INTERNATIONAL COMMERCIAL ARBITRATION AND THE TRANSFORMATION OF THE CONFLICT OF LAWS THEORY

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INTRODUCTION

Existing writings on the conflict of laws – or conflict of laws issues – in the specific context of international commercial arbitration generally address the more practical questions of what law applies to legal issues such as the validity of the arbitration agreement[1] or arbitrability.[2] Other contributions analyze the ways in which international arbitrators apply conflict of laws rules in order to determine the applicable substantive law.[3]

The purpose of this article is different. While its scope does encompass actual arbitral practice with regard to the application of conflict of laws rules (and, more generally, choice-of-law determinations),[4] the main objective of this study is to demonstrate how the development of international commercial arbitration has caused, or at least contributed to, a transformation of the "traditional" conflict of laws theory and of its methodology.[5]

The traditional conflict of laws theory has for a long time been the subject of lively debate and heavy criticisms on both sides of the Atlantic. Although the approaches advocated by those critical voices are diverse and nuanced, they have essentially formulated two types of criticisms. Some scholars have argued that the conflict of laws, due to its complex methodology, leads to unpredictable results and constitutes a "jump in the

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1. Jean-François Poudret, *Le droit applicable à la convention d'arbitrage, in* ASA SPECIAL SERIES NO. 8, THE ARBITRATION AGREEMENT —ITS MULTIFOLD CRITICAL ASPECTS 23 (1994); Julian Lew, *The Law Applicable to the Form and Substance of the Arbitration Clause*, *in* IMPROVING THE EFFICIENCY OF ARBITRATION AND AWARDS: 40 YEARS OF APPLICATION OF THE NEW YORK CONVENTION, 1998 ICCA Congress Series No. 9 114 (Albert Jan van den Berg, ed., 1999).

2. Bernard Hanotiau, *What Law Governs the Issue of Arbitrability?*, 12 ARB. INT'L 391 (1996).

3. Ole Lando, *The Law Applicable to the Merits of the Dispute*, 2 ARB. INT'L 104 (1986); Beda Wortmann, *Choice of Law by Arbitrators: The Applicable Conflict of Laws System*, 14 ARB. INT'L 97 (1998); Maniruzzaman, *Conflict of Laws Issues in International Arbitration: Practice and Trends*, 9 ARB. INT'L 371 (1993).

4. I distinguish between the application of conflict rules and the more general term "choice-of-law determination" because the former will invariably lead to the application of the domestic laws of a given country, while the expression "choice-of-law determination" includes those situations in which arbitral tribunals decide to apply a-national or transnational rules.

5. When I speak of the "traditional" conflict of laws theory, I mean the conflict of laws approach applied notably in Continental Europe and followed in the United States until the so-called conflict of laws "revolution" in the 1950's and 60's. This traditional approach is characterized, *inter alia*, by the strict separation between conflict rules and substantive rules, the bilateralism of conflict rules, equal treatment of domestic and foreign law, and the absence of substantive considerations in the law-selecting process. For an excellent overview of the differences between Continental European and American conflict of laws theory, see Gerhard Kegel, *Paternal Home and Dream Home: Traditional Conflict of Laws and the American Reformers*, 26 AM. J. COMP. L. 615 (1979).

dark."[6] They have notably taken issue with a number of methodological features of the conflict of laws such as, for example, the problem of characterization and the theory of *renvoi*.[7]

Others, especially American conflict scholars, have alleged that the conflict of laws is "unfair" because it does not take into account the substance of the laws that are "in conflict," i.e. because it is not concerned with achieving the most equitable or just result.[8] Those authors have therefore argued that substantive considerations should be part of the choice-of-law process. As early as 1933, Cavers had pointed out the gap between the theory of neutral conflict norms and actual practice, showing that many courts were taking account of the likely outcomes of their conflict of laws decisions.[9] During the "conflict revolution" that occurred in the 1950s and '60s, American scholars legitimized this practice by advocating a variety of novel approaches such as governmental interest analysis,[10] the preference for the *lex fori*,[11] and "better law."[12]

In addition to these two "classical" criticisms (i.e. unpredictability and unfairness), the conflict of laws theory has, often implicitly, been called into question in the specific context of international commercial relations. Numerous — mainly European — authors have argued that the conflict of laws is an inadequate method inasmuch as it leads to the application of domestic laws, those domestic laws being supposedly incapable of providing a satisfactory normative framework for international trade relations.[13] Those arguments have nourished the debate surrounding the

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6. LEO RAAPE, INTERNATIONALES PRIVATRECHT 90 (1955); *see also* KLAUS PETER BERGER, THE CREEPING CODIFICATION OF THE LEX MERCATORIA 10 (1999).

7. *See infra* text accompanying note 41.

8. For a comprehensive examination of American criticism of the "blindness" of the conflict of laws,with special emphasis on the doctrines of Currie and Ehrenzweig, see Gerhard Kegel, *The Crisis of Conflict of Laws*, 2 RECUEIL DES COURS 91 (1964); Kegel, *supra* note 5.

9. *See* David F. Cavers, *A Critique of the Choice-of-Law Problem*, 47 HARV. L. REV. 173, 173-208 (1933).

10. *See generally* Brainerd Currie, *The Constitution and the Choice of Law: Governmental Interests and the Judicial Function*, 26 U. CHI. L. REV. 9 (1959) [hereinafter Currie, *Constitution and Choice of Law*]; *see generally* Brainerd Currie, *Notes on Methods and Objectives in the Conflict of Laws*, 1959 DUKE L.J. 171 (1959) [hereinafter Currie, *Notes on Methods*]; Albert A. Ehrenzweig, *Guest Statutes in the Conflict of Laws—Towards a Theory of Enterprise Liability under "Foreseeable and Insurable Laws,"* 69 YALE L.J. 595 (1960); *see generally* Arthur Taylor von Mehren, *Recent Trends in Choice-Of-Law Methodology*, 60 CORNELL L. REV. 927 (1975).

11. Albert A. Ehrenzweig, *The Lex Fori—Basic Rule in the Conflict of Laws*, 58 MICH. L. REV. 637 (1960).

12. Robert A. Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U. L. REV. 267, 275 (1966).

13. *See*, *e.g.*, René David, *The International Unification of Private Law*, *in* 2(5) INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW 141 (1973); *see* BERGER, *supra* note 6, at 9; Michael Pryles, *Application of the* Lex Mercatoria *in International Commercial Arbitration*, 31 U.N.S.W.L.J. 319 (2008).

existence — or necessity — of an autonomous body of legal rules governing international commerce, also referred to as transnational law or *lex mercatoria*.[14]

Despite — or because of — the fact that *lex mercatoria* is hotly debated and gives rise to sometimes passionate exchanges, the discussion presents a number of gaps and insufficiencies.[15] First, the debate has focused on the controversial questions of the existence,[16] "true legal nature,"[17] and autonomy[18] of *lex mercatoria*, and on the determination of the rules that form part of such a "transnational legal order."[19] Only limited attention has

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14. Fundamental writings of those authors include: Goldman, *Frontières du droit et lex mercatoria*, *in* ARCHIVES DE PHILOSOPHIE DU DROIT 177 (1964); Goldman, *La lex mercatoria dans les contrats et l'arbitrage internationaux*, *in* CLUNET 475 (1979); Goldman, *Nouvelles réflexions sur la lex mercatoria*, *in* ETUDES DE DROIT INTERNATIONAL EN L'HONNEUR DE PIERRE LALIVE 241 (C. Dominicé, R. Patry & C. Reymond eds., 1993); Clive M. Schmitthoff, *International Business Law: A New Law Merchant*, *in* CLIVE M. SCHMITTHOFF'S SELECT ESSAYS ON INTERNATIONAL TRADE LAW 3 (1988); Clive M. Schmitthoff, *The New Sources of the Law of International Trade*, at 131; Clive M. Schmitthoff, *The law of International Trade, Its Growth, Formulation and Operation*, *in* THE SOURCES OF THE LAW OF INTERNATIONAL TRADE 3 (C. M. Schmitthoff ed., 1964); Clive M. Schmitthoff, *Nature and Evolution of the Transnational Law of Commercial Transactions*, *in* THE TRANSNATIONAL LAW OF INTERNATIONAL COMMERCIAL TRANSACTIONS 19 (C. M. Schmitthoff & N. Horn eds., 1982). *See* BERGER, *supra* note 6 (discussing how the *lex mercatoria* has given rise to an intense and sometimes passionate academic debate); *see generally* THE PRACTICE OF TRANSNATIONAL LAW (Klaus Peter Berger ed., 2001); *See* LEX MERCATORIA AND ARBITRATION (T.E. Carbonneau ed., 1998).

15. *See* Paul Lagarde, *Approche critique de la lex mercatoria*, *in* LE DROIT DES RELATIONS ECONOMIQUES INTERNATIONALES ETUDES OFFERTES A BERTOLD GOLDMAN 125 (1982); Celia Wasserstein Fassberg, *Lex Mercatoria – Hoist with its Own Petard?*, 5 CHI. J. INT'L L. 67, 68 (2005) (stating *inter alia* that "early writing on the subject was characterised by an ideological, almost mystical zeal.").

16. *See* Vanessa L. D. Wilkinson, *The New Lex Mercatoria - Reality or Academic Fantasy?*, 12(2) J. INT'L ARB. 103, 103-118 (1995); Stoecker, *The Lex Mercatoria: To what Extent does it Exist?*, 7 J. INT'L ARB. 101 (1990). Some authors have challenged the extremely widespread idea that the new *lex mercatoria* is a revival of its medieval predecessor. See, in particular, Charles Donahue, Jr., *Medieval and Early Modern Lex Mercatoria: An Attempt at the Probatio Diabolica*, 5 CHI. J. INT'L L. 21 (2005).

17. *See* Klaus Peter Berger, *The relationship between the UNIDROIT Principles of International Commercial Contracts and the New* Lex Mercatoria, 5 UNIF. L. REV. 153, 170 (2000) (noting that in order "to prevent the discussion on [*lex mercatoria*] from becoming [ ] bogged down in a futile struggle to determine its true legal nature, it seems more appropriate to focus on the contract itself. After all, it is the contractual consensus between the parties which, in international business transactions more than in any other field of daily life, determines the rights and duties that parties have towards one another.").

18. *See* Jan Paulsson, *La lex mercatoria dans l'arbitrage C.C.I.*, 1990 REV. ARB. 55 (1990); Michael Frischkorn, *Definitions of the Lex Mercatoria and the Effects of Codifications on the Lex Mercatoria's Flexibility*, 7 EUR. J.L. REFORM 331 (2005); Ralf Michaels, *The True Lex Mercatoria, Law Beyond the State*, 14 IND. J. GLOBAL LEGAL STUD. 447 (2007).

19. Goldman's claim that the *lex mercatoria* constitutes an autonomous "legal order" has provoked astonishment and criticism by positivist legal writers. A particularly forceful – though exaggerated – critique of Goldman's argument has been articulated by Lord Mustill.

been paid to the function that transnational law fulfils (or is meant to fulfill). Second, the debate has neglected the broader implications on the practice and theory of the conflict of laws. Third, the reasons why arbitral tribunals have elaborated specific conflict of laws rules or methods have only been examined superficially — no attempts have been made at linking this evolution to the specific normative requirements of international business transactions.

In this article, I intend to fill those gaps. Bridging conflict of laws scholarship highlighting the alleged failures of the conflict of laws method and the *lex mercatoria* discussion, I aim to offer a comprehensive examination of the appropriateness of the conflict of laws theory in the field of international trade. More specifically, I examine the validity of the three aforementioned criticisms (unpredictability, unfairness, substantive inadequacy) as applied to the particular context of international commercial relations and attempt to show how international commercial arbitration, mainly through the practice of arbitral tribunals, has been able to provide remedies to some of the drawbacks of the conflict of laws approach.

In Part 1, I analyze the alleged deficiencies of the conflict of laws in the field of international commerce. As far as the unpredictability and unfairness of the conflict of laws are concerned, I argue that those alleged defects may indeed be issues of concern (even though it is questionable whether it is at all possible to design tools to remedy such defects), and that it is therefore understandable that arbitral tribunals should seek to improve both the predictability and the fairness of their conflict of laws decisions.

I also explain why substantive inadequacy constitutes the most striking and fundamental defect of the conflict of laws theory. This particular shortcoming of the conflict of laws is only occasionally referred to in the context of the *lex mercatoria* debate because most authors either assume the existence of *lex mercatoria* as a means of self-regulation by international business operators or simply fail to investigate the function of transnational law. In fact, very few writers have attempted to capture the basic comparative advantages of transnational law when compared to domestic laws. It follows that the concept of the substantive inadequacy of domestic laws has rarely been explained and, to my knowledge, never has been satisfactorily conceptualized. In this article, I suggest a basic explanation for the inappropriateness of the application of domestic laws to international commercial relations. By the same token, I propose a definition of the underlying reason for such inappropriateness, i.e. of what is sometimes termed the "specific normative needs"[20] of international commerce.

See Lord Justice Mustill, *The New Lex Mercatoria: The First Twenty-five Years*, *in* LIBER AMICORUM FOR LORD WILBERFORCE 149 (1987).

