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Citation:

J. H. Dalhuisen, Legal Orders and Their Manifestation:  
The Operation of the International Commercial and  
Financial Legal Order and Its Lex Mercatoria, 24  
Berkeley J. Int'l L. 129 (2006)

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Wed Apr 24 11:25:38 2019

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# Legal Orders and Their Manifestation: The Operation of the International Commercial and Financial Legal Order and Its Lex Mercatoria

By  
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## I. INTRODUCTION

The emergence and content of a spontaneous new transnational law merchant, or *lex mercatoria*, substantially covering all international commercial and financial transactions remain contentious. At least in Europe, there now exists a sufficient, largely positive body of legal literature on the subject.<sup>1</sup> So far there

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This article grew out of presentations made at Duke University School of Law in the Spring of 2003 and at the Institute of Advanced Legal Studies in London in the Spring of 2004.

1. The most important early advocate was Berthold Goldman. See Berthold Goldman, *La lex mercatoria dans les contrats et arbitrage internationaux: realite et perspectives*, 106 J. DROIT INTERNATIONALE 475 (1979); B. Goldman, *Lex Mercatoria*, in 3 FORUM INTERNATIONALE (1983); B. Goldman, *The Applicable Law: General Principles of Law—the Lex Mercatoria*, in CONTEMPORARY PROBLEMS IN INTERNATIONAL ARBITRATION 113 (J. Lew ed., 1986); B. Goldman, *Lex Mercatoria and Arbitration: Discussion of the New Law Merchant*, in TRANSNATIONAL JURIS PUBLICATIONS INC., (Thomas E. Carbonneau ed., 1990); B. Goldman, *Nouvelles reflexions sur la Lex Mercatoria*, in ÉTUDES DE DROIT INTERNATIONAL EN L'HONNEUR DE PIERRE LALIVE 241 (Helbing & Lichtenhahn SA, eds. 1993).

The long-standing relative popularity of the *lex mercatoria* in France may be seen in light of the earlier development in that country of the notion of the 'international contract' operating under its own internationalized rules. It was particularly relevant for the validity of gold clauses that were upheld in these international contracts (but not in domestic French contracts) in the 1930s. See G.R. DELAUME, TRANSNATIONAL CONTRACTS 119 (1989).

For early interest in the notion of the new *lex mercatoria* in England, see CLIVE M. SCHMITTHOFF, INTERNATIONAL BUSINESS LAW: A NEW LAW MERCHANT, CURRENT LAW AND SOCIAL PROBLEMS 129 (1961); C. Schmitthoff, *International Trade Law and Private International*

is less interest in the US.<sup>2</sup> Case law, insofar as there is any, remains cautious.<sup>3</sup>

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*Law*, in VOM DEUTSCHEN ZUM EUROPÄISCHEN RECHT, 2 FESTSCHRIFT HANS DOELLE 261 (1963); C. Schmitthoff, *The Unification of the Law of International Trade*, J. BUS. L. 109 (1968). For a compilation of his most important writings on the subject, see C. SCHMITTHOFF, SELECT ESSAYS ON INTERNATIONAL TRADE LAW (Chi-Jui Cheng ed., 1988).

In the UK, Lord Mustill has been particularly critical of the *lex mercatoria* as a transnational legal system and wondered where this new law could come from. See Lord Justice Mustill, *The New Lex Mercatoria*, in LIBER AMICORUM LORD WILBERFORCE 149 (Maarten Bos & Ian Brownlie eds., 1987); L.J. Mustill, *Contemporary Problems in International Commercial Arbitration*, 17 INT. BUS. L. 161 (1989).

The *lex mercatoria* found early support in Germany. See NORBERT HORN, DAS RECHT DER INTERNATIONALEN ANLEIHEN (1972); N. Horn, *A Uniform Approach to Eurobond Agreements*, 9 L. & POL'Y INT'L BUS. 753 (1977); N. Horn, *Uniformity and Diversity in the Law of International Commercial Contracts*, in THE TRANSNATIONAL LAW OF INTERNATIONAL COMMERCIAL TRANSACTIONS 3 (N. Horn & C. Schmitthoff eds., 1982).

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

There is a fair amount of other early literature reflecting on the topic. See EUGEN LANGEN, STUDIEN ZUM INTERNATIONALEN WIRTSCHAFTSRECHT (1963); PHILIPPE KAHN, LA VENTE COMMERCIALE INTERNATIONALE (1961); *Lex mercatoria et euro-obligation*, in LAW & INTERNATIONAL TRADE, 215 (Fritz Fabricius ed., 1973).

For a more recent discussion, see Andreas F. Lowenfeld, *Lex Mercatoria: An Arbitrator's View*, 6 ARB. INT'L 133 (1990). See also Roy Goode, *Usage and its Reception in Transnational Commercial Law*, 46 INT'L & COMP. L. Q. 1 (1997); L. Yves Fortier, *The New, New Lex Mercatoria, or, Back to the Future*, 17 ARB. INT'L 121 (2001); MARY ELIZABETH BASILE ET AL., LEX MERCATORIA AND LEGAL PLURALISM: A LATE THIRTEENTH CENTURY TREATISE AND ITS AFTERLIFE (1998); Joachim Mertens, *Lex Mercatoria: A Self-applying System Beyond National Law?*, in GLOBAL LAW WITHOUT A STATE 31 (G. Teubner ed., 1997); Emmanuel Gaillard, *Transnational Law: A Legal System or a Method of Decision Making?*, 17 ARB. INT'L 59 (2001). But cf. Pierre Mayer, *Reflections on the International Arbitrator's Duty to Apply the Law*, 17 ARB. INT'L 235 (2001) for greater skepticism.

For a more comprehensive recent elaboration in France, see the work of Philippe Fouchard, in particular PHILIPPE FOUCHARD ET AL., TRAITE DE L'ARBITRAGE COMMERCIAL INTERNATIONAL (1996). See also PHILIPPE FOUCHARD, L'ARBITRAGE COMMERCIAL INTERNATIONAL (1965); EMMANUEL GAILLARD & JOHN SAVAGE, FOUCHARD, GAILLARD, GOLDMAN ON INTERNATIONAL COMMERCIAL ARBITRATION (1999). For a recent overview, see also KLAUS PETER BERGER, THE CREEPING CODIFICATION OF THE LEX MERCATORIA (1999). For an earlier skeptical analysis, see FILIP DE LY, INTERNATIONAL BUSINESS LAW AND LEX MERCATORIA (1992).

For a fuller elaboration and academic discussion of the subject and in particular of the development of a hierarchy of sources of law within the modern *lex mercatoria*, see JAN DALHUISEN, DALHUISEN ON INTERNATIONAL COMMERCIAL, FINANCIAL AND TRADE LAW (2d ed. 2004), and for a more sociological approach, see Gunther Teubner, *Global Bukovina: Legal Pluralism in the World Society*, in GLOBAL LAW WITHOUT A STATE 3 (G. Teubner ed., 1997). See also G. Teubner, *Breaking Frames: The Golden Interplay of Legal and Social Systems*, 45 AM. J. COMP. L. 149 (1997); AUTOPOIETIC LAW: A NEW APPROACH TO LAW AND SOCIETY (G. Teubner ed., 1988).

2. But see Friedrich K. Juenger, *Private International Law or International Private Law?*, 5 KING'S COLLEGE L.J. (1994-95); F. K. Juenger, *The UNIDROIT Principles of Commercial Contracts and Inter-American Contract Choice of Law*, UNIVERSIDAD NACIONAL AUTONOMA DE MEXICO—UNIVERSIDAD PANAMERICANA 229-36 (1998); F. K. Juenger, *Conflict of Laws, Comparative Law and Civil Law: The Lex Mercatoria and Private International Law*, 60 LA. L. REV. 1133 (2000).

