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Swimming in deep waters: choosing to arbitrate under non-national rules of law — and/or the UNIDROIT principles

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All international commercial law practitioners are familiar with governing law clauses. In the vast (if not prohibitive) majority of cases, a governing law clause states that the parties' contractual relationship is to be governed by reference to a defined system of national law — e.g., New York law, English law or Delaware law.

The clause is usually coupled with a forum clause that directs that disputes be adjudicated in a particular setting — either the courts of a particular country, or arbitration under a particular set of rules (e.g., ICC, AAA-ICDR, LCIA or JAMS). Drafters of these clauses usually eschew innovation, preferring the predictability of the systems, and dispute forums, that have been used in the past.

There have been several arbitral cases where a contract selected the UNIDROIT Principles, and arbitrators have applied them accordingly.

Every now and again, however, one stumbles upon clauses (or reads a past case) where more adventurous choices have been made. Sometimes it is in the choice of a little-used arbitral institution or seat. Sometimes it is in the choice of a little-used national law. Sometimes — and this is the focus of this article — it is where the drafters have abandoned the concept of national governing law entirely.

What happens when the parties choose a non-national governing law, or a set of non-national rules as their system of governing law? Why are such cases rare, and what practical factors might ordinarily deter parties from doing so? And do new "transnational law" codifications, such as the UNIDROIT Principles of International Commercial Law, offer parties a workable alternative to national law?

Sherlock Holmes once remarked, when presented with a new and complex case, "These are very deep waters." In the same vein, practitioners who abandon a "conventional" choice of law in favor of a non-national system (even one as sophisticated as the UNIDROIT Principles), can find themselves facing some complex issues.

The choice of non-national rules of law and the debate over "lex mercatoria"

From time to time, contracting parties (particularly in international commerce) have been known to elect for their contract to be governed not by a given national system of law, but by "general principles of law," "the usages of international trade" or a looser formula (e.g., "principles of justice."). In legal literature, some refer to this as "lex mercatoria" (although some think that "lex mercatoria" refers to a sub-set of rules concerning international trade).

In furtherance of this concept, there was published in 1994 a set of rules known as the UNIDROIT Principles of International Commercial Contracts.[1]

Drafted by an international team of commercial law experts from the International Institute for the Unification of Private Law (UNIDROIT), an international body that aims to harmonize private law and promote "uniform rules of private law," the UNIDROIT Principles form a code of contract law that (to quote their recitals) "may be applied when the parties have agreed that their contract be governed by general principles of law, the lex mercatoria or the like."

As explained by Professor Eckart Brödermann, in his leading text *UNIDROIT Principles of International Commercial Contracts: An Article-by-Article Commentary* (2018), they aim to be a "neutral legal regime of choice in international contracts."

Very typically, a contract that chooses non-national rules of law (whether via the UNIDROIT Principles or via a choice of "general principles of law") will also contain an arbitration clause. This might even be thought essential — as some national courts might not even be capable (constitutionally or temperamentally) of applying "non-national" law to a dispute.

It is important to distinguish the choice of a "non-national" system of law from cases where parties simply fail to specify a governing law. In such circumstances, courts or arbitrators may seek to ascertain the governing law by applying appropriate choice of law rules — in a U.S.-seated arbitration, paragraph 188 of the U.S. Restatement (Second) on Conflicts of Laws (directing the choice of the law with the "most significant relationship to the transaction and the parties").

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Also distinguishable are arbitration clauses calling for application of a religious law, or authorizing the arbitrators to decide "ex aequo et bono" and/or as "amiable compositeur."

There are also cases where parties sometimes confer specific powers on arbitral tribunals that go beyond mere adjudication of contract rights and include, for example, readjusting price formulae. Such clauses can raise interesting issues, but are not truly "non-national" choice of law clauses.

Will an arbitrator recognize a choice of "general principles of law" or UNIDROIT principles?

The history of arbitration involving "non-national" law is rather patchy, owing to the variety of ways in which parties have framed their contracts. Nevertheless, there are reported cases where arbitrators upheld and applied such clauses.

The drafters of the UNIDROIT Principles sought to reduce uncertainties, and eliminate gaps, by covering the entire field of contract law.

A number of mid-20th century oil concessions with non-Western countries provided that the rights of the oil operator were to be governed by "principles of natural justice and equity" and/or "general principles of law."