20. *See* Emmanuel Gaillard, *Transnational Law: A Legal System or a Method of Decision-Making?*, *in* THE PRACTICE OF TRANSNATIONAL LAW 53, 55 (Klaus Peter Berger ed., 2001) (discussing the substantive specificity of transnational law: "From this viewpoint

In Part 2, I argue that, and examine how, international commercial arbitration has allowed international business transactions progressively to elude the deficiencies of the conflict of laws. I explain how international arbitral tribunals have succeeded in freeing themselves from excessively rigid conflict of laws rules with a view to improving, to the extent possible, the predictability and substantive fairness of their choice-of-law determinations. Also, and most importantly, I show how those tribunals have managed to move towards application of transnational law in circumstances where the domestic laws involved provided — or where perceived to provide — an inadequate normative framework. With regard to both trends, I analyze the crucial role played by arbitral tribunals in the broader context of widespread legislative policies aimed at increasing arbitral autonomy,[21] both at the domestic and at the international level.

I. DEFICIENCIES OF THE CONFLICT OF LAWS IN THE CONTEXT OF INTERNATIONAL COMMERCIAL RELATIONS

A. Unpredictability of the Conflict of Laws

Classical critiques of the conflict of laws method have notably emphasized its alleged unpredictability,[22] i.e. the fact that when individuals or entities engage in certain activities or behavior (enter into a contract, commit a tortuous act), it is difficult, at the time when such activities or behavior occur, to "predict" by what law the latter will be governed, especially in the context of potential litigation.

Various factors are said to account for this lack of predictability. The first such factor — and main subject of doctrinal attacks — is the excessive methodological complexity of the conflict of laws.[23] Other factors do not pertain to the conflicts method itself, but rather to external causes. Those are the courts' inclination to apply the *lex fori* in disregard of the applicable conflict of laws rule (so-called *lex forism*) and the lack of international uniformity of domestic conflict of laws rules.

[which Gaillard does not share] international transactions require added flexibility, which the requirements found in national laws would seldom accommodate. This school of thought is related to the theory of the specific needs of international business." (internal quotation marks omitted)).

21. On arbitral autonomy more generally, see M. PETSCHE, THE GROWING AUTONOMY OF INTERNATIONAL COMMERCIAL ARBITRATION (2005).

22. *See also* Peter Klaus Berger, *The Lex Mercatoria Doctrine and the UNIDROIT Principles of International Commercial Contracts*, 28 LAW & POL'Y INT'L BUS. 943, 952 (1997), [hereinafter *Berger Mercatoria*] (stating that "the classical conflict of laws methodology takes into account neither the interests of the parties nor general trade interests" and that the prevalence of conflict justice over material justice leads to "unpredictability as to how courts will decide a case.").

23. *See* Laura E. Little, *Hairsplitting and Complexity in Conflict of Laws: The Paradox of Formalism*, 37 U.C. DAVIS L. REV. 925 (2004).

The criticisms regarding the alleged unpredictability of the operation of the conflict of laws are certainly not entirely unfounded, although it is likely that the problem stems as much — if not more — from an intentional misapplication of conflict rules (especially *lex forism*) as from an alleged methodological "flaw." Also, as far as international business transactions are concerned, the widespread recognition of the principle of party autonomy (i.e. the possibility for parties to an international contract to select the applicable law), considerably reduces the adverse impact of methodological complexity, *lex forism*, and lack of international uniformity.

1. Unpredictability and Functional and Methodological Complexity of the Conflict of Laws

One reason why the operation of the conflict of laws may at times lead to surprising and thus unforeseeable results consists in its functional and methodological complexity. The conflict of laws is, in fact, a very "technical" discipline involving the application of numerous abstract concepts. As Kegel and Schurig have shown, this is due to the fact that the conflict of laws must take into account various, potentially contrasting, interests: conflict of laws interests, public interests and "interests of order".[24]

First of all, the conflict of laws evidently involves "conflict interests", i.e. interests that relate to the very purpose of the conflict of laws, which is the determination of the law that most appropriately governs a given legal question or relationship. In order to determine this law, party interests, community interests, and interests of order need to be taken into account.[25] The formulation of a conflict rule that best serves those interests ensures the achievement of conflict of laws "justice".[26]

Second, the conflict of laws involves so-called interests of order,[27] i.e. interests that relate to domestic and international normative harmony and, more generally, to the overall coherence of a legal system. For example, it is in the interest of "order" that questions such as the validity of a contract or of a marriage receive one identical answer, independently of which court or judge is seized. Lack of normative harmony, in fact, creates legal

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24. *See* G. KEGEL & K. SCHURIG, INTERNATIONALES PRIVATRECHT 131 (2004). The authors list additional interests that play a role in the conflict of laws such as *Verkehrsinteressen* (roughly, the interests of commerce), for example. I do not mention those additional interests in my analysis because they do not, in my opinion, have a specific impact on the complexity of the conflict of laws method.

25. Kegel, *supra* note 5, at 621.

26. G. KEGEL & K. SCHURIG, *supra* note 24, at 131. I slightly distort the authors' terminological distinctions. While they distinguish conflict of laws "justice" from conflict of laws interests (which include party interests, interests of commerce, and interests of order), I use the term conflict of laws interests as an equivalent of conflict of laws justice.

27. *Id.* at 139.

uncertainty and encourages quasi-fraudulent behavior such as, forum shopping. It is thus detrimental to the overall efficient functioning of a legal system.

Lastly, the conflict of laws may also involve public interests,[28] i.e. the interests of the States whose laws are "in conflict". According to the traditional view — which is not shared by most American authors,[29] conflicts of laws do not as such involve conflicts between public interests and do not constitute conflicts between "sovereigns."[30] They primarily involve private interests, i.e. the interests of the private individuals or entities engaged in international activities. Yet, public interests must be taken into account by the conflict of laws when the application (or violation) of "public policy" or mandatory norms is at stake. Conflict of laws methodology needs to allow the application of such norms (especially those of the forum) in situations where those norms would be contravened by the otherwise applicable law.

The pursuit of interests as varied as conflict of laws interests, interests of order, and public interests translates into a high degree of methodological complexity, which causes the functioning of this discipline to be disturbed by a number of "complicating factors."[31] First, designing a conflict of laws rule that faithfully reflects the notion of the "seat" of a legal relationship is a difficult, if not impossible, task. This is due to the fact that a considerable number of factors could connect a legal question to the laws of a particular country and, even more importantly, to the fact that the choice of a particular connecting factor will, to some extent, always be arbitrary (because an international contract will by definition always be connected to more than one country).[32] In the field of international contracts, the conflict of laws rules are thus often deliberately vague and call for further refinement in the judicial process.

Even under an accomplishment instrument such as the Rome Convention on the Law Applicable to Contractual Obligations, conflict rules are vague. Indeed, under the Convention, absent a choice-of-law by the parties, the applicable law is the law of the country to which the contract bears the "closest connection."[33] This general principle laid down by the Convention

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28. *Id.* at 148.

29. *See infra* text accompanying note 60.

30. *See, e.g.*, Kegel, *supra* note 5, at 631(arguing that, "in private law, which the State promotes for justice between individuals, the State does not pursue aims of its own, but only acts as patron: To speak here of governmental interests only misleads. Rather, State and private interests are fundamentally different"); s*ee also* PIERRE MAYER, DROIT INTERNATIONAL PRIVE 53 (1977). Mayer explains that it was only until the end of the 18th century that conflicts of laws and conflicts of jurisdiction were commonly regarded as conflicts between sovereigns.

31. MAYER, *supra* note 30, at 146.

32. David, *supra* note 13, at 141.

33. Convention on the Law Applicable to Contractual Obligations, June 19, 1980 (90/934/EEC), Article 4(1) [*hereinafter* Rome Convention].

— which is of course not a workable rule — is supplemented by the presumption according to which a contract is most closely connected to the country of the party whose performance is "characteristic" of the contract.[34] While the characteristic performance test does provide some degree of precision, it does not usefully apply to complex contractual settings devoid of a characteristic performance.[35] Also, under the Convention, courts are authorized to disregard the characteristic-performance rule and apply another, more closely connected, law.[36]

Second, turning to the actual application of conflict rules, difficult questions of characterization may arise.[37] It is, for example, debatable whether the question of the validity of a contract entered into by a person allegedly lacking the necessary capacity should be characterized as a question relating to contracts or, alternatively, as pertaining to the category of legal capacity. Depending on the view taken, this question will be governed either by the *lex contractus* or by the personal law (which may be either the law of the person's nationality or of its domicile).[38] Similar issues of characterization may be raised with respect to other questions such as, for example, the validity of articles of association.[39]

Third, once the law applicable to an international contract has been designated by the relevant conflict of laws rule, the application of such law may encounter obstacles deriving from the need to preserve interests of order. One tool to ensure such "order" and, more specifically, international normative harmony, consists in the *renvoi*. Under this principle, a judge, rather than "automatically" applying the law designated by the forum's conflict of laws rule (law A), will examine the conflict of laws norms of that particular law. If those conflict norms differ from those of the forum, i.e. if they designate a different law (law B or the law of the forum), then the judge will follow the foreign conflict rule and apply that particular law.[40] Predictability of the operation of conflict of laws rules thus requires not

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34. *Id*. art. 4(2).

35. *See* BERGER, *supra* note 6, at 13 where the author explains that the application of conflict of laws criteria (such as the characteristic performance test) may be problematic in relation to complex contracts such as swap contracts, barter or countertrade transactions, letters of intent, and multilateral netting arrangements.

36. Rome Convention, *supra* note 33, art. 4(5).

37. According to Berger, "[t]he methodological uncertainties and frictions are particularly relevant with respect to the different approaches taken by domestic courts and doctrine to the issue of 'qualification' or 'classification' of the notions and terms used in the domestic laws of international private law." *See* Berger, *supra* note 22, at 953.

38. *See* Cavers, *supra* note 9, at 179.

39. H. VAN HOUTTE, THE LAW OF INTERNATIONAL TRADE 18 (1995) (considering the applicability of either the *lex societatis* or the *lex contractus*).

40. It should be observed that the *renvoi* does not always improve normative harmony: while it does so in cases where the conflict rules of the designated law refer to the laws of a third country (*Weiterverweisung*), it fails to accomplish this objective where those conflict rules refer back to the laws of the forum (*Rueckverweisung*).

only knowledge of the forum's conflict of laws norms, but also familiarity with the conflict norms of the country whose laws are applicable under those rules. It is thus understandable that various writers have expressed concern with the detrimental impact of the *renvoi* on predictability.[41] Today, in the area of international contracts, the *renvoi* is excluded under a number of domestic laws and international conventions,[42] but it continues to be applied in a number of jurisdictions.

Another tool to ensure normative order consists of the so-called "adaptation" of the forum's conflict of laws rules.[43] Such an adaptation may be necessary when the combined application of the forum's law and a foreign law to related legal questions leads to a result that contrasts with the overall solution that would have resulted from the application of either of the laws in conflict, and that thus contravenes the legislative policies of both.[44] To avoid such undesirable outcomes, one can adapt either the relevant conflict of laws norm or, alternatively, the material rule that leads to the incoherent result. Regardless of the approach followed, adaptation impacts the predictability of the functioning of the conflict of laws.

Fourth and lastly, public interests may interfere with the operation of the conflict of laws. On the one hand, it may be appropriate, under specific circumstances, to apply certain mandatory norms contained in a foreign law (i.e. a law different from the otherwise applicable law). On the other hand, certain norms of an applicable foreign law, or the legal situation generated by their application, may contravene the forum's public policy, and may thus have to be discarded. Since the notion of public policy is inherently vague, and since, in addition, an *a priori* identification of potentially applicable mandatory norms proves difficult, the application of these concepts inevitably affects the predictability of the conflict of laws method.

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41. Jean Robert, *De la règle de conflit a la règle matérielle en matière d'arbitrage international (spécialement en droit international privé français)*, *in* THE ART OF ARBITRATION: ESSAYS ON INTERNATIONAL ARBITRATION (Jan C. Schuktsz & Albert Jan Van Den Berg eds., 1982) (observing that "the *renvoi* is problematic because it is source of uncertainty and, moreover, unpredictability of the law that will finally be applied to a factual situation occurring in the forum" (translation by the author)).

42. *See* Rome Convention, *supra* note 33, art. 15.

43. *See* G. KEGEL & K. SCHURIG, *supra* note 24, at 357.

44. A classical example is provided by the question of the patrimonial rights of the surviving spouse: while the laws of country A only provide for marital rights and not for succession rights, the laws of country B grant the surviving spouse mere succession rights, thereby excluding marital rights. The combined application of the two laws can lead either to entirely exclude all patrimonial rights or, on the contrary, to allocate both marital and succession rights to the surviving spouse. Both results are contrary to the interests of order inasmuch as they lead to incoherent and undesirable situations.