In the United States, the subject is also largely neglected in the more functional approaches to the law. But see Robert Cooter, *Structural Adjudication and the New Law Merchant: A Model for Decentralized Law*, 14 INT. REV. OF L. & ECON. 215 (1994); Robert Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U. PA. L. REV. 1643 (1996). See also J. E. Rauch, *Business and Social Networks in International Trade Law*, 34 J. ECON. LIT. 1177 (2001); and earlier Yves Dezalay & Bryant G. Garth, *Merchants of Law as*

*Moral Entrepreneurs: Constructing International Justice from the Competition for Transnational Business Disputes*, 29 LAW & SOC'Y REV. 27 (1995).

3. We know, however, from modern international arbitration practices that arbitrators are considered to be autonomous in determining the applicable rules of procedure, evidence and conflicts of laws. In the merits they may now also rely on general principles of law, which may cover *lex mercatoria* notions. Thus the LCIA and ICC Arbitration Rules in their newest form give arbitrators great freedom in the application of laws and in the use of transnational principles and practices. See ICC Rules of Arbitration, art. 17 (1998), available at <http://www.iccwbo.org/court/english/arbitration/rules.asp>; LCIA Arbitration Rules, art. 14(2) (1998), available at [http://www.lcia.org/ARB\\_folder/arb\\_english-main.htm](http://www.lcia.org/ARB_folder/arb_english-main.htm). The French Code of Civil Procedure, C. CIV., art. 1496 (Fr. 1981), and the Dutch Code of Civil Procedure, RV, art. 1054(2) (Neth. 1986), both accept the application of the international *lex mercatoria* in international cases.

The English Arbitration Act § 46(3) (1996) does not yet do so and instead follows the UNCITRAL Model Law and UNCITRAL Arbitration Rules, which refer to conflict of laws rules. See UNCITRAL Model Law on International Commercial Arbitration, art. 28 (1985), reprinted in 24 I.L.M. 1302 (1985); UNCITRAL Arbitration Rules, art. 33 (1976), available at <http://www.uncitral.org/english/texts/arbitration/adriindex.htm>. Nevertheless, even English courts now uphold the application by arbitrators of internationally accepted principles of law governing contractual relations; at least they did so in respect of an award rendered pursuant to an arbitration governed by Swiss arbitration law. See *Deutsche Schachtbau und Tiefbohrgesellschaft mbH v. Ras al-Khaimah Nat'l Oil Co.*, [1987] 3 W.L.R. 1023. Earlier, the English courts, after having consistently rejected awards based on equity, had already changed that attitude. See *Eagle Star Ins. Co. v. Yuval Ins. Co.*, [1978] 1 Lloyd's Rep. 357.

In the *Deutsche Schachtbau* case, *supra*, there was no contractual choice of law clause and Article 13(3) of the old ICC Rules, which still referred to settlement of disputes through conflict of laws rules, applied. Even so, this requirement seemed no longer to exclude the application of general principles or the transnational law merchant or *lex mercatoria*. One of the first awards making a direct reference to the *lex mercatoria* under Article 13(3) of the old ICC Rules was *Pabalk Ticaret Ltd. Sirketi (Turkey) v. Ugilor/Norsolor S.A. (France)*, ICC Case 3131 (1979), which was upheld by both Austrian and French courts. See Decision of Austrian Supreme Court, 18 Nov. 1982, reprinted in 34 INT'L & COMP. L.Q. 747, 757 (1985); Decision of French Cour de Cassation, reprinted in 24 I.L.M. 360 (1984). See also *Primary Coal Inc. v. Compania Valenciana de Cementos Portland, CA, Paris*, Sept. 1 1988, No. 5953, reprinted in REVUE DE L'ARBITRAGE 701-12 (1990). For the situation in the U.S., see David W. Rivkin, *Enforceability of Arbitral Awards Based on Lex Mercatoria*, 9 ARB. INT'L 67 (1993).

Importantly, the 1965 Washington Convention on the Settlement of Investment Disputes between States and Nationals of other States (in respect of foreign investments), also called the ICSID Convention, allowed in Article 42 the application of transnational law in disputes between foreign investors and states in which their investments are made, and this transnational law is often preferred to the application of domestic laws. *Emilio Agustin Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7, Jan. 25, 2000, 16(1) ICSID REVIEW-F.I.L.J. 212 (Spring 2001).

Because of the greater freedom in respect of the applicable law, to which the ICC and LCIA rules now testify, the selection of a non-state law is now generally considered less of a problem in international commercial arbitrations. The 1980 Rome Convention on the Law Applicable to Contractual Obligations is sometimes thought not to allow it. In truth, this issue of a contractual choice in favor of transnational law was never considered at the time of the drafting of this Convention and it can easily be interpreted otherwise. See DALHUISEN, *supra* note 1, at 186. In any event, the Convention is addressed to State Courts and does not apply in arbitrations. See DALHUISEN, *supra* note 1, at 380. Yet a different attitude as to a contractual choice in favor of the *lex mercatoria* in state courts as compared to arbitrations would seem undesirable.

See *infra* note 95 for the *lex mercatoria* references in the European and UNIDROIT Contract Principles and for the freedom of parties to choose this law according to these Principles.

More startling, and perhaps more embarrassing, is the modern view in a lower court in England that even a contractual choice of law in favor of Sha'ria law as a non-national law does not stick in the English courts (replacing it with English law) on dogmatic grounds very similar to those inimical to the *lex mercatoria* and a choice of law in its favor. See *Summary Judgment Islamic Investment Co. of the Gulf (Bahamas) Ltd. v. Symphony Gems NV & ORS* (2002), LTL Oct. 17, 2002 (unre-

The probable reason is that there is still an incomplete understanding of the forces that shape this new law and maintain it. As a result there is no clear intellectual framework either, which could demonstrate stability and greater predictive value. Thus the legitimacy of a non-territorial transnational law of a private law nature that has no state as originator and operates more in the manner of public international law still poses some fundamental questions for some. In the view of others, the proper sources of the new *lex mercatoria* remain so opaque that it cannot yet function as a fully fledged system of law.

This Article attempts to formulate some answers to these questions and doubts, which seem exaggerated. In doing so, I maintain as a starting point that the strong forces deriving from the present trends toward globalization of the international flows of goods, services, and money worldwide (which together are now larger than any domestic flows) are at the root of a legal transnationalization process, whatever we may think of globalization itself. This development is characterized, at least in commerce and finance, by the creation of a distinct international legal order between professional participants that maintains its own transnational legal system. This order I call the "international commercial and financial legal order," and its law is the modern law merchant or the new "*lex mercatoria*."

More generally, legal orders are here understood as participatory social structures or communities that spontaneously produce their own laws. Of these, I consider states to be only one type, albeit the most important one. When and how social structures or communities other than states become operative as law-creating legal orders will be an important issue in this Article. When they do, it follows that their own laws in principle prevail in all matters properly belonging to their order. In this manner, the modern *lex mercatoria* should be expected to operate as the prevailing law in all international business transactions and to supersede in such transactions all national or domestic laws.

This approach goes against present day perceptions, which are on the whole still dominated by the statist view of law creation, and also goes against the related view that only domestic laws can cover international dealings and provide proper solutions to all problems that may arise in international transactions, even if these domestic laws were never written or developed to cover such dealings. Under this established view, international business must inescapably live with a fractured system of laws and with the resulting uncertainty and inequality as well as the inefficiencies this necessarily presents.

In this Article, the applicability of domestic laws in international transac-

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ported elsewhere).

