or the arbitrators, depending on the applicable arbitration rules - elect the UNIDROIT Principles as the law applicable to the merits of their arbitration.

They "may be applied" when the parties to an international contract have agreed that their agreement be governed by "general principles of law", and we have many examples, especially in State contracts about these formulations, the *lex mercatoria* or the like. So, in a nutshell, all that confirms that the UNIDROIT Principles have been designed to try to codify, as much as possible, the *lex mercatoria*, just giving a black letter face to its difficult body of rules⁵.

Then, they may provide a solution to an issue raised when it is not possible to establish the relevant rules of the applicable law; "They may be used to interpret or supplement international uniform law instruments. They may serve as a model for national and international legislatures".

Article 3 afford greater certainty as to what the parties may designate as rules of law governing their contractual relationship. The criteria refer to the admissible sources and the nature of those rules of law recognised under Article 3. In addition, Article 3 admits an exception to the general principle it expresses when the law of the forum so provide.

⁵ On this problem see, among others: M. Mustill, "The New Lex Mercatoria: The First Twenty-five Years", *Arb.Int'l* 1988, at 86 et seq.

Well, these issues are particularly important, because arbitrators are to a large extent free from the constraints imposed by conflict of law rules of the *lex situs arbitri*. Then, if the parties have opted for an arbitration, there are few doubts that an arbitrator applying the UNIDROIT Principles⁶, will do well, since even the EU Rome I Regulation is not binding for arbitrators.

I would even argue that by introducing Regulation Rome I, the legislator of the European Union has provided hidden incentives to the parties to go for arbitration instead of bringing more cases to local courts.

Now, coming back to the Preamble of the UNIDROIT Principles, let me just point out some of the classical issues of Private international law where I believe that the UNIDROIT Principles may provide some helpful solutions. These issues may be summarized as follows: a) issues of characterization; b) preliminary questions; c) the concept of foreign law; d) the relationship between foreign law, the UNIDROIT Principles and state control mechanisms.

So let's start with *characterization*. It's not directly mentioned in the UNIDROIT Principles' Preamble but if we look into arbitral practice, we can see that, sometimes, arbitrators do an exercise of characterization or classification. Let me just explain: "characterization" is a process of labelling legal issues by deciding, in particular, whether they are *contractual issues* for example, or *tort issues*; or whether they are *procedural* or *substantive issues*. This is something that domestic courts may do more or less consciously thanks to the *lex fori*. But the same turns out to be much more difficult for arbitrators since they do not have a *lex fori*.

Therefore, the UNIDROIT Principles provide here a foreseeable, predictable solution to such classical conflict of laws problems, identifying in advance what is "substance" and what is "procedure", as well as the confines of "contractual issues" vis-à-vis "tort issues".

An example is the famous issue of time-bar. Time-bar is under Common Law a procedural issue while in Civil Law it is a substantive one; so

⁶ 301 applications have been recorded at the Unilex database, see <http://www.unilex.info>

it's good to have a transnational standard like the UNIDROIT Principles showing that such an issue is one of "substance" of the contract.

Now, let's think back to how we operate "characterization" under Private international law. It is well known that the techniques for characterization are: *lege fori*; *lege causae* and resort to general principles of law. Let me just refer quickly to that.

Lege fori: characterization *lege fori* means that the judge and, by imitation, the arbitrator should characterize a legal issue according to the *lex fori*. But, as the French maxim goes, "*l'arbitre n'a pas de for*".

Take for example a German arbitrator sitting in London that has to decide an international dispute between an Italian and a Turkish party. Italian law is the *lex contractus*. Why should the arbitrator characterize issues according to English law? Is it just because it is the *lex situs arbitri*? Clearly, characterization *lege fori*, is not the ideal technique for an arbitrator.

Then the second technique is characterization *lege causae*, i.e. using the *lex contractus*. This is certainly more in line with arbitration practice and arbitration theory also. But such a method brings with it a difficulty of a logical kind. As a matter of facts, if characterization is used to interpret conflict of law rules, it follows that one needs to characterize in order to determine the *lex causae*. However, if the end-result of characterization is the identification of *lex causae*, it would be considered as a tautology, by some, to adopt a *lex causae* in order to determine itself.

A further method of characterization is to resort to general principles of law. This method was advocated many years ago by a great Comparative and International Law scholar: Ernst Rabel. I believe that, today, we need to reconsider that theory under the light of the UNIDROIT Principles of International Contracts.