2. *Unpredictability and Court Practice: The Problem of Lex Forism*

While methodological complexity is inherent in the conflict of laws approach as such, other factors diminishing the predictability of the operation of the conflict of laws are external. One such factor is *lex forism*. The term *lex forism* refers to an "undue" preference for the *lex fori*. This occurs when courts apply the *lex fori* in violation of the forum's conflict norms (judicial *lex forism*) or when the conflict norms themselves provide for an unduly "extensive" application of the forum's laws (legislative *lex forism*).

Judicial *lex forism* may result from various factors, including the court's unawareness of the existence of a conflict of laws issue (generally associated with lack of relevant argument by the parties), the court's insufficient knowledge of the applicable foreign law ("it is better rightly to apply the forum's law than wrongly to apply a foreign law"), and the belief that the domestic law is better than, or "superior" to, the conflicting foreign law. When applying the *lex fori* to the detriment of the otherwise applicable foreign law, courts frequently have recourse to one (or several) of the various methodological tools of the conflict of laws (characterization, *renvoi*, public policy, mandatory norms etc.), which allow them to "manipulate" the outcome of the choice-of-law process.[45]

When *lex forism* does not operate in the "shadow of the law", but is openly displayed by a legal system, one can speak of "legislative" *lex forism*. Legislative *lex forism* is thus inherent to the forum's conflict of laws rules and reflects a legislative policy favoring the application of domestic laws[46] to varying extents. Under a particularly exaggerated form, *lex forism* refers to the principle according to which a court should generally apply its own law, unless exceptional circumstances justify the application of a foreign law — a theory that has most famously been argued by Ehrenzweig.[47] The principled application of the *lex fori* in international settings constitutes, of course, a rejection of the conflict of laws discipline

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45. *See* Louise Weinberg, *Theory Wars in the Conflict of Laws*, 103 MICH. L. REV. 1631, 1633 (2005) (summarizing the works of the American legal realists regarding choice-of-law, Weinberg observes that "judges only professed to be complying with the command of inexorable bright-line rules" and that "[i]nevitably, [they] were manipulating the seemingly fixed rules to produce desired results").

46. It is generally reflected by the unilateralism of conflict of laws rules.

47. *See* Ehrenzweig, *supra* note 11, at 637. A number of American scholars have expressed views similar to those of Ehrenzweig; *see also* Currie, *Constitution and Choice of Law*, *supra* note 10, at 9 (arguing that "[n]ormally, even in cases involving foreign factors, a court should as a matter of course look to the law of the forum as the source of the rule of decision"). If the doctrine of *lex fori* is most famously associated with Ehrenzweig, it must be noted that it has been argued as early as in the end of the 19th century; *see* James M. Kerr, *The Doctrine of Lex Fori*, 27 CENT. L.J. 255 (1888).

as such.[48] It has never been the prevailing doctrinal view, nor a theory "officially" endorsed by courts or law-makers.

It is difficult to assess the extent to which courts engage in *lex forism*, largely because it is difficult to distinguish between due and undue application of domestic law. However, most authors concur that *lex forism* forms part of the reality of judicial decision-making,[49] although judicial attitudes may vary greatly from one court to another. Regardless of the actual extent to which domestic courts — or legislators — are guilty of *lex forism*, their preference for their domestic laws inevitably undermines the predictability of the functioning of the conflict of laws. In fact, judicial *lex forism* contrasts with the parties' legitimate expectations as based on conflict of laws legislation and doctrine. Legislative *lex forism*, while less unpredictable, may nevertheless be surprising because the relevant conflict norms will often differ from conflict norms applied at the international level.

3. Unpredictability and Lack of International Uniformity of Conflict Rules

Another external factor that potentially diminishes the predictability of the conflict of laws is the lack of uniformity of conflict rules at the international level.[50] Being domestic in nature, conflict rules may indeed vary from one country to the other. Disputes arising in connection with a particular international transaction may potentially be brought before the courts of several countries.[51] Those courts may, therefore, apply different

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48. Even Ehrenzweig admits that his approach calls into question the very existence of the conflict of laws as an independent branch of the law. *See* Albert A. Ehrenzweig, *The Lex Fori in the Conflict of Laws –Exception or Rule?*, 32 ROCKY MTN. L. REV. 13, 14 (1960) (stating that "the law of conflict of laws, while there is a great and increasing need for teaching it, is not a legal subject at all, at least not a subject which can be independently stated or restated"); *see also* Albert A. Ehrenzweig, *A Proper Law in a Proper Forum: A "Restatement" of the "Lex Fori Approach"*, 18 OKLA. L. REV. 340 (1965).

49. The view that *lex forism* is particularly widespread is taken notably by Carter. With regard to the practice of English courts, he notes that "an impartial observer surveying the overall operation in practice of purported choice of law could scarcely avoid being struck by the paucity of cases in which the eventual outcome has been that a law other than the *lex fori* has actually been applied." P.B. Carter, *Choice of Law: Methodology or Mythology?*, *in* ETUDES DE DROIT INTERNATIONAL EN L'HONNEUR DE PIERRE LALIVE 11, 16 (C. Dominicé et al. eds., 1993).

50. *See* Friedrich K. Juenger, *The* Lex Mercatoria *and Private International Law*, 60 LA. L. REV. 1133, 1138 (2000) (stating that "private international law rules differ widely from state to state, as the variations between recent European conflicts codifications demonstrate. . . . Hence it cannot be predicted with any confidence what substantive law will be held to control a given dispute").

51. This is due to the fact that, in contractual matters, the laws of many countries provide that both the courts of the defendant and the courts of the place of performance have jurisdiction. *See e.g.*, Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (Brussels), art. 2(1), 5(1), Sept. 27, 1968, 1262 U.N.T.S. 153; 8

conflict of laws rules, with the result that different substantive laws will be applicable.[52]

The lack of international uniformity of conflict rules thus adversely affects the predictability of the operation of the conflict of laws and opens the door to forum-shopping. In order to achieve greater predictability and to avoid such "fraudulent" behavior, several international institutions seek to promote the international unification of conflict of laws rules.[53] Those efforts have led to a number of achievements,[54] but major discrepancies in the conflict of laws rules of the various countries remain a reality.

4. Unpredictability and Party Autonomy

The laws of virtually all countries recognize the principle of party autonomy in the field of private international law, i.e. the possibility for parties to a contract to choose the applicable law,[55] subject to minor limitations. One could, therefore, assume that the predictability of the conflict of laws no longer is an issue. Neither its methodological complexity, nor the courts' *lex forism*, nor the lack of international uniformity seems to be able to affect the parties' choice of the applicable law.

This is true only to a certain extent. First of all, party autonomy only offers the *possibility* of selecting the applicable law; it does not imply that most, let alone all, parties to an international transaction do in fact express a

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I.L.M. 229 (1969); Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (Lugano), art. 2(1), 5(1) Sept.16, 1988, 28 I.L.M. 620 (1989) (now Council Regulation 44/2001 of Dec. 22, 2000).

52. The courts of country A may, for example, apply the law of the country where the party that "is to effect the characteristic performance" is established (which is the rule set forth in Article 4(2) of the Rome Convention), while the courts of country B may apply the law of the country where the contract was entered into or where the contract is, or was, to be performed.

53. The most prominent of these institutions is the Hague Conference on Private International Law, which was convened for the first time in 1893 and recognized by multilateral treaty in 1951. *See generally* Statute of the Hague Conference on Private International Law, *adopted* Oct. 31, 1951, 15 U.S.T. 2228, 220 U.N.T.S. 121 (July 15, 1955).

54. *See generally* Georges A.L. Droz, *A Comment on the Role of the Hague Conference on Private International Law*, 57 LAW & CONTEMP. PROBS. 3 (1994). For an updated list of Conventions adopted by the Hague Conference, see the Conference's website, www.hcch.net (last visited Feb. 24, 2010).

55. *See generally* SYMEONIDES, PRIVATE INTERNATIONAL LAW AT THE END OF THE 20TH CENTURY: PROGRESS OR REGRESS? 38–40 (1999) (demonstrating that party autonomy is followed by virtually all major legal systems). *See also* Matthias Lehmann, *Liberating the Individual from Battles Between States: Justifying Party Autonomy in Conflict of Laws*, 41 VAND. J. TRANSNAT'L L. 381, 385 (2008); Robert Johnston, *Party Autonomy in Contracts Specifying Foreign Law*, 7 WM. & MARY L. REV. 37 (1966); Giesela Rühl, *Party Autonomy in the Private International Law of Contracts: Transatlantic Convergence and Economic Efficiency*, *in* CONFLICT OF LAWS IN A GLOBALIZED WORLD 153 (E. Gottschalk et al. eds., 2007) [hereinafter Rühl, *Party Autonom*y].

choice-of-law.[56] Second, the actual scope of party autonomy is subject to two limitations. On the one hand, the parties' choice of the applicable law does not have the effect of excluding the application of relevant mandatory or public policy norms. On the other hand, the law selected by the parties does not apply to all issues arising in connection with their agreement since, under the conflict rules of many countries, the parties' choice of law does not extend to the formal validity of the contract.[57]

This being said, in practice, the principle of party autonomy considerably improves the predictability of the conflict of laws.[58] According to a number of authors, the inclusion of choice-of-law clauses is becoming increasingly frequent.[59] Also, the law chosen by the parties will govern the vast majority of issues that may potentially give rise to disputes (material validity, interpretation, performance, liability). To the extent that parties select the applicable law, predictability thus constitutes a minor defect of the functioning of the conflict of laws. However, in those instances where the parties fail to determine the applicable law, it remains a genuine concern.

B. Unfairness of the Conflict of Laws

A criticism voiced in particular by American scholars relates to the alleged unfairness of the conflict of laws.[60] This unfairness supposedly results from the fact that the conflict of laws' sole purpose is the determination of the *spatially*, not substantively, most appropriate law. The conflict of laws is, in fact, based on bilateral conflict norms (which ensure equal treatment of domestic and foreign law) formulating connecting factors that establish a "geographical" link between the legal situation at stake and a particular country. The applicable law is thus determined without the substance of the laws in conflict being taken into account, i.e. the conflict of laws is "neutral" vis-à-vis the laws in conflict.

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56. *See e.g.*, Gerald Aksen, *The Law Applicable in International Arbitration—Relevance of Reference to Trade Usages*, *in* PLANNING EFFICIENT ARBITRATION PROCEEDINGS: THE LAW APPLICABLE IN INTERNATIONAL ARBITRATION 475 (Albert Jan van den Berg ed., 1996).

57. Some countries follow the principle *locus regit actum* with regard to the formal validity of a contract.

58. *See* Fassberg, *supra* note 15, at 77.

59. Yves Derains, *Transnational Law in ICC Arbitration*, *in* THE PRACTICE OF TRANSNATIONAL LAW 48 (2001) ("[d]uring the last twenty years we have seen that, to an increasing extent, the parties decide what will be the law applicable to their contract.").

60. *See supra* text accompanying note 29. *See also* Rühl, *Party Autonomy*, *supra* note 55, at 153 (explaining that "the American Conflict of Laws Revolution… paved the way for a variety of novel approaches focusing on flexibility and fairness in individual cases"); *see* David F. Cavers et al., *Comments on Babcock v. Jackson, A Recent Development in Conflict of Laws*, 63 COLUM. L. REV. 1212, 1229 (1963) (noting that author Cavers believes a departure from the *lex loci delicti* rule is "likely to attain a much closer approximation to justice") [hereinafter *Babcock*].

According to the traditional view, this disregard for the actual contents of the laws in conflict is essential to ensure the uniform application of conflict of laws rules. In fact, if substantive considerations were to play a role in the choice-of-law process, then the determination of the applicable law would be conditioned upon the comparison of potential outcomes, which would render the conflict of laws totally unforeseeable. The neutrality of the conflict of laws is also indispensable for the pursuit of conflict of laws "justice." In fact, according to the traditional understanding, conflict of laws justice prevails over material justice.[61] Justice requires the application of the rules that achieve the fairest result in terms of *spatial*, not of *material*, justice, i.e. it requires the application of the spatially most appropriate law.

In the 1950s and 60s, American criticisms of the "blindness"[62] and "mechanical" nature[63] of the conflict of laws method have found expression in various doctrines such as governmental interest analysis[64] and choice-influencing considerations.[65] To some extent, this introduction of substantive considerations into the operation of the conflict of laws method merely confirmed and further supported a widespread practice of "manipulation" of conflict rules.[66] That this result-oriented use of conflict rules represents, even today, the prevailing doctrinal view is suggested, *inter alia*, by the anecdotal fact that American conflict scholars continue to perceive the various methodological subtleties of the conflict of laws, which

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61. G. KEGEL & K. SCHURIG, *supra* note 24, at 131.

62. Kegel, *supra* note 5, at 617 (observing that American Conflict of law scholars "find it odd to determine "*blindly*" which law to apply, instead of testing first of all what the substantive rules of the relevant laws look like").

63. *See*, *e.g.*, Cavers, *supra* note 9, at 194–95 (stating that "[t]he mechanical rule radically restricts the range of facts pertinent to its application, and only as to problems susceptible of mechanical disposition is its employment justified. Where, as in choice-of-law cases, the problem is essentially complex, the rules developed must contain variables to permit some degree of accommodation to those complexities whose precise nature cannot be anticipated.").