An award that is altogether detached from a *national* arbitration law may still have greater difficulties being recognized under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Alb.-Belg., June 10, 1958, 330 U.N.T.S. 3, although upheld in the U.S. Ministry of Defense of the Islamic Republic of Iran v. Gould, Inc., 887 F. 2d 1357 (9th Cir. 1989). In any event, this does not affect awards rendered on the basis of other than a national substantive law. See ALBERT JAN VAN DEN BERG, THE NEW YORK ARBITRATION CONVENTION OF 1958: TOWARDS A UNIFORM INTERPRETATION 33 (1981).

tions and hence also the concept of private international law pointing to the most appropriate domestic legal regime for international business transactions are fundamentally challenged in favor of transnationalisation through the new *lex mercatoria*. In the more traditional view, and in the legal nationalism it represents, there is no real room for a transnationalized uniform law unless it is formed by treaties which ultimately remain products of national laws and whose effect does not extend further than the territories of the contracting states.

Another important though separate point is that the new transnational *lex mercatoria* is likely to be of a *dynamic* nature, often expressed in practices that may change overnight if business logic or market forces so require. The search is therefore on for a forward-moving set of internationalized, uniform principles and rules that may be largely articulated by participants themselves and draws widely from their practical needs, established ways of dealing, best practices, trade organization rules, and from the innate rationality of their international dealings.

The traditional approach to private law also usually has little room for this view. Rather, the traditional approach embraces legal formalism, which perceives law in essence as a system of pre-existing hard and fast black letter rules, sufficiently complete and self-sufficient to be able to resolve all outstanding issues. It is inimical to the notion that law unavoidably changes when applied to new cases or new situations and also to the idea that modern law, at least in commerce and finance, must develop more naturally in response to the environment in which it operates and to the problems it must face, not merely as a matter of theory but as a practical requirement for it to remain relevant, responsive, and credible in an environment of internationalized business flows.

In international dealings, the challenge to the more traditional view can therefore be cast in terms of an end both to the statist view of private law formation and to legal formalism (two views which are often closely connected in what is called legal positivism), hampered as they are by the glaring inadequacies legal nationalism presents in the practice of international dealings and by the dogmatic rejection of social and economic developments as a self-creating legal force. At least in international transactions, this end may be inescapable, forced as it is by the dramatic multiplication of these transactions fostered by the globalization of the modern flows in goods, services, and money.

While there are clearly fundamental theoretical issues to be considered, this study aims to be at the same time highly practical in its conclusions in terms of what the new *lex mercatoria* is, how it can be identified, how it must be applied and can function. The simple formula this study presents is a hierarchy of norms, which, it is posited, characterizes for the time being the operation of the modern *lex mercatoria*.

In this hierarchy, domestic laws continue to play an important residual role, but their application is progressively preceded by the application of transnational fundamental legal principles, international custom or practices including trade organization rules and standards, uniform treaty law, expressions of party autonomy, and general principles in the manner discussed in greater detail below.

Importantly, even where domestic laws still residually apply in international dealings in this way, these domestic laws become part of the new transnational law operating in the international commercial and financial legal order and may therefore no longer function in a purely domestic manner. This simple scheme may be of great importance for international commercial arbitrators, but also for state courts that are increasingly becoming familiar with and more confident in the application of foreign and international or transnational laws.

As just mentioned, interest in the revival of the international law merchant as non-statist transnational law is itself no longer new, but my approach is more unusual in that it relates the emergence, development, and application of this law intimately to the operation of a new autonomous and independent legal order. I hope that it clarifies a number of issues and embeds the emergence and development of this new law in a clearer—although informal—institutional framework. In fact, the intimate relationship between law formation and legal orders is not a truly new insight either,<sup>4</sup> but it is rarer and among those who acknowledge this connection many consider these orders as being always of a statist, or at least national, character; states, therefore, having become the proxy in modern times for the whole concept of legal orders. It is submitted that this view no longer sufficiently accords with present day realities. However, it is accepted that law is not created at random and needs some social and economic framework in which it can be articulated and operate, but this framework need not be a state. This approach suggests at the same time a shift away from a territorial approach to law in favor of a more functional one.

The discussion which now follows will be largely an exercise in political and socio-economic thinking in terms of legal pluralism and dynamism. It is mostly abstract and not empirical. This is not to deny the importance of empiricism—although the possibility of reflecting on the new rules may itself be an important indication of their existence—but it is not the purpose of this paper. Empirical research in this area remains severely hampered by the absence of a sufficient intellectual framework, which should ideally precede any such research and direct it.

Undoubtedly, even at this stage, something can already be said from a more empirical perspective on the functioning, acceptance or internalization of transnational norms and their application, either voluntarily or involuntarily. Much of the present American legal scholarship revolves around these notions of internalization and voluntarism,<sup>5</sup> and it may well be exactly the operation of the new law merchant internationally that may prove many of the basic contentions of this new American approach but this remains to be confirmed.

Empirically, it may also be instructive to note the connection between how international arbitrators perceive the situation and what they do in practice and to look at how domestic case law reacts, but the sample remains limited and the

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4. See *infra* note 54. See also NEIL MACCORMICK, *QUESTIONING SOVEREIGNTY* (1999).

5. See Robert D. Cooter, *Three Effects of Social Norms on Law: Expression, Deterrence, and Internalization*, 79 OR. L. REV. 1 (2000); see also *infra* note 57.

reasoning often unclear. Nevertheless, such investigations, to the extent they have been undertaken, have been able to produce some important, if limited, insights into the existence and operation of the new international commercial and financial legal order and its new law merchant.<sup>6</sup>

The reaction of the participants themselves and their lawyers may also be of importance and empirically measurable. Yet so far the international business community has been less likely to opine meaningfully on the origin and nature of the rules that govern its activities. Generally more concerned with projects and the division of tasks, risks, costs, and benefits, the participants live in the hope and expectation that structuring by their transactional lawyers (if necessary around atavistic or parochial laws), or otherwise the default rules of whatever law is applicable, will adequately protect them. Their lawyers, although more prone to speak, remain on the other hand for the most part wedded to the more traditional, state-centered mantras. Transactional lawyers involved in international transactions often continue to believe themselves and their clients to be safe in domestic legal environments, even if a better feel for reality, a clearer perspective, and a truer understanding of what legal structuring really is, would dictate otherwise.

Besides the lack of a proper intellectual framework, these more traditional perceptions and attitudes remain an important constraint on meaningful empirical research into the transnational modern *lex mercatoria* and its operation. In practice, questions on the operation of the international commercial and financial legal order and its laws will often present themselves only when disputes arise. These questions have certainly become of increasing interest to international arbitrators, who have the advantage of being detached from the statist institutional scene where regular courts operate. Indeed, state courts are likely to confine themselves longer to localized legal thinking, although as we shall see this is not necessarily so for the more enlightened ones.

In the present discussions on the modern *lex mercatoria* and its impact, there may well be some sort of stalemate. From an academic point of view, it is time to search first for a better, or at least a more satisfactory intellectual framework, and to probe from a more theoretical perspective whether and how the modern law merchant can function and claim its place. For the *lex mercatoria*, that work remains in its infancy, also in the United States. Those of us who are more familiar with public international law and its long struggle with sovereignty claims are more likely to be familiar with the notion of supra-national legal orders and their tension with national aims. They will also be more comfortable with legal plurality and with a more searching and dynamic concept of the law, its formation, and its application. They will therefore more readily recog-

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6. For a rare, more empirical research effort into the trans-nationalization of private law, see YVES DEZALAY & BRYANT G. GARTH, *DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER* (1996). These authors take the perspective of the international arbitrators and interestingly note a greater resistance to the *lex mercatoria* in the academic community than among practicing lawyers.



nize some of the issues discussed below, but they may be less aware and therefore more particularly interested in how these issues play out in the transnationalization of private law.

