Transnational Law and the Choice-of-Law Competence of Arbitral Tribunals in International Commercial Arbitration

By Stefan Kirchner, Frankfurt am Main

Abstract

It is disputed, whether non-national or transnational law rather than the law of a state, e.g. Swiss law, can be the applicable law in international commercial arbitration, and therefore, if non-national lex mercatoria can be the sole applicable law in International Commercial Arbitration. Even more controversial is the question if Arbitral Tribunals can elect to apply non-national law if the underlying arbitration agreement does not provide for an applicable law or is unclear with regard to this matter. It is considered uncertain whether there will be a solution to this question, despite the fact that as early as at its 1992 meeting in Cairo the International Law Association recommended to give such a competence to Arbitral Tribunals. In this short paper we will look at the pros and cons regarding such a competence of Arbitral Tribunals to decide on their own which law to apply if neither the arbitration agreement nor the domestic law applicable in the seat of the tribunal provides for a solution. In developing an approach, we will look at a parallel aspect from another field of international law in order to shed light on the current state of the law on this question and to define its relation to domestic rules already in place. At first we will look at the legal situation within the UNCITRAL Model Law and in several jurisdictions which have been chosen according to the importance of the respective states’ economies for international trade. Arguments in favor for a wide competence will be brought to the readers' attention as well as arguments against it with a special look at CISG before a conclusion is drawn based on the current situation, the arguments heard and the needs of the parties involved.

* Referendar jur., Diploma in International Law (Helsinki), Diplom Humanitaires Völkerrecht (Bonn/Bochum/Geneva); doctoral student and former Lehrbeauftragter (associate lecturer) at the Faculty of Law of Justus-Liebig-University, Giessen, Germany; Rechtsreferendar, Frankfurt am Main. Email: kirchnerlaw@yahoo.com.
Introduction

It is disputed, whether non-national\(^1\) or transnational law rather than the law of a state, e.g. Swiss law, can be the applicable law in international commercial arbitration, and therefore, if non-national lex mercatoria\(^2\) can be the sole applicable law in International Commercial Arbitration.\(^3\) Even more controversial is the question if Arbitral Tribunals can elect to apply non-national law if the underlying arbitration agreement does not provide for an applicable law or is unclear with regard to this matter. It is considered uncertain whether there will be a solution to this question,\(^4\) despite the fact that as early as at its 1992 meeting in Cairo the International Law Association recommended to give such a competence to Arbitral Tribunals.\(^5\)

In this short paper we will look at the pros and cons regarding such a competence of Arbitral Tribunals to decide on their own which law to apply if neither the arbitration agreement nor the domestic law applicable in the seat of the tribunal provides for a solution. In developing an approach, we will look at a parallel aspect from another field of international law in order to shed light on the current state of the law on this question and to define its relation to domestic rules already in place.

At first we will look at the legal situation within the UNCITRAL Model Law and in several jurisdictions which have been chosen according to the importance of the respective states' economies for international trade. Arguments in favor for a wide competence will be brought to the readers' attention as well as arguments against it with a special look at CISG before a conclusion is drawn based on the current situation, the arguments heard and the needs of the parties involved.

---

\(^1\) For the purposes of this paper, the term "non-national law", i.e. law not based on national legislation (cf. also Gottwald – Internationale Schiedsgerichtsbarkeit (1997), p. 81) refers to a-national or trans-national law whenever no distinction is made between these two categories. The term "non-national law" is not thought to imply any legal qualification but has only been chosen to increase the readability of this paper.


\(^3\) Gottwald – op. cit. (fn. 1), p. 87.

\(^4\) Ibid., p. 81.

Art. 42 ICSID: the lex mercatoria as Public International Law

At first sight, Art. 42 ICSID does not include the lex mercatoria since it only refers to domestic and international private and public law and because the lex mercatoria is transnational law and transnational law is not the same as (public) international law, although some features of transnational law can also be found in (public) international law such as the fundamental principles of bona fide\(^6\) and pacta sunt servanda.\(^7\) But even if one would consider lex mercatoria to be part of public international law, it is clear that under the lex mercatoria corporations are full subjects of the law which is not the case under public international law.\(^8\) Moreover must the question be asked if public international law was meant to be included by Art. 42 ICSID since Art. 42 ICSID refers to national law (including domestic choice-of-law rules) and public international law. Such a wide understanding would have been better served by a more appropriate wording of the rule so that we cannot necessarily conclude that Art. 42 ICSID allows for a choice-of-law competence of arbitral tribunals concerning non-national or transnational law.

The UNCITRAL Model Law

The UNCITRAL Model Law allows parties to choose a law but also binds arbitral tribunals to a national law.\(^9\) The Model Law is therefore opposed to granting such competence to arbitral tribunals to base its decision on non-national law. It may be argued that the UNCITRAL Model Law also recognizes the usages of the trade\(^10\) but it has to be seen that usages are only a very small part of the lex mercatoria.\(^11\) But since the look at the UNCI-

---

\(^7\) Art. 26 Vienna Convention on the Law of Treaties.
\(^9\) Art. 28 (2) UNCITRAL Model Law.
\(^10\) Art. 28 (4) UNCITRAL Model Law.
TRAL Model Law only constitutes a non-binding suggestion we have to have a closer look at national laws on this issue.