64. *See generally* Currie, *Constitution and Choice of Law*, *supra* note 10; *see also* Alfred Hill, *Governmental Interest and the Conflict of Laws—A Reply to Professor Currie*, 27 U. CHI. L. REV. 463 (1960) (Probably the first and most famous case applying this analysis is *Babcock v. Jackson*, 12 N.Y.2d 473, 240 N.Y.S.2d 743, 191 N.E.2d 279 although there seems to be some "hesitation" among American scholars on whether the court actually applies a governmental interest analysis); *see Babcock*, *supra* note 60, at 1235 (noting that author Currie believes governmental interest analysis renders the conflict of laws fairer by diminishing undesirable methodological complexity and allowing for proper laws to be applied); *see generally* Currie, *Notes on Methods*, *supra* note 10. For an illuminating critique of the governmental interests analysis based on the fact that private law does not involve any public or governmental interests, see Kegel, *supra* note 5, at 631–32.

65. Leflar, *supra* note 12, at 282 (listing five such choice-influencing factors. At least three of those imply that courts take into account the substance of the laws concerned. They are: simplification of the judicial task, advancement of the forum's governmental interests, and application of the better rule of law.).

66. *See* Cavers, *supra* note 9, at 207–08; *see also* Lando, *supra* note 3, at 106 (describing the doctrine of Cavers).

their European counterparts consider as a reflection of its complex functions, as mere "escape devices," allowing judges to elude the application of ill-suited laws.[67]

Whether under the heading of governmental interests, better law[68] or even the most significant relationship test, American conflict scholars have argued the necessity of looking at the substance of the laws in conflict and comparing potential outcomes as part of the law-selecting process. Although those doctrinal developments originated from the perceived inadequacy of systematically applying the *lex loci* in tort cases,[69] they have influenced conflict of laws theory and practice beyond the field of tort law. It is, for example, not uncommon to find references to governmental interests in contract cases.[70] Similarly, Leflar's choice-influencing considerations, which comprise several "substantive" considerations, are of general applicability and not restricted to situations involving torts.

It is difficult to assess whether, and to what extent, those doctrinal developments in the United States have contributed to increasing the fairness of the conflict of laws.[71] It is in fact questionable whether the introduction of considerations of substantive fairness in the conflict of laws process is, at all, "fair" or desirable. Indeed, it is difficult not to be convinced by Kegel's masterful demonstration of the prevalence of conflict of laws justice over material justice and the intellectual strength of his analysis.[72]

However, even Kegel & Schurig admit that substantive considerations come into play and override conflict of laws interests when the forum's public policy is a stake.[73] Those considerations are thus not entirely foreign

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67. This is the general view expressed in most leading textbooks on the conflict of laws. *See*, for example, PETER HAY ET AL., CONFLICT OF LAWS CASES AND MATERIALS 494 (11th ed. 2000) (labeling characterization, *renvoi* and public policy as escape devices).

68. One of the advocates of the better rule of law "doctrine" is Leflar. In fact, his choice-influencing considerations include the application of the better rule of law. For a critical examination of this approach, see Gary J. Simson, *Resisting the Allure of Better Rule of Law*, 52 ARK. L. REV. 141 (1999).

69. *See Babcock v. Jackson*, *supra* note 64.

70. LUTHER MCDOUGAL ET AL., AMERICAN CONFLICTS LAW 517 (5th ed. 2001).

71. Kegel accepts the idea that American conflict scholars may have contributed to rendering the conflict of laws more "fair." *See* Kegel, *supra* note 5, at 633 (stating that American scholarship "represents an architectural accomplishment of high rank, erected *out of love for justice* and with frequently illuminating clarity and *unsurpassed fairness*") (emphasis added).

72. However, some — even European — authors argue that the pursuit of material justice by the conflict of laws is economically efficient. *See* Giesela Rühl, *Methods and Approaches in Choice of Law: An Economic Perspective*, 24 BERKELEY J. INT'L L. 801 (2006).

73. G. KEGEL & K. SCHURIG, *supra* note 24, at 632 (stating that the "exception of *ordre public*, which precludes the application of foreign law lagging insupportably behind one's own impressions of substantive private-law justice, justifies itself by regarding justice as indivisible: even if conflicts justice has preference on principle, it must retreat in serious cases behind substantive justice").

to the traditional Continental European understanding of the conflict of laws method. It could be argued that, to some extent, American scholars only advocate a more extensive application of the forum's notions of substantive fairness. While European scholars support substituting the *lex fori* for the applicable foreign law only in "extreme" cases, American conflict lawyers favor such an approach whenever (they believe that) serious policy considerations are at stake.

Although it is neither my task, nor my intention, to express a preference for either of those approaches, it must be borne in mind that, in actual practice, many courts do take into account considerations of substantive fairness, and not only in jurisdictions where those considerations officially form part of the choice-of-law process. Such a practice is notably reflected by widespread *lex forism* and extensive recourse to the public policy exception. If courts sometimes struggle with potentially "unfair" outcomes of the conflict of laws, it is understandable that arbitrators should face similar situations in which they might be tempted to alter traditional conflict of laws rules in order to render "fairer" decisions.

C. Substantive Inadequacy of Domestic Laws

In their critiques of the traditional conflict of laws method, American scholars have placed emphasis on its unpredictability and unfairness. They have struggled with the "blindness" of the conflict method and faced problems of predictability largely as a result of their own courts' practice of "escaping" undesirable outcomes. European writers, on the other hand, have focused their attention on the operation of the conflict of laws in the specific context of international commercial transactions. They have identified the substantive inadequacy of domestic laws, i.e. their inability to respond to the specific normative requirements of international business transactions, as the main drawback of the conflict of laws method.

1. The Existence of Specific Normative Needs of International Commercial Relationships

The existence of specific normative needs of international commerce has been argued by a number of scholars, including legal comparativists such as David,[74] the founders of the new *lex mercatoria* doctrine Schmitthoff and Goldman,[75] the new generation of *lex mercatorists* led by Berger[76] and arbitration experts such as Goode,[77] Pryles[78] and, to some extent, Gaillard.[79]

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74. David, *supra* note 13.

75. *See supra* note 14.

76. *See* BERGER, *supra* note 6; THE PRACTICE OF TRANSNATIONAL LAW (Klaus Peter Berger ed., 2001).

77. Roy Goode, *The Role of the* Lex Loci Arbitri *in International Commercial Arbitration*, 17 ARB. INT'L 19 (2001).

However, surprisingly few attempts have been made at defining what those needs consist of. In fact, most authors do not expressly address or argue the existence of such specific needs, but implicitly base their claims on their existence.

All of these authors agree on the necessity of establishing a uniform and autonomous legal framework governing international business transactions. However, they do not always clearly indicate why uniformity and autonomy are vital for the law of international commerce. Some scholars emphasize normative requirements that are not genuinely specific to international commercial relations. Schmitthoff, for example, puts the need for legal certainty and predictability in the forefront.[80] However, as I show below, predictability is not a concern that is "specific" to international commercial relations, even though international commercial transactions may indeed require a higher degree of predictability.

Other writers primarily stress the difficulty of determining the appropriate domestic law. David, for example, observes that the application of a domestic law to "a relationship which is *ex hypotesi* international" is "arbitrary."[81] Again others address what I term the "substantive inadequacy" of domestic laws. They note the existence of a basic contradiction between the international nature of an international commercial transaction and the domestic nature of the governing law Berger, for instance, claims that the application of domestic laws to international commercial transactions constitutes the "dilemma" of international trade law since the "natural territorial limitation of the principles and rules contained in domestic laws" leads to an undesirable "nationalization of international commercial cases."[82]

Berger's argument is based on the observation that domestic laws, designed to apply to domestic legal relationships, potentially unduly restrict party autonomy. The reasons for this include, according to Berger, the fact that domestic laws contain a large number of rules protecting weaker parties, the inability of domestic laws to "keep pace with the development and fast evolution as well as the high degree of specialization of

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78. Pryles, *supra* note 13.

79. *See generally* Emmanuel Gaillard, *Thirty Years of* Lex Mercatoria: *Towards the Discriminating Application of Transnational Rules*, 10 ICSID REV.—FOREIGN INVEST. L. J. 208 (1995).

80. Schmitthoff, *The Law of International Trade, Its Growth, Formulation and Operation*, *supra* note 14, at 15: "One of the difficulties in the transaction of international trade is that, owing to its connection with several municipal jurisdictions, it lacks the certainty which is widely regarded as essential for a sound legal order." See also, Schmitthoff, *International Business Law: A New Law Merchant*, *supra* note 14, at 33, where the author explains that the autonomous law merchant constitutes a means of conflict avoidance.

81. David, *supra* note 13, at 141.

82. *See* BERGER, *supra* note 6, at 9.

international commerce,"[83] and restrictive case law.[84] Similarly to Berger, Goode also believes that the undue limitation of party autonomy constitutes the main defect of the application of domestic laws to international transactions.[85]

2. *The Conceptualization of the Specific Needs of International Commerce*

While numerous writers have stressed the inappropriateness of applying domestic laws to international transactions, most authors refrain from questioning this basic fact — or assumption — any further. The discussion therefore lacks an attempt to offer a conceptualization of the specific needs of international business transactions. I will attempt to fill this gap by investigating the concept of "internationality" of international transactions, which triggers those specific needs. On the basis of this analysis, I argue that the specific normative needs of international commercial relationships consist of two simple, but nevertheless fundamental, requirements: substantive neutrality and — as others have suggested — party autonomy.

In order to determine the specific normative requirements of international commerce, it is necessary to have a precise understanding of "internationality." Internationality is a key-concept in the context of conflict of laws,[86] uniform law[87] and arbitration[88] conventions, and domestic laws specifically applying to international transactions. The definitions contained in those instruments are thus of particular interest. They suggest that the internationality of a legal relationship can be defined either by reference to party-related criteria (such as domicile, residence or nationality),by reference to transaction-related criteria (the performance of the transaction "transcends" national boundaries),[89] or both. The former are

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83. *Id.* at 16.

84. *Id.* at 15.

85. Goode, *supra* note 77, at 21 ("Why . . . should parties to an international contract be locked into a national law that in all probability was designed primarily for domestic transactions?").

86. *See, e.g.*, Rome Convention, *supra* note 33; Convention on the Law Applicable to Agency, art. 1, Mar, 14, 1998, 16 I.L.M. 775 (1977); 26 A.J.C.L. 438; Convention on the Law Applicable to Contracts for the International Sale of Goods, art. 1, Dec. 22, 1986, 24 I.L.M. 1575 (1985).

87. *See, e.g.*, Convention on Agency in the International Sale of Goods, art. 1, Feb. 17, 1983, 22 I.L.M. 249 (1983); *CISG*, art. 2, Feb.17, 1983, 22 I.L.M. 249 (1983).

88. *See, e.g.*, UNCITRAL Model Law on International Commercial Arbitration, art. 1(3), Dec. 11, 1985, 24 I.L.M. 1302 (1985).

89. A useful example of a transaction-related definition of internationality is provided by Article 1492 of the French N.C.P.C. According to this provision, an arbitration is "international" when it involves the interests of international trade. In practice, this criterion will be met when the underlying transaction entails a transfer of goods, services or funds across national boundaries.

often referred to as "legal" criteria of internationality, the latter as "economic" criteria.

Understanding the distinction between party-related internationality and transaction-related internationality is crucial because the two types of internationality give rise to different normative needs (even if, in practice, a relationship that satisfies one definition of internationally usually also satisfies the other one). Party-oriented internationality creates expectations of substantive neutrality, a concept that I will define below. In addition, both types of internationality generate a need for increased party autonomy.

When a legal relationship satisfies party-related criteria of internationality, i.e. when the parties are domiciled or resident in two different countries, or when they are nationals of two different countries, they "belong to" different legal systems and operate under different laws. When those parties enter into an agreement, the selection of the applicable law will often be an issue that cannot be solved in a satisfactory manner. Indeed, each party has an understandable preference for the application of its "own" law (because it is familiar with such law and because the operation of that law is largely predictable),[90] but at least one party will have to consent to the application of a foreign law. However, it is possible that none of the parties agrees to have the transaction subjected to the law of the other party and that, therefore, the parties select the laws of a third country, or altogether fail to select the applicable law.[91] Those difficulties are due to the fact that an international transaction requires neutrality of the applicable law, i.e. substantive neutrality.[92]

It is worth noting that substantive neutrality does not relate to the actual content or intrinsic "qualities" of the law chosen by the parties. Substantive neutrality does not, in fact, suppose that the law chosen by the parties achieves the best possible balance between the parties' respective rights, obligations, or interests. Substantive neutrality *could* have such a meaning

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90. The parties' unwillingness to have their contract governed by the other party's law is particularly marked in State contracts, for example contracts concluded by a private and a State or State-owned party. See Maniruzzaman, *supra* note 3, at 371. ("The parties to an international contract sometimes fail to reach agreement as to the substantive law applicable to any dispute that may arise during the course of their contractual relationship. This phenomenon is noticed more often than not in the context of state contracts.").

