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In support of *lex mercatoria*

Ercüment Erdem and Ceyda Süral of Erdem & Erdem Law Office discuss the merits of *lex mercatoria* in international arbitration

The *lex mercatoria* is a unique set of rules for international commercial law, independent of national laws and directly arising out of the usages and practices of international commerce.

The *lex mercatoria* has been created by, and for, the participants in international trade and is applied by arbitrators to settle international trade disputes. The binding nature of *lex mercatoria* does not stem from the sovereign power of a state, but from its recognition as an independent set of rules by the commercial community and sovereign states.

The *lex mercatoria* draws from usages developed in international trade, standard clauses and contracts, uniform laws, general principles of law (such as *pacta sunt servanda*, *rebus sic stantibus* and the deduction from compensation in cases of mutual fault), international instruments and arbitral awards (the principles of good faith, the obligation to mitigate losses, *rebus sic stantibus* and *pacta sunt servanda* are the general principles that are most widely referred to in the ICC arbitral awards).

The existence and impact of *lex mercatoria* is accepted in contemporary international commercial law, while modernised and revised national rules relating to international commercial arbitration and the conflict of laws is helping to increase the influence and application of the *lex mercatoria*.

**Party autonomy rules**

All modern national arbitration laws and institutional arbitration rules recognise party autonomy; parties are free to determine the substantive law applicable to the merits of the dispute to be resolved by arbitration.

It is accepted in the doctrine and in practice, that the arbitrators may apply non-national substantive rules, such as the *lex mercatoria*. The shift from a national substantive law to the application of international commercial law is heralded by the use of the expression “rules of law” that can be found in modern arbitration laws and rules. This provision allows the parties or the arbitrators to choose non-national rules or the *lex mercatoria*.

According to Article 28(1) of the Uncitral Model Law on International Commercial Arbitration: “The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute.”

According to Article 46(1) of the English Arbitration Act: “The arbitral tribunal shall decide the dispute (a) in accordance with the law chosen by the parties as applicable to the substance of the dispute, or (b) if the parties so agree, in accordance with such other considerations as are agreed by them or determined by the tribunal.”

The relevant provisions of procedural laws of the Netherlands, France, Germany, Russia and Italy are in line with the Uncitral Model Law.

According to Article 187(1) of the Swiss Private International Law Act: “The arbitral tribunal shall decide according to the rules of law chosen by the parties.”

In Turkish law, according to Article 12/C of the International Arbitration Act, the arbitrator or the arbitral tribunal shall decide according to the provisions of the contract between the parties and the “rules of law” that are chosen by the parties as applicable law to the substance of the dispute.

According to Article 17(1) of the ICC Arbitration Rules: “The parties shall be free to agree upon the rules of law to be applied by the Arbitral Tribunal to the merits of the dispute.”

According to Article 22.3 of the London Court of Arbitration Rules: “The Arbitral Tribunal shall decide the parties’ dispute in accordance with the law(s) or rules of law chosen by the parties as applicable to the merits of their dispute.”

According to Article 24(1) of the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce: “The Arbitral Tribunal shall decide the merits of the dispute on the basis of the law or rules of law agreed by the parties.”

In ICC arbitration, the arbitrators directly applied the *lex mercatoria* in the cases where the parties have not made any choice of law even in the seventies. However, the *lex mercatoria* was first directly used following agreement of the parties in a case from 1989 (numbered 5904). The subject matter of the case was a serial purchase order conducted by a distributor located in a developing country from a European supplier.

**Arbitrator’s choice**

The traditional method, the application of conflict rules of the place of arbitration, has been left aside by modern national arbitration laws.

Article VII of the European Convention on International Commercial Arbitration provides for a freedom of conflict of laws system in international commercial arbitration. According to Article VII(1) of the European Convention: “Failing any indication by the parties as to the applicable law, the arbitrators shall apply the proper law under the rule of conflict that the arbitrators deem applicable.”

The approach of the European Convention has been adopted by the Uncitral Model Law and followed by many arbitration laws, including English and German laws.