In two arbitration decisions from the 1950s involving Qatari oil concessions, and one other from the 1960s (the *Sapphire* case) involving Iran's national oil company, the arbitrators construed these contracts as validly importing transnational legal principles such as "*pacta sunt servanda*" (agreements must be kept) or the principle that, in the event a contract is cancelled, that the innocent party is entitled to damages for the lost value of performance.

Similar issues arose in the early 1970s, when Libyan dictator Colonel Muammar al-Qaddafi terminated the concessions of Western oil companies.

These concessions, which included an arbitration clause, also stated that the parties' agreement would be governed by "*the principles of law of Libya common to the principles of international law and in the absence of such common principles... then by and in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals.*"

In one of the ensuing arbitrations, *BP Exploration Co. (Libya) Ltd. v. Libyan Arab Republic*,[2] the arbitrator found that the parties' rights were to be determined according to "general principles of law," leading to an award for damages for wrongful termination of contract.

More recently, there have been several arbitral cases — as reported on the website "UNILEX.info" — where a contract selected the UNIDROIT Principles, and arbitrators have applied them accordingly in their award. Indeed, there are even a few cases where a vague non-national formula led to the arbitrators applying the UNIDROIT Principles.

This suggests that, when presented with a non-national clause, international arbitrators will seek, when possible, to give effect to it. This is arguably consistent with modern arbitral rules such as the International Chamber of Commerce Arbitration rules, which state that "[t]he parties shall be free to agree upon the rules of law to be applied by the arbitral tribunal to the merits of the dispute."

Indeed, one commentator, Professor Klaus-Peter Berger of Germany, has argued out that the phrase "rules of law" (which is broader than the simple word "law") allows for the adoption of transnational legal rules as the governing law of the contract.

At the same time, there remains a vigorous debate as to whether "transnational law" (whether expressed as "lex mercatoria" or "general principles of law") can even be said to exist. One proponent of this view, the late Professor Emanuel Gaillard, argued in 2001 that one can view "transnational law" "as a method of decision-making" under which arbitrators "will determine," using "comparative law sources" whether a particular asserted legal position is "supported by a widely accepted rule, or whether they merely reflect the idiosyncrasies of one legal system, in which case they should be rejected."

By contrast, Professor Sir Roy Goode of Oxford University, speaking at a public lecture in 2004, expressed skepticism at the notion that there could be "spontaneous international law-making through international trade usage" by such means as "rules of trade associations, standard-term contracts and general principles and rules and restatements formulated by international agencies."

He reiterated that " [n]o contract can speak to its own validity and no legal system allows complete freedom to contracting parties, whose agreement is everywhere bounded by rules of public policy and mandatory rules." For Goode, arbitrators did not create "law" — to the contrary, he quoted the words of another renowned expert, F.A. Mann, "*lex facit arbitrum*."

For many parties, as long as arbitrators are willing accept and apply the UNIDROIT Principles or "general principles of law," this debate may be viewed as purely academic. But for lawyers, the very fact of the controversy gives a hint that the use of non-national rules of law is not without its complications.

Problems in choosing non-national rules of law and/or the UNIDROIT principles

The use of a "non-national" set of rules of law has a certain seductive appeal, and the proponents of the UNIDROIT Principles have sung its praises very loudly. Yet, even assuming that this choice of law will be faithfully applied by an arbitral tribunal, in the long run, one can never completely escape national law. Mandatory laws (e.g., on contractual capacity, and/or on matters of public policy, such as antitrust law, anti-bribery law, and/or securities law) will still have a potential relevance to the dispute.

Moreover, a clause that merely chooses a "general principles of law" clause will thus inevitably leave gaps that will need to be filled somehow — for example, in determining limitations periods, in the

calculation of damages, or even in mundane matters such as the calculation of pre-award interest. Finding a means of "gap filling" will be a challenge for arbitrators and counsel alike and is likely to lead to extensive briefing in the arbitration.

The drafters of the UNIDROIT Principles sought to reduce these uncertainties, and eliminate gaps, by covering the entire field of contract law, from formation[3] to interpretation[4] to standards of performance[5] and what constitutes breach[6] and then to the consequences of breach, including possible termination[7] and damages.[8]

Precisely because the UNIDROIT Principles are a synthesis of different legal traditions, they contain some features that may be unfamiliar, or even shocking, to lawyers who deal only with one legal system.