91. Andreas F. Lowenfeld, *Lex Mercatoria: An Arbitrator's View*, 6 ARB. INT'L 133, 146 (1990) (stating that "agreements without a choice of law clause are common in my experience").

92. *See* Bernardo M. Cremades & Steven L. Plehn, *The New* Lex Mercatoria *and the Harmonization of the Laws of International Commercial Transactions*, 2 B.U. INT'L L.J. 317, 330 (1984) [hereinafter Cremades & Plehn]. *See also* Carlo Croff, *The Applicable Law in an International Commercial Arbitration: Is It Still a Conflict of Laws Problem?*, 16 THE INT'L LAWYER 613, 623 (1982) (stating that when parties reach the stage of selecting the applicable law, "they face an insurmountable barrier. They come from different countries with divergent economic and political backgrounds and therefore they are not acquainted with and do not confide in the respective national laws. In this situation parties prefer to leave the issue open rather than not to conclude the contract").

but the determination of the ways in which the application of a particular law favors the interests of one party (for example, the distributor rather than the manufacturer) is difficult, if not impossible (given, in particular, that it is not possible to foresee the issue/s that will give rise to litigation or arbitration). Substantive neutrality does not therefore refer to the parties' equal "rights" under the applicable law, but to the fact that the parties have equal knowledge of such law and predictability of the legal consequences. However, even the criteria of knowledge and familiarity may be overly rational, considering that contracting parties often ignore the precise contents of their "own" law (although their lawyers generally do not). Substantive neutrality therefore comprises a significant psychological aspect, i.e. the fact that parties feel "comfortable" with the application of a particular law (generally their "own" law) and that they believe that such law will guarantee adjudicatory fairness.

In addition, both party-related internationality and transaction-related internationality create a need for increased party autonomy. Whether it is the parties that "belong" to different legal systems or the transaction that involves the territories of more than one country, in each case the transaction will require an increased degree of party autonomy. When I say "require," I mean that, on the hand, such increased party autonomy is *desirable* from the point of view of the parties and, on the other hand, *acceptable* from the perspective of the legislator.

It is *desirable* from the point of view of the parties because domestic laws, due to their focus on domestic legal relationships,[93] often fail to take account of the specificity of international transactions. In my opinion, domestic laws may contain three types of problematic limitations of the parties' freedom of contract. First, domestic laws may restrict the parties' right to address issues that only arise in the international context. Focusing on domestic transactions, those laws may, for example, not accept, or restrict, the parties' right to select the applicable substantive law, the parties' right to select the competent forum or submit to arbitration,[94] and the parties' right to choose the currency of payment or stipulate specific payment clauses (for example, gold clauses).[95]

Second, domestic laws may interfere with the parties' ability to design a contractual framework that suits so-called "complex" contracts (such as turnkey agreements, technology transfers, mining concessions and joint

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93. *See* BERGER, *supra* note 6, at 15; JOACHIM G. FRICK, ARBITRATION AND COMPLEX INTERNATIONAL CONTRACTS 14 (2001) (making specific reference to the German BGB and the Swiss *Code des Obligations*).

94. In France, for example, arbitration clauses were traditionally prohibited in domestic contracts. In the 1930's, failing legislative enactments specifically authorizing recourse to arbitration in relation to international contracts, the *Cour de cassation* ruled that the prohibition did not apply to international contracts. *See* PETSCHE, *supra* note 21, at 139.

95. *See* Russell L. Post & Charles H. Willard, *The Power of Congress to Nullify Gold Clauses*, 46 HARV. L. REV. 1225 (1933).

ventures, for example),[96] which are concluded with increasing frequency at the international level. Due to the fact that the laws of most countries focus on "discrete" (exchange), rather than "relational" contracts, the relevant rules may be inappropriate in the context of complex international contracts. It may, therefore, be necessary for the parties to fill certain legislative gaps or to expressly exclude inadequate provisions (such as the general cancellation right in cases of default).[97]

Third, domestic laws may unduly interfere with the contractual balance established by the parties' agreement. As Berger rightly points out, domestic laws governing contracts frequently incorporate rules aimed at the protection of weaker parties (consumers, tenants, employees etc.).[98] Many of those rules may not directly apply to commercial contracts, but they nevertheless create a legislative climate prone to court interference. Moreover, the resulting restrictive case law may be applicable to international contracts since it forms part of the domestic law.[99]

Increased party autonomy is not only desirable for the parties, but it is also *acceptable* from the point of view of the State. First of all, business transactions do not as such involve public or regulatory interests; they primarily involve private interests.[100] Second, while domestic legislators have a legitimate interest in regulating activities occurring in their territories and/or involving their nationals, they understandably have a more limited interest in having their laws govern activities that involve foreign elements. This is reflected by the public international law principle according to which a State's sphere of legislative competence is defined by reference to its territory and its nationals.[101] An international commercial transaction does not, therefore, fall within the exclusive sphere of competence of any State, such competence being shared between the States that bear a connection to said transaction.

3. The Inability of Domestic Laws to Respond to the Specific Needs of International Commerce

Domestic laws generally fail to respond to the specific needs of international commercial transactions. However, domestic laws *could* be more responsive to those needs. Indeed, nothing prevents domestic legislators from adopting rules or laws specifically applying to international transactions. In practice, such an approach is reflected by dualistic

96. *See* FRICK, *supra* note 93.
97. *Id.*
98. *See* BERGER *supra* note 6, at 15.
99. *Id.* at 16.
100. Kegel, *supra* note 5, at 631.
101. Gerhard Kegel & Ignaz Seidl-Hohenveldem, *On the Territoriality Principle in Public International Law*, 5 HASTINGS INT'L & COMP. L. REV. 245, 250–51 (Joseph A. Darby trans., 1982).

legislation, i.e. the co-existence of two sets of norms: one governing domestic and the other governing international transactions or contracts. Sometimes the "international" rules stem from an international convention,[102] but those rules may also be enacted at the domestic level.[103] Still, even if domestic laws incorporate — or attempt to incorporate — international standards, those rules may nevertheless lack the degree of uniformity desirable for international transactions. In any event, they will have great difficulty in overcoming the psychological aspect of substantive neutrality.

This being clarified, domestic laws fail to address the two specific needs of international business contracts. First, domestic laws do not provide an appropriate solution for the problem of substantive neutrality. In the majority of international commercial contracts, the parties will agree on the application of the law of one of them. Less frequently, they will opt for the application of the law of a third country. By doing so, the parties do manage to ensure the substantive neutrality of the applicable law. However, in such a scenario, substantive neutrality comes at a cost: it entails the application of a law that both parties are largely unfamiliar with and that therefore entails the risk of having to face unforeseeable legal consequences. In addition, there are a number of other practical difficulties arising from such a choice-of-law due to the potential dissociation between legislative and judicial competence[104] and possible legislative restrictions on the parties' right to select the law of a country that bears no material connection to the transaction.[105]

Second, due to their focus on domestic legal relationships, domestic laws also prove unable to satisfy the increased need for party autonomy of international business transactions. As I have explained above, domestic laws may contain at least three types of undue restrictions: restrictions on the parties' ability to address questions arising only in the international context, restrictions on the possibility for the parties to effectively respond

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102. Probably the best illustration of this is the United Nations Convention on Contracts for the International Sale of Goods (CISG). This multiparty treaty replaces the domestic sales laws of a contracting state with respect to sales agreements covered by the Convention. *See generally* United Nations Convention on Contracts for the International Sale of Goods, *adopted* Apr. 11, 1980, 1489 U.N.T.S. 3 (Jan. 1, 1988).

103. Numerous countries have adopted dualistic arbitration laws, i.e. laws that contain separate provisions for domestic arbitration, on the one side, and international arbitration, on the other.

104. When the parties opt for the application of a third law (the law of country A), they will not necessarily (not even generally) select the courts of country A as the competent forum. Therefore, the competent court will often have to apply foreign law with which it will be largely unfamiliar.

105. Certain laws limit the parties' freedom to choose the applicable substantive law by requiring that the law chosen (for example the country concerned) bear some connection to the dispute. *See* DICEY, MORRIS & COLLINS ON THE CONFLICT OF LAWS 1562 (2006).

to the needs of increasingly complex transactions, and restrictions based on legislative policies aimed at protecting weaker parties.

II. DEPARTURE FROM THE CONFLICT OF LAWS AND THE APPLICATION OF TRANSNATIONAL LAW

The traditional conflict of laws approach does not represent an ideal method of solving conflicts arising in international commercial transactions. Although this state of affairs is by no means due to mistakes attributable to conflict scholars or domestic legislators, the conflict of laws continues to struggle with occasional unpredictability and questionable fairness. Above all, the conflict of laws proves unable to provide a substantively adequate set of norms as domestic laws continue to lag behind economic reality.

Over the past thirty years, arbitral tribunals deciding international business disputes have rather successfully attempted to remedy those shortcomings. They have progressively freed themselves from "rigid" conflict of laws rules in order to improve, to the extent possible, the predictability and fairness of the determination of the applicable law. They have also sought to take into account the specific normative needs of international dispute resolution and increasingly resorted to transnational law, rather than domestic laws.

A. Departure from the Traditional Conflict of Laws Approach

Since the early 1980's, arbitral tribunals have enjoyed steadily increasing discretion in the determination of the applicable law, absent a choice of law by the parties.[106] This trend found doctrinal support in the theory of delocalization[107] of international arbitration, which is based on the "multi-connectedness" of international arbitration proceedings and the fictitious character of the concept of the arbitral "seat" or "forum."[108] Roughly

106. See, for example, the French decree of May 12, 1981 on international arbitration (Articles 1492-1507 of the *Nouveau Code de Procédure Civile*), the 1985 UNCITRAL Model Law, and the 1987 Swiss Private International Law Statute, Articles 176-194.

107. The theory of delocalization rejects the traditional approach according to which all aspects of arbitration proceedings (the arbitration agreement, the arbitral procedure, and the arbitral award) are governed by the laws of the place of arbitration or arbitral "seat." The localized Approach of arbitration has been argued by a number of scholars and, most famously, by Mann. *See* F.A. Mann, *Lex Facit Arbitrum, in* INTERNATIONAL ARBITRATION—LIBER AMICORUM FOR MARTIN DOMKE 157 (P. Sanders ed., 1967). An example of such an approach is provided by ICC Case No. 5460, COLLECTION OF ICC ARBITRAL AWARDS 1986–1990, at 138 (S. Jarvin et al. eds., 1994). However, it should be noted that, as a matter of positive law, the application of the laws of the seat has never been exclusive.

108. For a discussion of the progressive acceptance of the idea that international arbitration proceedings are devoid of a forum, see Marc Blessing, *Regulations in Arbitration Rules on Choice of Law*, *in* ICCA CONGRESS SERIES NO. 7 PLANNING EFFICIENT ARBITRATION PROCEEDINGS/THE LAW APPLICABLE IN INTERNATIONAL ARBITRATION 391 (A.J. van den Berg ed., 1996).

speaking, proponents of this theory argue that the laws and courts of the arbitral seat or place of arbitration should not play a preponderant role.[109] Under a delocalized approach, the validity of the arbitration clause, the merits of the dispute, the arbitral procedure, and the "validity" of the arbitral award are thus not (necessarily) governed by the laws of the seat. Delocalization theory also implies that the conflict of laws rules of the seat do not apply to the determination of the applicable substantive law.

Most contemporary arbitration laws have incorporated this delocalized approach. They recognize that arbitrators are not bound by the ordinary conflict rules of the seat and grant them considerable powers to select the applicable law or rules of law. The most restrictive of those laws require arbitral tribunals to apply the "rules of law with which the case is most closely connected."[110] Others grant arbitrators the power to resort to the conflict of laws rule they consider appropriate.[111] Still others allow arbitral tribunals to apply any "rules of law" that they deem fit,[112] a formulation that is generally considered to officially recognize the possibility of applying transnational law (which I will discuss later). A similar trend characterizes the evolution of institutional arbitration rules such as those of the ICC, the LCIA or the AAA.[113]

While it is uncontroversial that arbitrators do enjoy broad discretionary powers to determine the applicable law or rules of law, the determination of the ways in which they use those powers is more problematic. In fact, when arbitral tribunals decide to apply a particular conflict of laws rule leading to the application of a given domestic law, they do not necessarily motivate their decisions. In particular, they will often refrain from referring to considerations of substantive fairness, even if such considerations play a significant role in their decision-making process. Also, in line with the traditional approach, many tribunals may not take into account the consequences of their conflict of laws decisions.

However, some of the approaches followed by arbitral tribunals reveal a clear intent to improve the predictability and fairness of their choice-of-law

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109. For a general discussion of the delocalization of international arbitration, see Pippa Read, *Delocalization of International Commercial Arbitration: Its Relevance in the New Millennium*, 10 AM. REV. INT'L ARB. 177 (1999).

110. *See, e.g.*, Swiss Private International Law Statute, art. 187 [hereinafter Swiss PIL]; Italian C.P.C., art. 834; German ZPO art. 1051(2).