**Choice-of-Law competences of Arbitral Tribunals under domestic law**

In Canada, similarities to Art. 28 (2) UNCITRAL Model Law can be seen in the legal regulations of all Canadian provinces as the Model Law is modified to the effect that the Arbitrator can choose the applicable law directly without having to take conflict laws into account. In Italy, the door has also been opened for the application of the lex mercatoria, although indirectly: the law requires to take usages into account which is deemed to include i.a. the lex mercatoria. According to French Law, the arbitrator can – if the parties have not chosen the applicable law – apply the rules of law he or she deems appropriate, which may include the transnational lex mercatoria. Therefore French law differs from Art. 28 (2) UNCITRAL Model Law. Transnational Law can therefore be easily applied by Arbitrators under French Law, which is considered to be a mere application of law without the arbitrator assuming for him- or herself the rights of an amiable compositeur. The same is true for both Japan and The Netherlands, where Art. 1054 (2) [2] R.V. is clear in giving Dutch Arbitrators the same rights which are granted to French Arbitrators under Art. 1496 of the New Code on Civil Procedure.

While the law for the then Crown Colony of Hong Kong did not recognise the lex mercatoria at all, Arbitral Tribunals in Germany have to apply a national law but also have to take into account usages. The German law is de facto identical to the situation under the UNCITRAL Model Law, after the Zivilprozeßordnung had been changed in 1998. In the United States, Arbitrators are given a rather broad freedom in choosing the applicable law, but also in the U.S. recourse to a non-national law as the applicable law is only possible with the parties' consent. This position is also upheld by legal scholars in Austria, but in Palbak v. Norsolor the Austrian Supreme Court decided that the application of the lex mercatoria would not

---

14 Art. 834 (3) Italian Code on Civil Procedure.
16 Gottwald – op. cit. (fn. 1), p. 82.
17 ibid., at p. 83.
18 Gottwald – op. cit. (fn. 1), p. 84.
19 § 1051 (2) ZPO.
20 § 1051 (4) ZPO.
violate Austrian law, in particular not § 595 (5) and (6) of the Austrian Code on Civil Procedure.

The same conclusion has been drawn for English Common Law in the case of Deutsche Schachtbau- und –tiefrohr GmbH v. Ras al Khaima National Oil Co. and Shell International Petroleum Co. Ltd. (also known as DST v. Rakoil)\textsuperscript{23} by the High Court with regard to transnational law. A contrary conclusion, though, was drawn by Lord Justice Kerr a year later in Naviera Amazonica Pernana v. Compagnia Internacional de Seguros del Peru.\textsuperscript{24} In Switzerland it is not yet fully clear whether or not the relatively new law also includes the transnational lex mercatoria as a form of applicable law or not, but it can be concluded from the wording of the Swiss Code on International Private Law that this is not the case: the arbitrators are to choose the rules of law which are most closely connected to the case. On one hand, the term "rules of law" ("règles de droit") allow for a wide interpretation, limiting the applicable law not only to laws in a "proper" Civil Law sense as being Codes of Law but also includes precedents, customary law etc. One could conclude that the lex mercatoria could easily pass the test to constitute such a legal rule. But on the other hand does the fact that a connection between case and law is required change the issue completely: as along as some form of connection between a case and a legal system is required, there is no real space to apply non-national law. There will always be states in which the seat of the Arbitral Tribunal is located, in which arbitration agreements are being concluded, where the parties reside, where their respective headquarters, factories and other facilities are located, there will always be tax-payments by firms and their employees to states, all of this creating a link between a party to the case and a state. There might be third states in which a contract is to be performed etc., which makes it very unlikely that there will ever be a case in which there will be no national legal system which is or at least can be deemed to be closer to a certain case than the lex mercatoria. It can therefore be concluded that under Swiss Law, the lex mercatoria in general is not applicable.\textsuperscript{25}

\textsuperscript{24} Kerr LJ, in: Naviera Amazonica Pernana v. Compagnia Internacional de Seguros del Peru (1988) 1 Lloyd's Rep. 16 (89 et seq.).
\textsuperscript{25} An other approach is relected in the decision by the Paris Chamber of Industry and Commerce in Arbitral Award N° 7565/1994, ICC International Court of Arbitration Bulletin 6 (November 1995), N° 2, pp. 64 et seq. in which it was held that the CISG had become part of the "laws of Switzerland" but were not "Swiss Law", defining as "Swiss Law" the law of obligations under domestic Swiss law. This difference is only of a linguistic nature and it is uncertain if the drafters of the arbitral agreements want to make such a distinction when choosing any national law.
Neutrality and CISG

Of special interest is also the aspect of neutrality, when determining the applicable law. Even if not the national law of one of the parties is applied, a party may be more familiar with a legal system than the other party. But still the question arises which law is truly neutral or as fair as possible.