To make my point, I shall discuss in Part II the law, and private law in particular, as a purely nationalist or statist phenomenon and how, as a nineteenth century development, it came to be so. In Part III, I shall discuss the phenomenon of legal orders and their manifestation more generally, including their operation as statist, non-statist, or immanent legal orders, and take the international commercial and financial legal order as a prime example of the latter. Its evolution and identification in commerce and finance may more properly be understood from the perspective of normative sociology or economics, as legal scholarship in this area is beginning to show. The law that is in this manner autonomously and spontaneously produced may at least to some extent be a matter of social psychology, building on and supported by more traditional natural law or more universal notions of legal rationality. But, as already mentioned, there is also an important evolutionary aspect to be considered in which the law simply changes under pressure from outside forces and the circumstances—here the internationalization of the commercial and financial flows—in which it must operate. In business, this may by itself contribute to its transnationalization.

In Part IV, I shall focus on the overlap, competition, and conflict between the international and statist or other legal orders and their laws. In particular, I shall focus on areas where states exert justified public policy preferences, at least regarding all that is happening in their territories, including international transactions conducted in or having an effect on such territories. The international commercial and financial legal order cannot, it is submitted, ignore public policy preferences of states that can claim a legitimate interest. In American terms, this is the issue of the jurisdiction to prescribe, especially relevant with respect to the impact of domestic mandatory and regulatory laws.

In Part V, I shall attempt to deal with the law produced by the new legal order and therefore with the question of how we can know and apply the positive modern *lex mercatoria*. As already mentioned, I shall introduce here a hierarchy between the different sources of law that may claim application and argue that, in this hierarchy, domestic laws found through the more traditional rules of private international law retain for the time being a fall-back position, even if such law enters thereby the international legal order and may no longer function in a purely domestic manner.

Such domestic law may remain especially important in proprietary matters where, because of third party effect and mandatory concepts, transnationalization is more difficult to achieve. It must be admitted, however, that in modern financial products (which themselves are increasingly internationalized and in any event often difficult to locate) and in the determination of their bankruptcy-resistance, traditional domestic proprietary concepts may no longer be very helpful either. Especially in this area there may therefore be room for more law deriving from uniform treaties, such as the 2001 UNIDROIT Cape Town Convention on International Interests in Mobile Equipment and the 2001

UNCITRAL Convention on the Assignment of Receivables in International Trade,<sup>7</sup> if not also increasingly from international custom and practices.

To continue to use domestic laws as the residual rule in this manner counters an important and well-known argument against the notion of transnationalization and the new *lex mercatoria*. This argument centers on the incompleteness of the legal transnationalization process for the time being and therefore on the potentially limited nature and inadequacy of transnational law as a legal system. Even though no system of law is ever complete, especially in a rapidly changing environment, it may nevertheless be realistic and efficient to accept that in the formative era of the new *lex mercatoria*, application of the domestic laws of countries most closely connected with an international transaction remains important as long as it is understood that application of these laws is increasingly preceded by other, higher ranking sources of law such as international practices and perceptions, and is itself modified or superseded thereby.

To give a poignant example of how this principle might operate in practice it may mean that the application of English law in a domestic English case is not necessarily the same as its application in an international case. This would be true even where parties have selected that law unless they make it clear at the same time that they wish to disregard the international nature of their transaction and its dynamics altogether. For common law applied in international transactions, this could mean that in contract the traditional contractual notion of consideration no longer plays a role, a situation borne out by the 1980 Vienna Convention on the International Sale of Goods that is often considered standard and no longer operates with notions of consideration or bargain.<sup>8</sup> Similarly, the need in common law to deal contractually with issues of *force majeure* at the risk of not otherwise being able to use this excuse, may no longer obtain in international transactions either, even if English law were declared applicable by the parties.

Often it is still said that the need for legal certainty excludes the operation of a more dynamic notion of the law and its transnationalization in the manner here described. It is then argued that domestic laws connected with greater legal formalism provide such certainty, but this has in itself become highly debatable, not only in international transactions. Because of the parochial and atavistic fla-

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7. The text of the UNIDROIT Cape Town Convention on International Interests in Mobile Equipment is available at <http://www.unidroit.org/english/conventions/mobile-equipment/main.htm>. For a comment, see ROY GOODE, OFFICIAL COMMENTARY ON THE CONVENTION ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT AND THE PROTOCOL THERETO ON MATTERS SPECIFIC TO AIRCRAFT EQUIPMENT (2002). The text of the UNCITRAL Draft Convention on the Assignment of Receivables in International Trade is available in the Appendix to the Report of UNCITRAL on its 34th Session (2001), GAOR supp. No.17 (A/56/17), available at <http://www.uncitral.org>. For a comment, see Harry C. Sigman & Edwin E. Smith, *Towards Facilitating Cross-Border Secured Financing and Securitization: An Analysis of the United Nations Convention on the Assignment of Receivables in International Trade*, 57 BUS. LAW. 27 (2002).

8. In this vein, see also Ole Lando, *supra* note 1. This is also borne out by the UNIDROIT and European Contract Principles which no longer require valid consideration for contracts to become binding.

vor of much existing domestic law, it may be cogently argued that, at least in international transactions, local laws increasingly produce a certainty that has a transaction-destabilizing effect and represents therefore an internally contradictory perspective and a low quality legal environment. This is only bearable because of the facility of transactional lawyers to structure around it as well as they can—which only serves to highlight further the inadequacy of such laws. It will be argued that in the new world of commerce and finance, certainty can only come from the insights, good sense, behavior, and self-restraint of the participants—it was in fact never otherwise.

## II.

### LAW AS A NATIONAL OR STATIST PHENOMENON

We often characterize the arrival of the new transnational law merchant as a revival of the much older *lex mercatoria*<sup>9</sup> because the situation reminds us of the one that existed before the time of the 'nationalization' of the law in the nineteenth century, even in respect of international trade. On the European Continent, this nationalization of all law resulted in private law from the codification ethos in which law creation, even relating to international commerce and finance, became territorial and a state matter. But it developed just as strongly in England due to the nationalistic undercurrent that became apparent at virtually the same time, even if it did not lead to the primacy of legislation in private law, at least not in commerce and finance. In fact, in England the law merchant (like the ecclesiastical laws) had already been incorporated into local common law earlier in the eighteenth century. Thus, centralization and nationalism in the law and its formation ended everywhere the law merchant of those days that until that time had in many of its aspects an important non-territorial and more universal application among the international community of merchants. As a result, the state arose as the only remaining legal order and law formation was considered its natural preserve. It follows that in this environment the close connection between legal orders and law could no longer be meaningfully explored in any other context and any concept of a plurality of legal orders was lost.

Yet, there were always some important exceptions. Thus, it is well known that in public law, we have an international legal order of sorts and therefore a legal order between states, even if some legal thinkers of note have struggled to assign a place to the law obtaining in that order.<sup>10</sup> International public law, ex-

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9. It should of course be realized that the content of the new law merchant or *lex mercatoria* is very different from the earlier one, see DALHUISEN, *supra* note 1, at 6 *et seq.* Although in the area of negotiable instruments and bills of lading there is mainly progression, in other areas, especially in finance, there are major new departures. In fact, it can be argued that this new law is no longer primarily driven by commerce or mercantile considerations but rather by finance. It raises in particular the issue of the bankruptcy residency or proprietary status of new financial instruments in an international context and moves property rather than contract law to the forefront as to some extent had already happened when the bills of lading and bills of exchange were developed in the earlier law merchant as negotiable documents of title or negotiable instruments.