111. *See, e.g.*, U.N. COMM'N ON INT'L TRADE L. [UNCITRAL], UNCITRAL MODEL LAW ON INT'L COM. ARB. at Art. 28, U.N. Doc. A/40/17, Sales No. E.08.V.4 (1985) (*amended* 2006). This document has acted as the framework for numerous countries in their creation of international commercial arbitration laws.

112. *See, e.g.*, Article 1496 of the French N.C.P.C and Article 1054(2) of the 1986 Netherlands Arbitration Statute.

113. *See* ICC International Court of Arbitration, Rules of Arbitration, art 17(1), Jan. 01, 1998, ICC No. 808 [hereinafter ICC Rules]; London Court of International Arbitration Rules, art. 22.3, Jan. 1. 1988 [hereinafter LCIA Rules]; American Arbitration Association Rules, art 28.1 [hereinafter AAA Rules].

determinations. Beyond those specific examples, which I will discuss below, it seems fairly reasonable to assume that, as a general rule, arbitrators use their discretion in ways that favor the common interests of the parties, i.e. the predictability of the choice-of-law process and, to the extent possible, substantive fairness.

1. Efforts to Render the Operation of the Conflict of Laws More Predictable

As I have shown in Part 1, factors reducing the predictability of the conflict of laws process include — excessive — methodological complexity, *lex forism*, and the lack of international uniformity of conflict rules. While arbitral tribunals have largely avoided having recourse to methodological subtleties such as characterization, *renvoi* or adaptation, they have nevertheless encountered obstacles in the pursuit of greater predictability of their choice-of-law determinations. On the other hand, they have — sometimes without any effort on their part — successfully battled *lex forism* and the international diversity of conflict rules.

Obstacles to the Improvement of the Predictability of the Conflict of Laws

At first sight, it seems difficult, if not impossible, for arbitrators to render the operation of the conflict of laws more "predictable." Several reasons account for this difficulty. First, delocalization and broad discretionary powers in the determination of the applicable law may actually diminish the predictability of the law-selecting process. In fact, since arbitrators are not bound to follow any particular set of conflict of laws rules, whether domestic or international, their freedom to determine the applicable law or rules of law is virtually unlimited. *A priori*, this considerable discretion, renders arbitral choice-of-law determinations less foreseeable since increased judicial discretion generally favors fair outcomes in individual cases, but diminishes overall predictability.[114] It may, in fact, seem illogical to argue that a non-rule should lead to more foreseeable results than a rule, however complex or vague. The systematic application of the conflict of laws rules of the seat or of any "precise" conflict of laws rule that may be contained in the applicable arbitration law should, in principle, be easier to predict than the discretionary selection or "creation" of a conflict norm by an arbitral tribunal.

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114. *See* Lando, *supra* note 3, at 512 (considering what type of conflict norms should be adopted: "Is a method to be adopted which insures justice in the individual case, a method which more or less will sacrifice the need for certainty and predictability – or are rules to be introduced which pay regard to the need for foreseeability and which if they are consistently applied will sometimes cause hardship in a particular case?").

Second, one may wonder whether it is at all feasible to alter traditional conflict of laws rules to the effect of improving the predictability of their operation. The very concept of predictability implies that the parties do have certain expectations with regard to the arbitrators' decision on the applicable law. However, where the parties are unable to reach an agreement on the applicable law, they probably have no specific expectations as to the decision an arbitral tribunal might render in a hypothetical dispute. Also, and even more importantly, the parties may not have any "common" expectations with regard to the arbitral determination of the applicable law, and it is the arbitrators' role to ensure that their decision is predictable for all parties involved.

However, and despite those serious obstacles, arbitral tribunals have found ways to address two sources of unpredictability of the conflict of laws: *lex forism* and the lack of international uniformity of conflict of laws rules. Contrary to State courts, arbitral tribunals have generally held that the place of arbitration does not constitute a "forum." Therefore, they have notshown a particular preference for the lex fori. Also, arbitral tribunals have increasingly resorted to conflict of laws rules that are common to the parties' respective countries or to conflict norms that reflect international standards. By doing so, they have avoided the application of isolated or "unusual" conflict norms and thus increased of their choice-of-law decisions.

The Absence of a *Lex Fori*: Arbitrators Do Not Generally Prefer the Law of the Place of Arbitration

Two consequences follow from the general acceptance of delocalization theory and the resulting idea that arbitral tribunals do not have a *lex fori*. First, the predictability of their conflict of laws decisions is not likely to be diminished by *lex forism*. An arbitral tribunal sitting in Geneva, for example, will not attempt to apply conflict rules in such way as to ensure to application of Swiss law. Occasionally, arbitral tribunals — or rather the individual members — may have a preference for their "own" law, for example a French arbitrator may be inclined to prefer French law over, say, Italian law, but those instances are, in my opinion, relatively rare.

Second, being deprived of a forum, arbitral tribunals will also be less inclined to act as "protectors" of public policy rules of that non-existent forum. An arbitral tribunal sitting in Vienna and hearing a dispute between a Czech and a Spanish party will have little reason to take into account Austrian public policy. The conflict of laws reasoning of arbitral tribunals will thus be less likely to be affected by public interests. Those tribunals will therefore have more limited recourse to mandatory norms and the public policy exception.

Cumulative Application of Conflict Norms: Application of International Standards of the Conflict of Laws

As I explained above, under the laws of most countries, arbitrators are not generally bound by the conflict norms of the seat. If arbitrators apply a traditional conflict of laws reasoning, they may apply the conflict rules of the seat, those of the country of one of the parties or any other country connected to the transaction. Those particular conflict of laws rules may follow an isolated or outdated approach that neither of the parties foresaw at the time of the conclusion of the agreement. The relevant conflict rule may, for example, provide for the application of the law of the country in which the contract was entered into,[115] which is a rather unusual — and unpredictable — rule in contemporary comparative conflict of laws.

Arbitral tribunals have elaborated two methods to address this difficulty. The first such method consists in the cumulative application of the conflict of laws norms of the countries involved,[116] which will typically be the countries of the parties' respective residences or nationalities and the country or countries of performance. Under this approach, arbitrators will apply the law that is designated by both (or all) conflict norms involved. Arbitral tribunals have, for example, cumulatively applied Irish and French conflict rules in a dispute between a French manufacturer and an Irish distributor,[117] Italian and Tunisian conflict norms in a dispute between a Tunisian manufacturer and two Italian agents,[118] and Egyptian, French, and Yugoslav conflict rules in a dispute between a Yugoslav seller and an Egyptian buyer.[119]

Critics of this method have argued that it is of little practical usefulness since it can only be used where the conflict norms concerned are identical and since the result of the cumulative application of those conflict rules will thus not differ from the individual application of the conflict rules of either country.[120] They claim that this approach aims to solve a so-called "false conflict."[121] In my opinion, those criticisms miss the point. If a particular

115. An example of such a law is provided in ICC Case No. 6281 (the arbitral tribunal notes that under Egyptian conflict of laws rules, a contract is governed by the law of the country where the contract is signed, article 19 of the 1949 Civil Code). *See* COLLECTION OF ICC ARBITRAL AWARDS 1986–1990, *supra* note 107, at 395.

116. Klaus Peter Berger, *International Arbitral Practice and the UNIDROIT Principles of International Commercial Contracts*, 46 AM. J. COMP. L. 129, 131 (1998) (stating that "[i]nstead of referring to just one conflict of law rule, they [arbitrators] justify their choice of law decision with reference to all conflict of laws rules concerned . . .").

117. ICC Case No. 7319, COLLECTION OF ICC ARBITRAL AWARDS 1996–2000, at 300, 304 (J.J. Arnaldez et al. eds., 2003).

118. ICC Case No. 5118, COLLECTION OF ICC ARBITRAL AWARDS 1986-1990, *supra* note 107, at 318, 319.

119. *Id.* at 394, 399.

120. Wortmann, *supra* note 2, at 108.

121. *Id*.

law is applied as a result of the cumulative method, it is irrelevant that the application of the conflict laws of country A would have had the same effect. The arbitral tribunal precisely applies a given law only because such law is designated by both (or all) conflict norms concerned. The legitimacy of its application derives from the fact that the conflict rules are identical, not from any domestic conflict rule as such.

The second method to tackle the predictability problem consists in the application of conflict norms that are widely recognized at the international level, i.e. in the application of what could be termed "general principles" of the conflict of laws.[122] Such an approach may be used as an alternative to the cumulative method. It bears particular usefulness when, due to divergences between the conflict norms involved, this latter method cannot be applied. In fact, recourse to general principles of the conflict of laws does not necessarily suppose a convergence of the conflict rules involved (although this will frequently be the case). This method therefore allows arbitrators to avoid the application of uncommon and hence unpredictable conflict of laws rules. When following such an approach, arbitrators often apply the provisions of international instruments such as the Rome Convention or principles that derive from the arbitrators' comparative conflict of laws analysis.[123]

2. *The Introduction of Considerations of Substantive Fairness into the Law-Selecting Process*

When arbitral tribunals are called upon to determine the applicable substantive law, they do not necessarily pursue substantive fairness; they may select the applicable law on the basis of other considerations or legal standards which they consider relevant. However, when they do attempt to increase the substantive fairness of their choice-of-law decisions, they do not generally disclose their underlying motivation. Rather than stating that the application of law A leads to a "fairer" result than the application of law B, they would confine themselves to observing that law A is the more appropriate or "suitable" for the case at stake. However, as I suggested with respect to the pursuit of greater predictability of choice-of-law decisions, it is reasonable to assume that arbitral tribunals use their almost unlimited

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122. *See*, for example, ICC Case No.7205 (application of the law of the country in which the party that effects the characteristic performance has its central administration). COLLECTION OF ICC ARBITRAL AWARDS 1991-1995, 622 (J.J. Arnaldez et al. eds., 1997).

123. *See*, *e.g.*, *id.* (applying the law of the country in which the party that effects the characteristic performance has its central administration); ICC Case No. 4996, COLLECTION OF ICC ARBITRAL AWARDS 1986–1990, *supra* note 107, at 292, 294 (presiding arbitral tribunal takes into account various international conventions, including the Rome Convention, in order to decide that the law of the place of performance — which is also the country where the party that is to effect the characteristic performance has its habitual residence — should apply).

discretion in ways that increase the substantive fairness of their decisions. Indeed, it can be assumed that the various methodological approaches elaborated by arbitral tribunals seek to ensure such fairness. This is notably confirmed by explicit references to substantive fairness contained in choice-of-law determinations aimed at ensuring the validity of the contract or at complying with the parties' legitimate expectations.

Overview of Methodological Approaches

Under the laws of most countries and the rules of the major arbitral institutions, absent a choice-of-law by the parties, arbitral tribunals enjoy wide discretionary powers in the determination of the applicable law.[124] In their exercise of those powers, arbitrators have developed three main methodological approaches. First, arbitrators may decide to determine the applicable law by having recourse to what they consider the "most appropriate" conflict of laws rule. Under such an approach, arbitral tribunals apply an "existing" conflict rule, whether contained in a domestic law or in an international convention. Second, arbitrators may disregard all domestic and international conflict of laws norms and decide to "create" their own conflict rule (for example, the cumulative method). Third, arbitrators may also "directly" apply a particular domestic law without any reference to a conflict of laws norm, whether existing or created *ad hoc*.

In actual practice, those approaches considerably overlap and are not always easily distinguished. For instance, an arbitral tribunal may decide that the cumulative application of the conflict norms of the parties' respective laws constitutes the "most appropriate" conflict rule.[125] Arbitrators may even hold that the most appropriate conflict rule is the one that provides for the cumulative application of the *substantive* laws involved.[126] Similarly, when arbitrators decide to create their "own" conflict norm, they may in fact directly select the applicable law without referring to any specific conflict of laws reasoning.[127]

Despite some degree of incoherence in the actual application of the methodological approaches outlined above, the elaboration of those methods signals a trend towards ever increasing discretion of arbitral tribunals in the law-selecting process. In fact, those tribunals are "freed" from all domestic and international conflict of laws norms and can apply any domestic law they deem suitable, even without stating reasons. This

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124. *See supra* notes 113–23.

125. ICC Case No. 2626, COLLECTION OF ICC ARBITRAL AWARDS 1974–1985, at 318 (Y. Derains & S. Jarvin eds., 1990).

126. ICC Case No. 2886, COLLECTION OF ICC ARBITRAL AWARDS 1974–1985, *supra* note 125, at 332.

127. ICC Case No. 3880, COLLECTION OF ICC ARBITRAL AWARDS 1974–1985, *supra* note 125, at 463.

virtually unlimited discretion provides arbitral tribunals with the means to take into account considerations of substantive fairness.

The Application of Laws Upholding the Validity of the Parties' Agreement and Complying with the Parties' Substantive Expectations

In a number of cases, the application of one of the laws involved may threaten the validity of the parties' agreement. In some cases, such invalidity may be considered as appropriate and "fair." This will be the case when the contract is illegal or violates international public policy. In many other cases, though, the invalidity of the contract may be considered as "unfair," notably when such invalidity results from unduly restrictive validity requirements, such as specific formal requirements, for example.[128] As I have explained above, those requirements may be appropriate in a domestic context, but they unduly restrict party autonomy at the international level.