The idea here is to step-out from the *lege fori* – *lege causae* debate and use a transnational standard such as the UNIDROIT Principles since they are much more than an academic Comparative Law exercise.

A further contribution of the UNIDROIT Principles to Private International Law is on the treatment of preliminary questions. Preliminary questions may also occur in international commercial arbitration. Think about a European bank which pre-finances via a red herring documentary credit a series of export-sales by a Brazilian producer. Now, in order to cover the commercial risk of such a contract, the bank enters into an insurance contract, subject to French law. The insurance contract contains an arbitration clause referring to ICC arbitration. Now, if there's an ICC arbitration between the bank and the insurer, and the insurer typically, just to escape from its obligation to pay, raises an issue of validity of the underlying sales contract, the arbitrators will face a preliminary question⁷. Now, in this case, there was no choice of law in the sales contract.

So, how far can you go with this exercise of choice of law at the level of a preliminary question? Well, once again, one can learn a lot by classical Private international law. We know that two methods are generally used. One is the so-called "conjunctive method" and the second is the "disjunctive method".

By the conjunctive method, one is led to joint the applicable laws in favor of the *lex contractus*, then in our case the insurance contract will be regulated by the law applicable to the underlying sales contract.

By the disjunctive method, which is in my view the most correct, a judge (or an arbitrator) has to determine the applicable law to each different contract.

Going back to the example I proposed, since the sales contract had no provision on the price of the sale, if French law was applied, then the result would have been that the export contract would have been null and void leading to the nullity of...the insurance contract. That is because French law requires for a clear written price, and not just a determinable price as the Germans or the Italians would accept, or even the UNIDROIT Principles accept.

⁷ See Marrella F. Contratti di vendita internazionale privi di prezzo, questione preliminare e Principi UNIDROIT, nota al lodo arbitrale CCI n°7819, in *Rivista dell'arbitrato*, 2002, pp. 129-138.

Therefore, if the disjunctive method is applied for arbitrators dealing with preliminary questions an international standard works much better than the application of a national law unexpected by the parties to a transnational contract.

In the case at stake, the arbitrators considered the UNIDROIT Principles as a tool for interpretation of the CISG concluding in favour of the validity of a price fixing clause in the sales contract.

I am going quickly towards the end Mr. Chairman, but I should mention perhaps the more famous application of the UNIDROIT Principles in the context of private international law, i.e. the expansion of the domain of *lex contractus* beyond the choice of any national law.

If we take Article 21 of the ICC Arbitration regulations whose formula is unchanged since the old one of Article 17, you know certainly that a choice of *lex mercatoria* and the UNIDROIT Principles is fully admitted. That article says: "The parties shall be free to agree upon the rules of law to be applied and in the absence of any such agreement the Arbitral Tribunal shall apply the rules of law" and we know, by unanimous interpretation, that this means not only domestic laws, but also *lex mercatoria* and the UNIDROIT Principles. You may have therefore an application of *lex mercatoria* under this light. You may have express choices -which could be positive or negative choices - in favour of the UNIDROIT Principles; implied choices and applications in absence of any choice of law, as it has been done in a famous award, ICC award n°7375 by a distinguished arbitration tribunal where the UNIDROIT Principles were applied as a sort of default law.

So, from the standpoint of the private international lawyer, the UNIDROIT Principles and the *lex mercatoria* may represent a new kind of *foreign law*. We need to broaden our mind and finish considering that only national law is qualified to be a *lex contractus*. There is still a lot of criticism by scholars but, in my view, they are the victim of an academic dogma of national law as the most perfect system to solve issues arising from transnational contracts.

I can just report that in a recent arbitration, an international construction contract between a French company and an Italian constructor with French law as the governing law turned out to be a nightmare for the non-French party just because French Law may be too exotic if not inadequate for such long term contracts.

Those general clauses giving some flexibility to parties' obligations over a long period of time such as good faith and fair dealing, well known in German and Italian Law and even better in the UNIDROIT Principles are only exceptionally admitted under French law for historical reasons⁸.

Thus, once again, the UNIDROIT Principles provide a useful common international standard to which transnational contracts have to align avoiding the application of national solutions whose rules diverge from them. For the same reasons, the UNIDROIT Principles have been applied sometimes also in conjunction with a domestic law.