According to Uncitral Model Law on International Commercial Arbitration Article 28(2): “Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.”

Some national arbitration laws authorise the arbitrators to directly apply the rules they deem applicable without any reference to conflict of laws rules. Swiss, French, Dutch and Canadian laws can be given as examples.

Modern institutional arbitration rules accept the method of direct determination of applicable substantive law. Direct determination allows a tribunal to select the applicable substantive law or rules relevant for the particular case without reference to any conflict of laws rules.

According to Article 17(1) of the ICC Arbitration Rules: “In the absence of any such agreement [by the parties], the Arbitral Tribunal shall apply the rules of law which it determines to be appropriate.”

According to Article 22.3 of the London Court of Arbitration Rules: “If and to the extent that the Arbitral Tribunal determines that the parties have made no such choice, the Arbitral Tribunal shall apply the law(s) or rules of law which it considers appropriate.”

“Quote”

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According to Article 24(1) of the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce: “In the absence of such an agreement [by the parties], the Arbitral Tribunal shall apply the law or rules of law which it considers to be most appropriate.”

The application of non-national rules of law or the lex mercatoria, in the absence of the choice of law by the parties, is not yet accepted by some national arbitration laws. Pursuant to the dominant view, it is not fortuitous that the Uncitral Model Law uses the term “law” instead of “rules of law”. The purpose of this wording is to ensure the application of national laws by the arbitrators. There is a similar distinction in some of the arbitration regulations.

According to Article 46(3) of the English Arbitration Act: “If or to the extent that there is no such choice or agreement, the tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.”

According to Article 12/C of the Turkish International Arbitration Act, in the absence of the choice of law by the parties, the arbitrators shall decide according to the “law of the country” with which the dispute is most closely connected with.

On the other hand, there is no similar distinction in some national arbitration laws. French, Dutch and Italian Law of Procedure Acts and Swiss Private International Law Act provide that the arbitrators may apply the appropriate “rules of law” in the absence of the choice of law by the parties. The most significant institutional arbitration rules also provide that the arbitrators may apply the “rules of law” as applicable law.

Using lex mercatoria

Indeed, in international commercial arbitration there is no need to localise legal issues, as many transactions and legal relationships have contacts with several jurisdictions and are truly international or de-nationalised. Thus, it is appropriate for arbitrators to find some international or non-national rules or practice appropriate to the question at hand rather than apply a conventional national law. The most closely connected law shall be the rules of law whose content is appropriate to the needs of international commerce, that resolves the validity of the contract between the parties, and that recognise the legal concepts used by the parties in their contracts, instead of necessarily having a geographical connection to the dispute.

The restriction of application of non-national rules of law or the lex mercatoria is not consistent with the nature of commercial international arbitration. Such freedom to apply non-national rules of law or the lex mercatoria actually constitute one of the advantages of international commercial arbitration along with its many other advantages from the point of view of the international merchants.

Thus, the relevant provision of the Turkish International Arbitration Act falls behind the modern theories and forms an impediment before the progress of contemporary international arbitration culture and practice in Turkey. The relevant provision shall be revised in line with the modern views.

Ercüment Erdem
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Ercüment Erdem is the senior partner of the firm. He specialises in commercial law (international and national), energy law, project finance (including BOO and BOT models), capital markets law, contracts, corporate law, privatisation law, international commercial arbitration, corporate finance, law of obligations, private international law, industrial property law, law of trade marks and copyright, competition law, international leasing, mergers and acquisitions, and international construction law.

He is also Professor of Commercial Law at Galatasaray University Law School (Istanbul) and he teaches law of negotiable instruments, corporate law, competition law and international commercial law. He speaks French, English and German.

Memberships: Istanbul Bar Association; ICC Institute Council; ICC Incoterms Experts Group; ICC Turkish National Committee Arbitration Council; Representative of Turkey in ICC Commercial Law and Practice Commission; member of several ICC task forces; Association Henri Capitant des amis de la culture juridique française; Banking and Commercial Law Institute; Competition Law Association.

Author biography