Arbitral tribunals have, in various instances, motivated their choice-of-law decisions by the need to uphold the validity of the parties' contract. In an interim award rendered in 1983, an ICC tribunal decided to apply Swiss law rather than the laws of the Arab claimant on the grounds that the application of such laws "might partially or totally affect the validity of the Agreement" and that it was "reasonable to assume that from two possible laws, the parties would choose the law which would uphold the validity of the Agreement."[129] In 1985, another ICC tribunal held that an agency agreement concluded between an Italian company and a French agent should be governed by French rather than Italian law, *inter alia* because the Italian law requirement according to which all commercial agents need to be registered in Italy would have unduly invalidated the parties' contract.[130]

Arbitral tribunals have applied such reasoning not only to issues of contract validity strictly speaking, but also to the application of statutes of limitation potentially preventing a party from bringing a claim. In 1993, an ICC tribunal hearing a dispute between a French and an Algerian party chose to apply Algerian rather than French law on the grounds that the application of French law might have led to the claimant's claim being time-barred, which, since the respondent had filed a counter-claim, would have been prejudicial to both parties.[131]

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128. ICC Case No. 4996, COLLECTION OF ICC ARBITRAL AWARDS 1986–1990, *supra* note 107, at 293.

129. ICC Case No. 4145, COLLECTION OF ICC ARBITRAL AWARDS 1986–1990, *supra* note 107, at 53, 57.

130. ICC Case No. 4996, COLLECTION OF ICC ARBITRAL AWARDS 1986–1990, *supra* note 107.

131. ICC Case No. 7154, COLLECTION OF ICC ARBITRAL AWARDS 1991–1995, *supra* note 122, at 555.

Admittedly, this *favor validitatis* found in arbitral decisions is not a unique to international arbitration. It can be found in a number of jurisdictions, and notably in those countries that apply the Rome Convention.[132] However, arbitral tribunals were able to validate contracts where the *favor validitatis* rule contained in the Rome Convention or other conflicts laws were not "normally" applicable. In particular, as the cases reported above indicate, they were able to render such decisions prior to the entry into force of the Convention.[133]

One — if not the main — reason why arbitral tribunals render choice-of-law decisions favoring the validity of the parties' contract is that the parties *expect* their contract to be valid. In other words, the validity of the contract conforms to the parties' legitimate expectations.[134] If the issue of contract validity provides a particularly insightful example, it is not the only instance in which arbitral tribunals take the parties' legitimate expectations into account.

In fact, in an attempt to render fairer decisions, arbitral tribunals have not only taken into account the parties' substantive expectations (notably regarding the validity of their contract), but also conflict of laws expectations. This is well illustrated by a 1988 decision in which an ICC tribunal hearing a dispute between several European claimants and a number of Tunisian respondents decided to apply, to the extent possible, trade usages and rules that are common to French and Tunisian law, observing that such a decision conforms to the parties' legitimate expectations.[135]

Arbitral tribunals have even taken into account the parties' expectations when deciding on the application of mandatory norms. In 1995, an ICC tribunal hearing a dispute between an American and a Belgian party had to solve the question of whether the RICO (Racketeer Influenced and Corrupt Organization) Act was applicable to the dispute which the parties had subjected to New York law. The tribunal decided that RICO did not apply because, absent a choice-of-law by the parties, the dispute would be governed by Belgian law (the law of the place of performance).[136] The tribunal based its decision *inter alia* on the necessity to comply with the parties' expectations and to ensure predictability.[137]

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132. Rome Convention, *supra* note 86, art. 8 (material validity), art. 9 (formal validity).

133. *See supra* notes 125–31.

134. ICC Case No. 4145, COLLECTION OF ICC ARBITRAL AWARDS 1986–1990, *supra* note 107.

135. ICC Case No. 5103, COLLECTION OF ICC ARBITRAL AWARDS 1986–1990, *supra* note 107, at 361.

136. ICC Case No. 8385, COLLECTION OF ICC ARBITRAL AWARDS 1996–2000, *supra* note 117, at 474.

137. *Id*.

B. The Application of Transnational Law

As I have explained above, arbitral tribunals, with a view to improving the predictability and fairness of the operation of the conflict of laws, have subjected the traditional conflicts approach to a number of methodological transformations. However, those developments do not alter one essential feature of the classical conflict of laws theory, namely the fact that the applicable law will always be the domestic law of a particular country. Those modifications do not, therefore, allow arbitral tribunals to adequately respond to the specific normative needs of international commercial relations.

This is why, in addition to the evolution taking place at the conflict of laws level, arbitral tribunals have moved away from the strict application of domestic laws towards the application of "transnational" law.[138] This trend constitutes a quantum leap in international dispute resolution: arbitral tribunals do no longer modify *how* the applicable domestic law is determined; their decisions affect the substance of *what* the applicable law is.

1. Transnational Law as a Means to Ensure Substantive Neutrality and Increased Party Autonomy

The exact meaning of transnational law[139] is the subject of some controversy and attempts to define this notion are rather sparse. A little less than twenty years ago, even distinguished international lawyers such as Paulsson viewed transnational law (*lex mercatoria*) with skepticism.[140] Paulsson distinguished three approaches or conceptions of transnational law: (i) an autonomous legal order, (ii) a set of rules governing international contracts (very much like domestic laws) or (iii) a number of trade practices and usages. Paulsson himself subscribed to the latter, most restrictive, approach.[141]

Such a restrictive view is no longer sustainable in light of the growing number of decisions in which arbitral tribunals have expressly subjected international contracts to transnational law. *Lex mercatoria* must thus be considered as a body of rules capable of governing international business transactions. In an attempt to define this concept of transnational law further, a number of authors have emphasized the private, as opposed to

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138. *See* Cremades & Plehn, *supra* note 92, at 347.

139. The term "transnational law" is generally attributed to Jessup. *See* P. C. JESSUP, TRANSNATIONAL LAW 2 (1956) (this author adopts a particularly broad definition of transnational law stating that it "is all law which regulates actions or events that transcend national frontiers. Both public and private international law are included, as are other rules which do not wholly fit into such standard categories.").

140. *See* Paulsson, *supra* note 18.

141. *Id.* at 69.

public, "source" of transnational law.[142] Others have stressed the fact that transnational law is constituted by rules that "transcend" national boundaries.[143] The writings of various scholars include, to some extent, both definitional approaches.[144]

Under the first approach, transnational law is characterized by the private origin of its rules, i.e. the fact that those rules are not enacted by States, but adopted "spontaneously" by the international business community itself (self-regulation). Such a definition thus essentially views transnational law as commercial customs and practices. To the extent that those practices and customs may be codified in international uniform law conventions, such a definition also includes those uniform laws.

Under the second approach, transnational law is defined by reference to the nature of its rules: transnational law rules are rules that "transcend" national boundaries, i.e. rules that are common to all or a certain (significant) number of legal systems. Under such a definition, the actual source of a particular rule is irrelevant. Transnational law may notably include rules contained in domestic laws and international (inter-governmental) conventions, provided that those rules are widely applied at the international level.

Defining transnational law by reference to the nature of its rules is the more adequate approach. Indeed, the "private source" criteria is incompatible with the fact that a number of legal norms anchored in domestic legal systems (such as general principles of law) or derived from international law (such as uniform law conventions) are generally considered to form part of transnational law,[145] — even by those who argue that *lex mercatoria* is characterized by its private origin. Also, and most

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142. This is notably inherent in Goldman's understanding of the *lex mercatoria*. *See* Goldman, *Nouvelles réflexions sur la lex mercatoria*, *supra* note 14, at 244 (translation by the author) (arguing that "transnational principles, rules and usages," rather than being imposed by state or interstate authorities, are "formed spontaneously in the course of the conclusion or functioning of these [international economic relations]").

143. *See, e.g.*, Norbert Horn, *Uniformity and Diversity in the Law of International Commercial Contracts*, *in* THE TRANSNATIONAL LAW OF INTERNATIONAL COMMERCIAL TRANSACTIONS VOL. 2, 3, 12 (N. Horn & C.M. Schmitthoff eds., 1982).

144. Schmitthoff, for example, expressly states that transnational law comprises what he terms "international legislation" and international commercial custom. *See* Clive Schmitthoff, *Nature and Evolution of the Transnational Law of Commercial Transactions*, *supra* note 14, at 23.

145. *See, e.g.*, David W. Rivkin, *Enforceability of Arbitral Awards based on Lex Mercatoria*, 9 ARB. INT'L 67, 67 (1993) (stating that *lex mercatoria* is "an amalgam of most globally-accepted principles which govern international commercial relations: public international law, certain uniform laws, general principles of law, rules of international organizations, customs and usages of international trade, standard form contracts, and arbitral case law"); Horn, *supra* note 143, at 67 (stating that transnational law includes international conventions, semi-official texts such as the UNIDROIT principles and non-codified principles of transnational law as recognized by courts and arbitral tribunals and used by lawyers when drafting international contracts).

importantly, the distinction between private and public sources of rules is not conceptually accurate and to a large extent merely "formal": while certain rules are formally enacted by domestic legislators or adopted by international conventions, they may merely codify existing usages and customs followed in actual business practice.

Rules of transnational law are thus rules that "transcend" national boundaries. They are "common" to a certain number of legal systems[146] and are, to this extent, "uniform" rules.[147] It is this uniformity of transnational law rules that explains why those rules support party autonomy and substantive neutrality. Uniform rules are substantively neutral because they are "common" to the laws of the parties or, at the very least, do not privilege the approaches and rules contained in either of those laws.[148]

Due to its uniformity, a rule of transnational law also frees parties to an international transaction from domestic technicalities,[149] and thereby grants them increased contractual freedom. In fact, rules containing particular "undue" restrictions on party autonomy differ from one country to another and will not be common to the parties' respective legal systems, nor, *a fortiori*, to a large number of those systems. A rule requiring a buyer to immediately notify the seller upon arrival of the goods in order to preserve its right to bring a claim on the basis of the late delivery,[150] or a rule laying down severe restrictions on the ability of an agent to bind a corporation,[151] for example, will be found only in few legal systems, and can thus be avoided by the application of transnational norms.

2. *Progressive Move Towards the Application of Transnational Law*

Legislative Context Favoring the Application of Transnational Law in International Arbitration

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146. In order to qualify as a rule of transnational law, a rule should generally be followed in a "significant" number of countries. However, the "uniformity" of a particular norm may also be limited to the parties' respective legal systems. Such limited uniformity allows arbitral tribunals to apply rules that are common to those legal systems.

147. Stoecker, *supra* note 16, at 101 (stating that "[t]he idea behind such a uniform law [transnational law] is to get around the conflict of law question as there is only supposed to be one possible law to apply").

148. The success of the UNIDROIT Principles is sometimes attributed to their substantive "neutrality." *See* Berger, *supra* note 22.

149. Ole Lando, *The Lex Mercatoria in International Commercial Arbitration*, 34 INT'L & COMP. L.Q. 747, 748 (1985).

150. *Id.* at 753. Lando demonstrates the usefulness of the recourse to transnational law by the example of a sale of goods contract concluded between a Danish seller and a German buyer, showing that it allows arbitrators to avoid the excessively restrictive Danish law provision.

151. *See* Lowenfeld, *supra* note 91, at 138.

If arbitral tribunals have been successful in formulating and applying rules of transnational law, their ability to do so has rested, at least in part, on a favorable legislative context (in a broad sense): on the one hand, arbitral tribunals have benefited from the formal recognition by domestic legislators of their right to have recourse to such rules; on the other hand, they have taken advantage of the availability of sets of transnational rules elaborated by formulating agencies. Arbitral tribunals, therefore, not only have the *right*, but also improved *means*, to apply transnational law.

The recognition of the right of arbitrators to apply transnational law forms part of the general legislative tendency to increase arbitral "autonomy."[152] The acceptance of such autonomy has allowed arbitral tribunals (and parties) to largely escape State interference during the various stages of the arbitral proceedings (conclusion of the arbitration agreement, conduct of the proceedings, and enforcement of the award). It has also granted arbitral tribunals increasing autonomy with regard to the determination of the applicable substantive law and opened the door to the application of transnational law.

Although arbitral tribunals have had recourse to rules of transnational law prior to such enactments, their power to do so has been officially recognized by a number of arbitration statutes adopted since the early 1980s.[153] Those laws have empowered arbitral tribunals to apply the "rules of law" that they consider appropriate, an expression that has signaled acceptance of transnational law. The most recent versions of the rules of the major arbitration institutions, including the ICC, LCIA, and AAA, confirm this trend.[154] The courts of numerous countries have enforced arbitration awards based on *lex mercatoria*.[155]

Although numerous contemporary arbitration laws grant arbitral tribunals the right to apply transnational law, they do not provide any guidance as to what transnational law consists of or how it can be determined. Arbitrators are thus faced with the difficult task of "identifying" or "formulating" rules of transnational law. This task has been facilitated by the works of a number of governmental (such as UNCITRAL and UNIDROIT) and non-governmental (such as the International Chamber of Commerce) institutions pursuing the progressive unification of the law of international trade.[156] Indeed, the efforts of those institutions have led to the adoption of legal texts formulating or codifying

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152. *See* PETSCHE, *supra* note 21.