Now, all that has given raise to another kind of criticism. Some scholars or practitioners are saying "look, if you have domestic law *and* the UNIDROIT Principles, then you don't need to have non-state rules. Because you may just apply domestic law *and* the UNIDROIT Principles." But if you look carefully into the awards you will see that the UNIDROIT Principles have been used as a standart to read domestic law and to arrive to the conclusion that some domestic law solutions were in line with such transnational rules, namely with basic expectations of professional international business people. So, once again, this confirms that it's a new chapter, it's not an enemy of domestic law, but it's a new chapter where arbitrators have to address these issues.

Iura novit curia is another classical issue, and it has been mentioned this morning. On that, let me just add that *iura novit curia* means that a judge knows the law and must apply the law. But which law? The applicable law. Now, in some private international law systems, like for example the Italian one, courts have the obligation to do their own research. So

⁸ See, in particular, C. Yildirim, *Equilibrium in International Commercial Contracts with particular regard to Gross disparity and Hardship Provisions of the UNIDROIT principles of international commercial contracts*, Wolf Legal Publishers, 2011.

it's not enough to sit down – as it happens in many jurisdictions- and wait for the lawyers to bring the evidence of foreign law⁹.

So, how do you apply this to arbitration? One may just refer you to the International Law Association resolution of 2008¹⁰ which, I think, answers, more or less clearly, to the question.

The balance was found saying that arbitrators should not introduce legal issues that the parties have not raised; but at the same time, at recommendation number 7, it says that “arbitrators are not confined to the parties’ submissions about the contents of the applicable law”, which leaves a window of opportunity to interpret domestic law under the light of the UNIDROIT Principles or *lex mercatoria*. I have called this method in my own writings as the “TNT test”; the transnational test of domestic law. Just because, an arbitrator, at the end of the day, has to produce a decision which is sound and is reasonable and understandable for both parties; what is not always the case for domestic courts, for they can hide behind the famous maxim “*dura lex, sed lex*”.

Conversely, arbitrators have to convince the parties that they have resolved the dispute and that is the core of the difficult job of the arbitrators.

Finally, private international law, after the analysis of preliminary questions, characterization, *lex contractus* goes down and proceeds with the analysis of the famous control mechanisms which are in the hands of each nation-state.

What control mechanism do we have? Well, in private international law the classical ones are: *loi de police*, (overriding mandatory rules) and

⁹ Art.14 of the Italian PIL so provides: “1. L'accertamento della legge straniera è compiuto d'ufficio dal giudice. A tal fine questi può avvalersi, oltre che degli strumenti indicati dalle convenzioni internazionali, di informazioni acquisite per il tramite del Ministero di grazia e giustizia; può altresì interpellare esperti o istituzioni specializzate. -2. Qualora il giudice non riesca ad accertare la legge straniera indicata, neanche con l'aiuto delle parti, applica la legge richiamata mediante altri criteri di collegamento eventualmente previsti per la medesima ipotesi normativa. In mancanza si applica la legge italiana”.

¹⁰ <http://www.ila-hq.org/en/committees/index.cfm/cid/19>.

public policy. Hence the question would be: if we have a choice of *lex mercatoria* and the UNIDROIT Principles, does that cancel, override State control mechanisms? The answer is certainly “no.” Then, *loi de police* and *ordre public* are the condition of national validity of an international commercial arbitration award decided on the basis of the Unidroit Principles without making any scandal.

Therefore, under the perspective of State control mechanisms provided by private international law it is hard to see a real difference between *lex mercatoria* together with the UNIDROIT Principles *vis-à-vis* any other domestic foreign law before the *lex loci executionis*. All of them must comply with State control mechanisms, in particular the New York Convention of 1958.

Thus, why should we ask *lex mercatoria* and the UNIDROIT Principles more than what we ask for a foreign law from the perspective of the *forum executionis*?

If we admit that arbitrators perform a function which is as important as domestic courts- 80% of the times by the way - then we should also be ready to accept that *lex mercatoria* and the UNIDROIT Principles are a new kind of “foreign law”, particularly visible in international commercial arbitration. Therefore, without panic, we should easily conclude that its possible threat to national public interest may be easily neutralized by the application of overriding mandatory rules and public policy of the *lex loci executionis* state (or states).

Thank you very much, that’s my presentation for now.