The UNIDROIT Principles[9] also has a section dealing with limitation periods — including a three-year "general limitation" (commencing with the putative claimant acquiring knowledge of the relevant "facts"), *plus* a 10-year "maximum."

But there remain traps for the unwary. Precisely because the UNIDROIT Principles are a synthesis of different legal traditions, they contain some features that may be unfamiliar, or even shocking, to lawyers who deal only with one legal system.

Moreover, in codifying the law, the drafters have had to make some policy choices that are materially different from those adopted in "major" commercial law systems — including some principles that are quite distinct from common law precepts.

As but a few examples of potentially surprising features of the UNIDROIT Principles:

- The UNIDROIT Principles has a series of rules concerning the grounds for avoiding a contract, including being based upon unconscionability/"gross disparity" or "threat,"[10] most of which differ from the position in common law countries, where such doctrines either do not exist or are narrowly construed in commercial settings.
- The UNIDROIT Principles[11] treat "long-term contracts" as subject to special treatment, whereas the common law largely treats contracts as the same, regardless of their duration.
- Article 6.2.3 of the UNIDROIT Principles has a series of provisions allowing "renegotiation" in the case of "hardship," which represents a departure from common law principles.
- In cases of breach, the UNIDROIT Principles[12] has very specific rules about the breaching party's opportunity to "cure any non-performance," which is "not precluded" by a "notice of termination." In the common law, this subject-matter is not prescribed as a matter of law — parties can provide for (or preclude) a "cure" right in the contract as they see fit.
- The UNIDROIT Principles has a body of rules for "force majeure"[13] a topic that, within the common law world, is sometimes dealt with specifically in the body of an individual contract, and sometimes regulated by the laws regarding frustration or impossibility.

Furthermore, despite the codification effort, the UNIDROIT Principles expressly leave open the possible application of national rules: they state[14] that "[n]othing in these Principles shall restrict the application of mandatory rules, whether of national, international or supranational origin, which are applicable in accordance with the relevant rules of private international law."

This reflects that there are policy areas (e.g., antitrust law, consumer law, and securities law) where national law may continue to play a real role in commercial disputes. As this provision states, however, it will be the task of the arbitrators to determine what "rules of private international law" are applicable to the dispute — a point that could well prove controversial when argued in practice.

One can thus see that, before a commercial law practitioner recommends the UNIDROIT Principles to a client, he or she may need to explain, in some detail, the features of the UNIDROIT Principles that depart from the "norm" of more familiar legal systems.

And for practitioners at most international law firms and in-house counsel at major corporations and banks, who often deal in "known" systems of law, the process of familiarizing oneself with the UNIDROIT Principles may take some considerable effort.

As can be seen, if a contract contains a non-national governing law clause, but also contains a valid submission to international arbitration, there is enough guidance in past precedent and arbitral literature to argue that the arbitrator should give effect to the choice. This is so even if the clause only calls, in vague terms, for "general principles of law" to be followed.

And if the parties want to choose a non-national system, but prefer a "codified" system of law, the UNIDROIT Principles do offer parties a relatively sophisticated and thoughtful set of contract rules, which may, in various situations, be found attractive.

But, as noted above, the UNIDROIT Principles, by the very act of codifying a set of contract principles, has managed to be highly prescriptive in certain policy areas (e.g., force majeure, limitations periods and hardship), with results that may be surprising, and even out of the "mainstream" of major commercial law systems. These can be deep waters indeed.

Notes

[1] https://bit.ly/3CiLWcY

[2] 53 I.L.R. 297 (Oct. 10, 1973).

[3] Arts. 2.1.1-13.

[4] Arts. 4.1-4.8.

[5] Arts. 6.1.1-6.1.17.

[6] Arts. 7.1.1-7.1.3, 7.2.1-7.2.2.

[7] Arts. 7.3.1-7.3.7.

[8] Arts. 7.4.1-7.4.13.

[9] Art. 10.

[10] Arts. 3.2.6, 3.2.7.

[11] Art. 7.3.7.

[12] Art. 7.1.4.

[13] Art. 7.1.7.

[14] In article 1.4.

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