10. Notably HERBERT LIONEL ADOLPHUS HART, *THE CONCEPT OF THE LAW* 227, 231

actly because of its de-nationalized status and the abandonment of the territoriality principle, but sometimes also because of its ultimate dependence on state enforcement of international norms, thus suffers in the opinion of some in terms of legitimacy, even if the adjudication of this law may take place in international courts or tribunals such as the International Court of Justice and normally also in domestic state courts.

Since the 1960s, in the European Union (hereinafter the EU), we have also become used to the emergence of a separate legal order in what could be called a confederate environment. It is now well distinguished from the kind of international legal order between states just mentioned. It was not expressly so ordained in the founding treaties. Nevertheless, the European Court of Justice assumed it virtually from the beginning.<sup>11</sup> This order operates not only between the Member States but also in respect to their citizens,<sup>12</sup> and may therefore even produce transnational notions of private law in the limited areas of EU competency in this field.<sup>13</sup> This private law is in the case of conflict superior to state or other local laws, even if its application and enforcement depends mostly on Member State courts and enforcement mechanisms. Importantly for our subject, this superior European legal order derives primarily from, and is largely dictated by, the operation of the EU internal market with its emphasis on the free flow of persons, goods, services, and money and an economic and monetary union. These were the original objectives of what became the present EU, to which, for many member countries, the operation of a single currency (the Euro) is now added.<sup>14</sup>

In the U.S., there is at least some duality of legal orders. The federal legal order operates distinctly from the states' legal orders and could be seen in respect of the states as an inter- or supra-state order. It is not normally explained in terms of the free flow of persons, goods, services, and money or from the perspective of the Commerce Clause, as from the beginning the U.S. was meant to be more than a common market and economic union. Rather it was to be a federation aiming at a 'more perfect union,' whereas the EU, according to the Pre-

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(1994), but not necessarily other modern positivist writers. Cf. HANS KELSEN, *GENERAL THEORY OF LAW AND STATE* 385 (Anders Wedberg trans., 1961).

11. See Case 26/62, *Van Gend & Loos v. Nederlandse Administratie der Belastingen*, 1963 ECR 1; see also Case 6/64, *Costa v. ENEL*, 1964 ECR 1203; Case 14/68, *Walt Wilhelm v. Bundeskartellamt*, 1969 ECR 1.

12. The literature on this phenomenon is enormous and I may refer to any European law handbook. See also GORDON SLYNN, *INTRODUCING A EUROPEAN LEGAL ORDER* (1992). For a more recent account, see *THE EUROPEAN UNION AND ITS ORDER: THE LEGAL THEORY OF EUROPEAN INTEGRATION* (Zenon Bankowski & Andrew Scott eds., 2000).

13. TAKIS TRIDIMAS, *THE GENERAL PRINCIPLES OF EC LAW* 313 (Oxford Univ. Press 1999); see also *infra* text accompanying note 78.

14. As restated in Article 2 of the European Union Treaty. See Treaty Establishing the European Community, Nov. 10, 1997, 1997 O.J. (C 340) 145 (as in effect 1997) (now article 202) [hereinafter EC Treaty]. In fact, it has often been commented that the EU does not have any preconceived notion of European unity, federal structures or something similar, but only considers in this connection the clearly laid down integration principles themselves. See, e.g., T. Koopmans, *Federalism: The Wrong Debate*, 29 *COMMON MKT. L. REV.* 1051 (1992).

amble to the European Community Treaty (in language later also used in the Preamble to the European Union Treaty) only wants an 'ever closer union' in which the interim goals of a common market, along with economic and monetary union, were clearly defined but do not constitute the end-aim, which remains unspecified.

The duality of legal orders in the U.S. has relevance even in private law, which remains in essence a state matter. Yet, whatever the original idea, the law merchant also operates at the federal level,<sup>15</sup> and there are even limited pockets of spontaneous federal common law.<sup>16</sup> Constitutional notions of due process (and full faith and credit) also contribute to this federalization, as is well known from conflicts law,<sup>17</sup> which tends in the U.S. towards the development of a more substantive, interstate approach to the applicable law. Thus, even in a fairly clearly defined constitutional framework, the development of new law is not always limited to its appointed legal order and can spontaneously occur in others. The law merchant often sticks out in such cases and is likely to seek a broader environment.

Importantly, it is even argued that there is in the U.S. effectively a *national* law that transcends both the federal and state legal orders and finds its legal force in the recognition and invocation of its rules by the American legal profession.<sup>18</sup> Such a transcendent law would suggest the existence of a national legal

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15. *Clearfield Trust Co. v. United States*, 318 U.S. 363 (1943). In marine insurance and the interpretation of the relevant policies, the federal courts applied federal private law from early on, see *Robinson v. Commonwealth Ins. Co.*, 20 F.Cas. 1002 (1838), followed later by the law concerning negotiable instruments and interstate common carriers. Thus a diversity case involving a bill of exchange in respect of the sale of land, title in which was subsequently disputed, relied on federal law for its decision. *Swift v. Tyson*, 41 U.S. 1 (1842) (holding that Section 34 of the 1789 Judiciary or Rules of Decision Act generally upholding state law in these matters did not apply to questions of commercial law, but was confined to the interpretation of local statutes and customs). Interestingly, with reference to Lord Mansfield in *Luke v. Lyde*, 2 Burr. R. 883, 887 (1759), it was explicitly stated that the law of negotiable instruments was not the law of a single country. In *Western Union Tel. Co. v. Call Publ'g Co.*, 181 U.S. 92 (1901), the use of common information carriers was not believed subject to any state law either, but in the absence of any federal statute rather to federal general common law, containing the *general rules and principles* (emphasis added) deduced from the common law enforced in the different States. See also William Fletcher, *The General Common Law and Section 34 of the Judiciary Act of 1789: The Example of Marine Insurance*, 97 HARV. L. REV. 1513 (1984).

An important instance of federal law may thus be the further development of the law merchant in interstate trade. See *S. Pac. Transp. Co. v. Commercial Metals Co.*, 456 U.S. 336 (1982). It confirms clearly that there is room for such interstate commercial law in the U.S. It is true that since *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938), state law is generally applied in federal courts in diversity cases in private law matters. This has since been extended to conflict of laws matters. *Klaxon Co. v. Stentor Elec. Mfg. Co., Inc.*, 313 U.S. 487 (1941). But the law merchant may still be of a *supra-state* nature as the cases show.

16. Typical federal matters are also lifted out of (private) state law like a claim in respect of injuries caused to a federal soldier. *United States v. Standard Oil Co. of Cal.*, 332 U.S. 301 (1947). The key here is the protection of uniquely federal interests in situations where Congress has been given the power to develop substantive law. See *Texas Indus., Inc. v. Radcliff Materials Inc.*, 451 U.S. 630 (1981).

17. See, e.g., *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985); *Allstate Ins. Co. v. Hague*, 449 U.S. 302 (1981).

18. Melvin Eisenberg, *The Concept of National Law and the Rule of Recognition*, 29 FLA.

order in the U.S. with a momentum and inner structure of its own.