The idea of neutrality favors transnational law either directly or incorporated into a national legal system over domestic law. But can transnational law also be neutral if it is incomplete and leaves gaps intra legem which have to be filled by national laws as CISG does since it does not include any regulations on the transfer of ownership / passage of title but well on passage for risk? A simple example may illustrate the problem: Under English and Welsh Law, both the property and the risk pass at the same time, i.e. with the conclusion of the contract. Under CISG, since a uniform rule exists on the transfer of risk but not on the transfer of property, a gap is opened and is to be filled with the chose applicable (national) law. If the chosen law is e.g. English law, we have a situation in which the buyer becomes owner immediately upon the conclusion of the contract but does not have to bear the risk of loss. Consequently the buyer is favored over the seller, which is an inequitable and unwanted outcome.

An emerging idea which in turn is based on an old concept might offer a solution to this problem: the problem of favor emptoris would not arise if uniformity with regard to the passage of ownership would be possible, what is held by several authors, who all favor the delivery principle or Traditionsprinzip, which can be found in Art. 3:84 of the Dutch and § 929 of the German Civil Code. This rule is analogous to the rule res petit domino which is also accepted in England and Wales.

For sake of completeness it shall be noted that Grigera Naòn rejects the idea of neutrality in favour of a "reaspnable", i.e. outcome-orientated (so understood by Gottwald – op. cit. (fn. 1), p. 86), choice-of-law approach bases his approach on the fact that it would be artificial to base the lex fori on a-national law since many aspects of the lex mercatori (e.g. bona fide, pacta sunt servanda etc.) can also be found in national legal systems (Grigera Naòn – op. cit. (fn. 2), p. 80, examples from Gottwald – op. cit. (fn. 1), p. 86). This is undoubtedly the case and the reader is reminded that this paper does not focus on the choice of a-national but of trans-national law as the applicable law, and proposes, as will be seen later, to treat the lex mercatori, the ius commune of mercantile law, as a potential transnational applicable law in International Commercial Arbitration.


See also the similar example used by Visser – op. cit. (fn. 28), at pp. 89 et seq. with regard to Articles 1583 and 1138 (2) of the French Civil Code.

Art. 69 (1) CISG.

At this point the reader is reminded that this paper looks mainly at the choice of Arbitral Tribunals to apply transnational lex mercatoria in cases in which the parties have not made a choice. But with regard to the idea of neutrality the question comes up whether an Arbitral Tribunal may go so far as to derogate from the choice-of-law made by the parties and apply only CISG as the source of trade usages because it considers the chosen national law to be in contradiction to CISG rules and the latter to be more neutral, thus leading to a more just result? In a 1989 decision, the Arbitral Tribunal of the Paris Chamber of Industry and Commerce derogated from Turkish Law and applied Articles 38-40 CISG instead because it considered CISG to be the best source available on trade usages.\textsuperscript{32} Yet by then only 17 states had ratified CISG, raising the question of how representative Art. 38-40 CISG were.

Consequently we may conclude that the applicable law is not necessarily a codified non-national or transnational law but rather the law which follows from common standards and expectations: a lex mercatoria based on the common interests of the actors in international commerce.

**Arbitral Awards as precedents**

Arbitral decisions are quasi-judicial decisions which are meant to lack and precedential function. In fact, the parties will often have an interest in avoiding the publication of the details of the case. At best, arbitral awards can provide soft precedents which do not have to but can be taken into account, although arbitral awards are unlikely to gain the same status as ICJ decisions which technically are also not binding as precedents but help in determining the law.

In one respect, though, arbitral awards provide evidence for our question. The large number of arbitral awards based on non-national or transnational law and the high degree of compliance with such awards indicate that non-national laws are applied by arbitral tribunals in case no national law has been chosen by the parties and are applied so to the satisfaction of the parties, which, after all, can be said to be the tribunals' customers. Unlike regular courts, arbitral tribunals would not be there would it not be for the choice to arbitrate rather than to sue, making "customer satisfaction" a valid, if also unspoken, concern for arbitral tribunals.

\textsuperscript{32} CCI / Paris Chamber of Industry and Commerce Arbitration Tribunal - Arbitral Award N° 5713/1989, 2 Recueil des Sentences Arbitrales de la CCI (1986-1990), pp. 223 et seq.
Conclusions

Consequently, even if arbitral awards do not constitute hard precedents, there is a certain and widespread – although it is hard to measure how widespread – custom to apply non- and trans-national law. This custom by arbitral tribunals is accompanied by opinio juris shared by arbiters and parties that arbitral awards can indeed be based on non- and trans-national law in cases in which the arbitral agreement does not provide for a domestic law as the basis of any decision, provided that the local national laws allow for this option. We therefore have a rule of customary law in statu nascendi of International Commercial Arbitration allowing arbitral tribunals to decide to apply non-national or trans-national rather than national legal rules to come to their decision.