153. *See* Article 1496 of the French N.C.P.C ; Swiss PIL, *supra* note 110, art. 187(1); Wetboek van Burgerlijke Rechtsvordering (Dutch Code of Civil Procedure), art. 1054(2); and Article 813 of the Lebanese Nouveau Code de Procédure Civile.

154. *Supra* note 113.

155. *See* Rivkin, *supra* note 145 (examining more particularly enforceability of *lex mercatoria* awards in the UK, France, and the United States).

156. *See* Franco Ferrari, *Defining the Sphere of Application of the 1994 "UNIDROIT Principles of International Commercial Contracts"*, 69 TUL. L. REV. 1225 (1995).

uniform legal rules or usages, whether confined to a particular type of transaction or of more general application.

Actual Application of Transnational Law

Arbitral tribunals have resorted to transnational law in the absence of a choice of law by the parties. They have sometimes applied transnational law without further specifying the nature or origin of the rules concerned. More often, they have applied particular "branches" of transnational law, including notably the *tronc commun*, general principles of law, transnational law codifications such as the UNIDROIT Principles, and trade usages. Interestingly, arbitral tribunals have applied transnational law not only in the absence of a choice-of-law clause concluded by the parties, but also when the parties expressly submitted their agreement to a particular domestic law.

Arbitral choice-of-law determinations selecting *lex mercatoria* as the applicable law in the absence of a party choice date back at least to the late 1970's.[157] Since then, numerous tribunals have found the application of transnational law to be the most appropriate solution in an international context.[158] They have sometimes construed the parties' failure to agree on the applicable law as an indicator of the parties' intention not to subject their agreement to any domestic law.[159] Some tribunals have even affirmed that the application of *lex mercatoria* is the "only possible solution" in an international context.[160] Others have taken a more conservative approach and chosen to apply transnational law in conjunction with domestic law or laws.[161]

Arbitrators have quite frequently resorted to the so-called *tronc commun* method,[162] an approach consisting of the cumulative application of the

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157. *See* Award, Nov. 3, 1977, 1980 REV. ARB. 560. It should however be observed that, in this case, the arbitrators were acting as *amiables compositeurs*.

158. *See, e.g.*, ICC Case No. 3540 (award of Oct. 3, 1980), Y.B. COM. ARB. VOL. VII 124 (1982); ICC Case No. 3131 (the "Norsolor" case), Y.B. COM. ARB. VOL. IX 109 (1984); ICC Case No. 5953 (partial award of Sept. 1, 1988), 1990 REV. ARB. 701; ICC Case No. 8486, Y.B. COM. ARB. VOL. XXIVA 162 (1999); ICC Case No. 9246 (award of Mar. 8, 1996), Y.B. COM. ARB. VOL. XXII 28 (1997).

159. ICC Case No. 3131, Y.B. COM. ARB. VOL. IX, *supra* note 158, at 110 (holding that in the absence of a choice-of-law clause, the drafting of the parties' agreement did not reveal a sufficiently clear intent to "localize" the contract).

160. ICC Case No. 5953, *supra* note 158, at 712.

161. *See* ICC Case No. 3540, *supra* note 158, at 129 (the arbitral tribunal states that it will examine whether "the solution contained in its award based on the *lex mercatoria*… would be fundamentally different from national law"); ICC Case No. 8486, Y.B. COM. ARB. VOL. XXIVA, *supra* 158 (applying Dutch law in light of the UNIDROIT Principles and international contractual and arbitral practice).

162. On the *tronc commun* doctrine in general, see Ancel, *The Tronc Commun Doctrine: Logics and Experience in International Arbitration*, 7 J.INT.ARB. 3, 65 (1990);

parties' respective laws. The *tronc commun* method has proven particularly useful in the context of State contracts since the unbalance between the respective positions of the parties increases the need for substantive neutrality.[163] As the well-known *Aminoil* arbitration illustrates,[164] considerations of substantive neutrality have sometimes prompted parties to contractually provide for the application of rules common to their respective legal systems.[165]

The *tronc commun* method has also been resorted to by arbitral tribunals deciding disputes between private parties. Arbitral tribunals have, for example, decided to apply the rules common to Belgian and Italian law in a dispute involving an Italian patent holder and a Belgian manufacturer,[166] the rules common to Yugoslav and German law in a dispute involving a commercial agency agreement concluded between a German and a Yugoslav party,[167] and the rules common to French and Tunisian law in a dispute between several European buyers and a number of Tunisian sellers.[168]

Despite its apparent simplicity, the practical application of the *tronc commun* method can be problematic. Indeed, the relevant rules of the legal systems concerned may be dissimilar and it may thus be impossible to determine any "common rules" to solve a particular legal question. This is why arbitral tribunals frequently decide to apply the *tronc commun* only once they have established that the relevant rules are in fact identical. The practical difficulties associated with the *tronc commun* method, as well as the growing availability of transnational law codifications, have caused arbitral tribunals to be increasingly reluctant to follow this approach.

In a number of cases, arbitral tribunals have decided to apply transnational law in the form of general principles of law or as a body of norms potentially comprising various sources of transnational law. In a case reported by Derains, an ICC Tribunal hearing a dispute between a Japanese manufacturer and a Middle Eastern distributor, decided that the parties' contract should be governed by "principles of international business

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Rubino-Sammartano, *Le Tronc Commun des lois nationales en présence (réflexion sur le droit applicable par l'arbitre international)*, 1987 CLUNET 133 (1987).

163. *See* Rivkin, *supra* note 145, at 67 (stating that "in contracts between a private company and a governmental entity, no state law is likely to be ideal").

164. Kuwait v. American Independent Oil Co. (Aminoil), 21 I.L.M 976 (Mar. 1984).

165. In this case, the parties had agreed that their agreements should be governed by "principles common to the laws of Kuwait and of the State of New York" and, in the absence of such common principles, by "the principles of law normally recognized by civilized states."

166. ICC Case No. 2272, COLLECTION OF ICC ARBITRAL AWARDS 1974–1985, *supra* note 125, at 11.

167. ICC Case No. 2886, COLLECTION OF ICC ARBITRAL AWARDS 1974–1985, *supra* note 125, at 332.

168. ICC Case No. 5103, COLLECTION OF ICC ARBITRAL AWARDS 1986–1990, *supra* note 107, at 361.

law."[169] In a 1995 decision, another ICC Tribunal decided to apply "what is more and more called *lex mercatoria*" on the grounds that "the application of international principles of law offers many advantages" and that such principles "take into account the particular needs of international relations."[170]

Since their adoption in 1994, arbitral tribunals have on numerous occasions applied, or referred to, the UNIDROIT Principles. Although scholars and arbitral tribunals are divided on the question of whether those Principles constitute transnational law strictly speaking,[171] a number of tribunals have held that the parties' agreement shall be governed by those Principles, either exclusively or in combination with other sources of transnational law. Arbitral tribunals have also resorted to the Principles as a means of interpreting and supplementing the applicable domestic law.[172]

Although they are relevant only for a limited number of aspects of an international business relationship, trade usages constitute a vital part of transnational law. In fact, arbitral tribunals frequently decide issues brought before them on the basis of such usages. According to experienced arbitrators, trade usages and practices play a significant role in the majority of international business disputes.[173] Those international customs and usages are subject to a codification process similar to the one characterizing other "branches" of transnational law.

Arbitral tribunals have applied rules of transnational law not only in the absence of a choice-of-law clause concluded by the parties, but sometimes

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169. Derains, *supra* note 59, at 43, 47.

170. THE PRACTICE OF TRANSNATIONAL LAW 228 (Klaus Peter Berger ed., 2001) (quoting ICC Case No. 8385).

171. This is mainly due to the fact that the UNIDROIT Principles do not only aim to codify existing general principles of contract law, but also to lay down rules that their drafters considered as particularly appropriate in an international context, even if such rules are not, or not yet, widely recognized. Authors who take the view that the Principles form part of *lex mercatoria* include, for example, Lalive. *See* P. Lalive, *L'arbitrage international et les Principes UNIDROIT*, *in* CONTRATTI COMMERCIALI INTERNAZIONALI E PRINCIPI UNIDROIT 71, 80 (M. Bonell & F. Bonelli eds., 1997). The opposite view is expressed, for example, by van Houtte. *See* Hans van Houtte, *UNIDROIT Principles of International Commercial Contracts and International Commercial Arbitration: Their Reciprocal Relevance*, *in* UNIDROIT PRINCIPLES FOR INTERNATIONAL COMMERCIAL CONTRACTS: A NEW LEX MERCATORIA?, ICC Publication No. 490/1, at 181, 184 (1995). Arbitral awards holding that the UNIDROIT Principles constitute a source of transnational law include, for example, ICC Case No. 7110 (partial awards), 10(2) ICC BULL. 39 (1999) and ICC Case No. 8261, 1 UNIFORM L. REV. 171 (1999). For a decision implying that the UNIDROIT Principles do not yet constitute transnational law, see ICC Case No. 7375, 2 UNIFORM L. REV. 598 (1997).

172. François Dessemontet, *L'utilisation des Principes UNIDROIT dans le cadre de la pratique contractuelle et de l'activité arbitrale—L'exemple de la Suisse*, *in* THE UNIDROIT PRINCIPLES 2004: THEIR IMPACT ON CONTRACTUAL PRACTICE, JURISPRUDENCE AND CODIFICATION 159, 161 (Eleanor Cashin Ritaine & Eva Lein eds., 2007).

173. *See, e.g.*, Aksen, *supra* note 56, at 470 (stating that "in almost every international arbitration experience . . . custom and usage has played a prominent part in deciding the substance of the dispute").

also where the parties have selected the applicable law. According to Derains, arbitrators do so in order to fill gaps or supplement the applicable domestic law.[174] In both cases, such an application of transnational law rules is in reality unnecessary and, strictly speaking, legally wrong. However, it illustrates the growing acceptance of the idea that transnational law is the most appropriate body of law to govern international commercial relationships.

Arbitral tribunals arguably resort to transnational law principles in order to "fill gaps" in the applicable domestic law. This point of view is debatable. In fact, each domestic legal system contains rules governing gap-filling,[175] and recourse to transnational rules does not appear to be necessary. Moreover, the idea that the general and rather vague principles of transnational law should provide answers to questions that are left open in domestic legal systems (which contain infinitely more detailed norms) is puzzling. As one of the examples provided by Derains illustrates,[176] the reality of the gap-filling function of transnational law is slightly different: arbitral tribunals rely on rules of transnational law, despite the fact that they could have resorted to domestic rules having a comparable legal effect.

Similarly, when arbitrators "supplement" the applicable domestic law, they apply a transnational rule that is identical or similar to a domestic rule. They would, for example, apply the "general principle of international business law"[177] according to which parties have to perform a contract in good faith, rather than refer to the good faith principle found in the applicable domestic law. This "preference" for transnational law indicates that arbitral tribunals, and probably also parties to international business disputes, perceive the application of transnational law as more legitimate than the application of a particular domestic law. It provides additional support for the view that transnational law constitutes the most appropriate body of rules for international commercial transactions.

CONCLUSION

The traditional conflict of laws method undeniably fails adequately to respond to the specific normative requirements of international commercial transactions. The principal weaknesses of the conflict method include the limited predictability and questionable fairness of its choice-of-law determinations and, more fundamentally, the inadequacy of the applicable

174. Derains, *supra* note 59, at 48.

175. *See* NICOLE KORNET, CONTRACT INTERPRETATION AND GAP FILLING: COMPARATIVE AND THEORETICAL APPROACHES (2006).

176. Derains provides the example of arbitral tribunals applying the transnational rule according to which a party is under a duty to mitigate damages, although they could have applied the French law notion of causality in order to reach the same result. *See* Derains, *supra* note 59, at 49.

177. *Id*.

(domestic) substantive law. As I have shown, international arbitral tribunals, which constitute the preferred fora for international business dispute resolution, have managed successfully to address part of these defects by developing a series of innovative methodological approaches. On the one hand, they have introduced "adjustments" to the classical conflict method and formulated new conflict rules (cumulative application of the conflict norms involved, application of general principles of conflict of laws etc.). On the other hand, they have occasionally rejected the basic precept of the conflict approach — which is the solving of a "conflict" between competing laws and the selection of the applicable law — by applying transnational law to the merits of the dispute, rather than a particular domestic law.

For the purposes of this article, the analysis ends here. However, the observations and conclusions that I have formulated may give rise to additional questions, which may be the subject of further reflection. First, one may ask whether the conflict of laws evolution that has taken place in the context of international commercial arbitration will eventually affect the way in which domestic State courts handle conflict issues. If the more flexible approaches elaborated by arbitral tribunals are indeed superior to the classical method, then domestic courts hearing international commercial disputes may be inclined to follow suit. Second, adopting a more critical view of arbitral choice-of law determinations, one may ask whether, and to what extent, the increased discretion that arbitral tribunals are enjoying with respect to conflict of laws issues leads to arbitrary decisions, rather than rulings that aim to improve predictability, fairness, and substantive adequacy.