In the meantime, international human rights concepts like those articulated in the European Convention on Human Rights and its Protocols may entail internationalized concepts when enforced by the European Court of Human Rights (ECHR) and by domestic courts, wherever this Convention is incorporated in domestic laws. Interestingly, these human rights concepts may sometimes also concern private law notions and include, for example, a transnationalized concept of possession and ownership under Protocol 1 (Article 1), which is especially relevant in the context of protection against state-induced property violations other than those in the public interest.<sup>19</sup> Here again we have some denationalized law, even private law, operating in an international legal order, in this case the one being upheld by the Council of Europe and further reinforced in Europe through regular transcription of these rules into EU law as general principles.<sup>20</sup>

In criminal law, we have had the Nuremberg trials, and in The Hague there are now the *ad hoc* Criminal Tribunals for the Former Yugoslavia (1993) and Rwanda (1994), and the permanent international criminal court (the International Court of Criminal Justice), which also rely heavily on universal, perhaps less westernized, laws and notions in determining gross human rights and humanitarian abuses.

ST. U.L. REV. 1229 (2002). In this view, an economic and convenience argument may be invoked but also a common tradition fostered by national law schools and a large 'national' slice in the bar examinations of each state. The informal creation of this law is stressed and its flexibility noted. The rules do not then figure as black letter law and their binding force may depend on the situations in and the purposes for which they are invoked. They may as such provide the framework for much legal argument and the central core of much of the living (private law) in the U.S., much more fundamentally than is normally acknowledged.

19. See *Marckx v. Belgium*, 31 Eur. Ct. H.R., app. no. 6833/74, (ser. A) at ¶ 63 (1979); *Gasus Dossier-und Forderintechnik GmbH v. Netherlands*, 306 Eur. Ct. H.R., app. no. 15375/89, (ser. A) at ¶ 53 (1995). It can as such even cover security interests of the tax authorities and others, reservation of title, and other conditional ownership interests or limited proprietary rights. It also includes intellectual property rights and claims based on contract and tort. This is clear from the reference to '*valeur patrimoniale*' or the notion of 'assets,' which suggests at the same time that the essence of ownership is here a right with a commercial value that can be sufficiently ascertained. It may as such even cover goodwill or an existing clientele. See *Van Marle v. Netherlands*, 101 Eur. Ct. H.R., app. no. 8543/79, (ser. A) at ¶ 41 (1986); *Iatridis v. Greece*, 1999-II Eur. Ct. H.R., app. no. 31107/96 (1999), available at <http://hudoc.echr.coe.int/>. It may not, however, cover a mere expectancy (of an inheritance) or a right to receive property. See *Marckx, supra*. Yet a right to an inheritance of a deceased person (if interfered with by a state) may be claimable even if non-partitioned. *Inze v. Austria*, 126 Eur. Ct. H.R., app. no. 8695/79, (ser. A) at ¶ 38 (1987); *Mazurek v. France*, 2000-II Eur. Ct. H.R., app. no. 34406/97 (2000), available at <http://hudoc.echr.coe.int/>. A disputed claim is not sufficiently established, however, but once adjudicated it is and a state against whom the claim was awarded can no longer annul the claim through legislation. See *Stran Greek Refineries v. Greece*, 301B Eur. Ct. H.R., app. no. 13427/87 (ser. A) at ¶ 61 (1999). Even a claim in a *prima facie* case might be protected. See *Pressos Compania Naviera v. Belgium*, 332 Eur. Ct. H.R., app. no. 17849/91 (ser. A) at ¶ 31 (1995).

For a comment, see THE RIGHT TO PROPERTY. THE INFLUENCE OF ARTICLE 1 PROTOCOL NO.1 ECHR FOR SEVERAL FIELDS OF DOMESTIC LAW (Jan-Peter Loof ed., 2000).

20. EC Treaty, *supra* note 14, art. 6(2). See *Roper v. Simmons*, 125 S.Ct. 1183 (2005); see also *Lawrence v. Texas*, 539 U.S. 558 (2003) (Justice Kennedy's references to international normativity of a human rights nature in the US).

It was thus never completely true that law, even private law,<sup>21</sup> could develop only within the context of a state, or as a national or territorial phenomenon only, although it could still be argued in respect of public international law, the EU, the ECHR, the *ad hoc* Criminal Tribunals, and the International Court of Criminal Justice, that transnational law only emerges and operates here by state fiat on the basis of treaties. But this ignores the important role of international customary law, and at least the EU in its various pillars does not, strictly speaking, operate in this manner. Its laws are in truth the product of its own internal market and the momentum it has generated.

There were, therefore, always important examples of transnational law that originate and operate independently from domestic legal orders even in the area of private law. Also, like in the U.S., law may apparently mutate and escape its appointed legal order. Clearly all awareness of other legal orders in which law emerges and functions more spontaneously has not been lost. In private law, the re-awakening to this reality and increasing awareness of this state of affairs can be credited to globalization. Indeed, it would confirm that the concept of law, and certainly also of private law, does not require a state or nation *per se* for its functioning and development. Only the concept of coercion on the basis of such law might require a state. This problem of coercion and enforcement presents an important but different issue that will be explored further in Part IV.

More generally, it may be useful to recall that, at least on the European Continent before the nineteenth century, the law, even at domestic levels, was not primarily considered statist or even nationalist and territorial; this was certainly not the case concerning private law. Much of the general law of those times was directly based on Roman law which was never officially promulgated, while other areas of law were personal (in tribes), group-related (in guilds), or transactional (in commerce).<sup>22</sup> The move towards an exclusively territorial and

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21. See also *infra* note 53 (referencing ICSID). However, the application of transnational private law is here facilitated by treaty law.

22. The history of the law and of its development in Western Europe is a long one and can hardly be summarized in a nutshell. First, in its evolution, one has to accept a split from the beginning, around the twelfth century, between the English law development and that on the European Continent. The English law evolved eventually into what we now call the common law and the Continental European law into what is now called the civil law. Both developments were quite different and complex. In either system, it is nevertheless possible to identify a number of salient features that are relevant in the present context. Again we are concerned here with the development mostly of private law, which on the European Continent did not clearly separate from public law—nor in the civil law tradition either—until the nineteenth century era of nationalism. In fact, even after the Peace of Westphalia (1648), often marked as the moment from which states in the modern sense emerged in Continental Europe, it was thought for a long time that the law that obtained between private citizens was per definition the law that obtained for all (therefore also between states amongst themselves and between states and its citizens).

As is well known, Grotius in particular propounded this view in 2 HUGO GROTIUS, *DE IURE BELLI AC PACIS* (Francis W. Kelsey trans., 1925) (1646). It was preceded by his more detailed *INLEIDINGE TOT DE ROMEINS-HOLLANDSE REGTSGELEERDHEIT* [INTRODUCTION TO ROMAN DUTCH LAW] (Robert Warden Lee transl., 1953) (1621). For important essays on the modern relevance of Grotius' work in the areas of contract, negligence and unjust enrichment especially, see generally ROBERT FEENSTRA, *LEGAL SCHOLARSHIP AND DOCTRINES OF PRIVATE LAW, 13TH-18TH*

CENTURIES, VIII & IX (Variorum 1996). See also Robert Feenstra, *Grotius' Doctrine of Liability for Negligence*, in NEGLIGENCE, THE COMPARATIVE LEGAL HISTORY OF THE LAW OF TORTS 197 (Eltjo J. H. Schrage ed., 2001).

In this universalist view, there was no place nor indeed much need for the concept of legal orders (or states). It had been fed by a long tradition in which the Roman law of Justinian was received on the European Continent as universal law. This happened as early as the twelfth century without any form of promulgation or similar official backing, at a time when, in the late Middle Ages, the need for better laws became apparent. In the fourteenth century writings of Bartolus, Baldus and their successors, a search began for a more substantive rather than procedural law that had in essence been the Roman law approach. See J. E. Scholtens, *Bartolus and his Doctrine of Subjective Rights*, ACTA JURIDICA 163 (1958). This law was subsequently increasingly explained as the *law of reason*, supporting the universalist view in which the Roman law came to be referred to as the *Ius Commune*. To fill the gaps and meet more up-to-date requirements, there also emerged, however, local laws especially of commerce, like in the cities of Northern Italy, in the Hanseatic towns in the North of Germany, in the fair towns of Eastern France, especially Champagne and Brie, in the French and Belgian towns trading with England, in Flanders and later in the Dutch Provinces. We are then in the sixteenth and seventeenth centuries. It should be noted in this connection that even though we speak here of local laws, they were not necessarily territorial but were often geared to particular activities or classes of participants in guilds or particular markets and then indeed confined to commercial activities only.

More territorially inspired were the more official compilations of customary law in Northern France, especially the early *Coutumes of Beauvais* and later the famous ones of Paris (1510), but these laws still competed with the revived universalist Roman law or *Ius Commune*. It posed, however, the question of precedence, which was not uniformly decided in favor of the Roman texts. The complicated arguments need not be related here; I have summarized them elsewhere. See DALHUISEN, *supra* note 1, at 26; see also Jacques Krynen, *The Absolute Monarchy and the French Unification of Private Rights*, in PRIVILEGES AND RIGHTS OF CITIZENSHIP: LAW AND THE JURIDICAL CONSTRUCTION OF CIVIL SOCIETY 27 (J. Kirshner & L. Mayali eds., 2002). The result was that in France (as elsewhere) several sources of law either of a territorial or more personal or transactional nature started to operate side-by-side or competed, both being supported by very diverse court systems. The result was no unity in the law and its enforcement. Whether the law was Roman or local, it hardly presented a coherent system, but at least the Roman law continued, as it developed as the rational law, to have a universal, non-territorial, pretence.

In this environment, the notion that law could only figure in a cultural and economic order that was state-related was unknown, states and nations admittedly not yet having fully developed in a modern sense. Even in a country like France, which was in this respect more centralist at least from the seventeenth century onward, there were thus still very different laws per region, a situation that royal ordinances only partly redressed. Roman law remained particularly dominant south of the Loire River but even north of it, in the Paris region, it also retained an important impact through the *coutumes*, especially in the law of chattels.

Another development that took place at the same time was that of the *canon law*, which was from the beginning more principled and value based, more coherent (but also more limited) and emanating from authority in a particular legal order (that of the Roman Catholic Church). It was first to introduce a concept of *natural law*, which was thought to be a reflection and elaboration of the divine law, both well distinguished from the human law which was all the rest of the canon law and also the Roman and domestic laws.

The *secularized* version of this natural law school started with Grotius (1585-1645) and was first in striving for and presenting a more fully coherent view of the substantive law that was based on Roman, Canon and local laws and presented an updated model for all. This scheme was developed in DE IURE BELLI AC PACIS, *supra*. Book 2 of that work gives a detailed view of this system, based on private law concepts that were believed to prevail also in all other types of relationships, even in those between states (to which area of the law this work is now often relegated). This law was considered driven, no longer by religion or its values, but rather by an innate sense in all people of what was good and bad and by the need for them to live and work together in peace (*appetitus societatis*). It had as such no statist flavor and was not considered territorial. Indeed the more powerful message was that this law was in essence universal (as Roman law had been in much of Continental Europe), not therefore confined by time or space or even by the type of parties or their type of interaction. So



statist concept of the law was on the European Continent a nineteenth century development resulting in a statutory approach, which, at least in civil law, became intolerant of plurality and was no longer primarily functional or activity-driven.<sup>23</sup> From early on this caused some stress in the newly codified systems, evident especially in the role of custom, the status of which became unsettled but tended to be increasingly ignored. There was also a question mark in respect of the use of more fundamental or general legal principles to fill the gaps in the codified system with its preference for systematic reasoning.<sup>24</sup> This could not last and more flexibility was needed if only to preserve the pretense that these codes were complete and covered everything. Thus, in the twentieth century, in what in the U.S. is broadly called 'legal realism' and in civil law normative interpretation (*Interessenjurisprudenz*),<sup>25</sup> some increasing sensitivity was shown

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there was no difference between public and private laws or domestic and international laws.

This law was in essence considered rational (although no longer as Roman law), an approach supported by the philosophy of the Stoa which was the popular direction of seventeenth and eighteenth century thought. It obtained a broad following, later especially articulated by Pufendorf and Wolff in Germany, and remained very influential on the European Continent until the time of the great codifications in the early nineteenth century. It made the drafting of these codes possible even if they relied for their force on national cultures subsequently identified with the modern state.

23. The different private law regimes concerning non-merchants and merchants in Germany and France, even after the codification, are a remnant of the older approach. In these countries, as in many other civil law countries, the distinction became incidental (commercial law becoming *lex specialis* to the general body of private law contained in the codes which were primarily applicable also in commerce) and lost much of its meaning, as it has in common law, where, however, it had remained more separate and self-contained. See DALHUISEN, *supra* note 1, at 16. That is not, however, necessarily so for modern international transactions, as the new international law merchant shows.

The operation of law as 'personal' rather than 'territorial' in this manner, on the other hand, reminds one of tribal laws but was also the approach in Rome where the *ius civile* was for Roman citizens and the *ius gentium* for foreigners, until the latter become the generally recognized private law when after 212 AD the distinction between Romans and foreigners was abandoned (earlier the *ius gentium* had supplemented the *ius civile* also for the citizens). In the early Middle Ages, the operation of tribal laws besides the Roman law became again apparent. Nothing of the sort is suggested here in respect of the new law merchant, except to note that, upon the analogy of the difference between public and private law and commercial and other private law, the application of different laws to different types of dealings between different types of participants or within different communities, groups or partnerships or for different types of transactions within one territory has always subsisted, even in civil law. The operation of a separate law between professionals in the international commercial and financial sphere is therefore hardly a new idea.

In common law, the development of the law merchant can more readily be explained by putting emphasis on the type of actors rather than on their acts. This has often been thought to be a special feature of the common law approach. See *Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd.*, [1989] 1 Q.B. 433, 439 (C.A. 1987) (Opinion of Bingham L.J.). As a consequence, common law may be better able to distinguish between professional dealings and others, dealings with local authorities and others, and dealings within families and others. Civil law, which in its codifications started to de-emphasize this approach, was therefore perhaps in need of a more formal distinction between public and private law and, within the latter, between various types of contracts, while only within the more modern concept of good faith other relational differences can now more easily be taken into account. See also DALHUISEN, *supra* note 1, at 219.

24. For the place of custom and for fundamental or general principle in a codified system of private law, see DALHUISEN, *supra* note 1, at 90. For custom, see also *infra* note 60.

25. For the many different strands of legal realism in the U.S., see M. J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1870-1960; THE CRISIS OF LEGAL ORTHODOXY* 171 (1992). The basic idea is to look at the law as it functions in society and at its operational sufficiency. See

Karl Llewellyn, *Some Realism about Realism*, 44 HARV. L.R. 1222 (1931). It follows that social considerations and policy issues may become more prominent in the formulation and especially interpretation of the law by the courts. It still assumed, however, some coherent view of what was ethically, socially, and perhaps even from the perspective of utility and efficiency more desirable; of course, such coherence may not always exist. This has become clearer in the later functional approaches which investigate in particular the impact of ethics, sociology, economics, aesthetics, psychology, or culture on the law.

Many have opined that as a consequence the law lost its autonomous character. See, e.g., Richard Posner, *The Decline of Law as an Autonomous Discipline: 1962-1987*, 100 HARV. L. REV. 761 (1987). It remains true, however, that most, while talking about ethical or social and other norms, really refer to legally enforceable norms and therefore to (in origin) extra-legal norms that are brought into the legal sphere as sources of legally enforceable rights and duties if pressing with sufficient strength. This could in turn be seen as reconfirmation of the law's autonomy regardless of where the legal norms originate—from ethics, sociology, economics, aesthetics, psychology, and so on. In fact, Posner accepted that “disinterested legal-doctrinal analysis of the traditional kind remains the indispensable core of legal thought” *Id.* at 777. Thus a more dynamic view of the law's development does not need to mean a denial *per se* of its intellectual and practical autonomy, although it usually goes together. Indeed in Posner's view, at least academically thinking in terms of the law's autonomy is no longer the normal way of thinking about the law.

Formalism is the opposite of realism and rests on the idea of the self-sufficiency of the legal system as a set of pre-existing often hard and fast black letter rules that can be more or less mechanically applied and is considered to produce acceptable results in what is thus considered a more objective manner. In doing so, legal formalism is inclined to disregard the background reasons that a particular norm was meant to serve and considers the norm therefore as being self-contained and self-sufficient. See Larry Alexander, *With Me, It's All er Nuthin' Formalism in Law and Morality*, 66 U. CHI. L. REV. 530, 531 (1999). Thus the essence of legal formalism becomes the systematic application of a rational system leading to mechanical decision-taking and autonomous reasoning. Brian Leitner, *Review Essay: Positivism, Formalism, Realism*, 99 COLUM. L. REV. 1138, 1145 (1999); see also B. Neuborne, *Of Sausage Factories and Syllogism Machines: Formalism, Realism, and Exclusionary Selection Techniques*, 67 N.Y.U. L. REV. 419, 421 (1992) (claiming that “pure formalists view the judicial process as if it were a giant syllogism machine”); see also NEIL DUXBURY, *PATTERNS OF AMERICAN JURISPRUDENCE* 10 (1995) (placing emphasis in this connection on “the endeavor to treat particular fields of knowledge as if governed by interrelated, fundamental and logical demonstrable principles of science”).

Legal formalism may in this manner also stand for the acceptance of the law's immanent moral rationality. For this view, see Ernest J. Weinrib, *Legal Formalism: On the Immanent Rationality of Law*, 97 YALE L.J. 949, 951 (1988), and Ernest J. Weinrib, *The Jurisprudence of Legal Formalism*, 16 HARV. J.L. & PUB. POL'Y 583 (1993), who supports this kind of formalism; for this type of definition of formalism, see also Roberto Unger, *The Critical Studies Movement*, 96 HARV. L. REV. 561, 571 (1983), who, however, objects to it as a pretentious and self-centered method of legal justification in dispute resolution concerning matters that are in truth social and therefore ideological, philosophical or visionary in nature. Here the critique concerns allegedly unjustified claims (of legal formalism) to impersonal purposes, policies, and principles as tools of legal reasoning. Its claims to objectivity and rationality are here denied.

Legal formalism would seem to require that an immanent legal order and its law, like the international commercial and financial legal order and its *lex mercatoria*, as any statist legal order, must at least be substantially self-contained, systematically complete and exhaustive in order to count. Yet legal realism in the sense that it is willing to draw extra-legal considerations into the law to achieve substantive justice and continues to search for coherence is not necessarily incompatible with such views nor is the fact that it gave interdisciplinary inquiry greater legitimacy and opened the way for the functional movements and empiricism. The true difference between legal formalism and legal realism would appear to be in the former's inability to accommodate a more dynamic concept of law formation and application. It seems to have a more perfectionist view of law as it operates, a more optimistic view of the certainties it can provide, but also a more limited understanding of the type of discretion that is often assumed in order to reach acceptable results both in legal structuring and in legal adjudications.

Note the close connection between legal formalism and legal positivism. Although the first is

to the extra-legal objectives and purposes of the law. In this way, a better eye was also acquired for ethical, social, economic, or other considerations not only in the formulation of the law in statute, where as a political matter this was only natural, but more importantly also in its day-to-day application by the courts. And although in modern states, of course, legislation is now by far the more important source of law everywhere, case law consequently regained special importance even in the codification countries on the European Continent. Thus, legal realism rediscovered at least some diversity in the available sources of law in the codification countries, and therefore in civil law, and also allowed for a renewed influx of fundamental and more general legal principles. Most importantly, legal realism allowed for increasing acceptance of law as a dynamic concept ("law in action").

Subsequently, legal realism led, at least in civil law jurisdictions, to some greater appreciation of the different legal needs of different groups of social participants, like consumers, workers, and now also professionals, an area in which common law had perhaps always been stronger.<sup>26</sup> The result was a more facilitating or responsive approach to the law, certainly in areas of private law like those of commerce and finance.<sup>27</sup> In civil law, this response was particularly demonstrated by the operation of the notion of good faith (although mostly limited to contract law), now also increasingly invoked in the U.S.,<sup>28</sup> as demonstrated by the U.C.C. (sections 1-201(20) and 2-103(1)(j)) and the Restatement Second of Contracts (section 205).<sup>29</sup>

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primarily concerned with the law's application and the latter with the law's validity or legitimacy, to the extent both believe in the autonomy and self-sufficiency of legal system as sets of pre-existing rules, there is obviously a close relationship.

26. See *supra* note 23.

27. For a broader analysis of this trend, see PHILIPPE NONET & PHILIP SELZNICK, *LAW AND SOCIETY IN TRANSITION* (2001). The early development of the *lex mercatoria* through the Middle Ages and later will not be discussed here in any detail. *But see* DALHUISEN, *supra* note 1, at 6. Its early absorption in the common law in England in the eighteenth century was part of the same nationalization process discussed here. See *infra* note 33.

28. See DALHUISEN, *supra* note 1, at 255; see also Melvin Eisenberg, *The Emergence of Dynamic Contract Law*, 88 CAL. L. REV. 1743 (2000) (showing a significant approximation in modern American thought to more advanced Continental legal thinking in the area of contract law).

29. This is not to suggest that in international business transactions a more flexible application of the law is always appropriate and called for. For the notion of internationality itself, see *infra* note 42. Greater legal formalism may have been the parties' intent and is in any event normally exercised with respect to negotiable instruments, documents of title and letters of credit, all of which depend greatly on appearances of regularity and do not often allow judges to go beyond it. Similar lack of judicial flexibility may exist in payments and their finality. See DALHUISEN, *supra* note 1, at 269; see also *infra* note 42. For a more general critique of the modern liberal interpretation techniques, see M. Stone, *Focusing the Law: What Legal Interpretation is Not*, in *LAW AND INTERPRETATION* 31 (A. Marmor ed., 1995). Naturally where the law is absolutely settled and the fact situation clearly covered, there is little room for the thought that "[t]he rules change as the rules are applied" as maintained by E. H. LEVI, *AN INTRODUCTION TO LEGAL REASONING*, 1, 3-4 (1949). But there is some considerable truth in this statement as it has to be accepted that in a rapidly changing society the rules as they are may become seriously antiquated whilst those that may become applicable to differing configurations of the facts may not be clear. Whether it likes it or not, the law must evolve and that development is now often fast and informal, that is through the interpretational techniques in the adjudicatory process or through legal structuring.

Of particular importance in the context of this discussion is that these extra-legal objectives and considerations are by their very nature often not clearly expressed in black letter law and are therefore *not* statist *per se*. They may indeed represent much broader values. These objectives could, however, still be considered of a national character, and therefore as emerging *only* within a *national* legal order with its territorial limitations. Art. 3.12 of the new Dutch Civil Code<sup>30</sup> would suggest as much. But where we admit that the law and its functioning are intrinsically connected with social and economic realities and value systems which invade the law and its operation at all times, at the same time justifying it and in specific cases imposing extra demands or giving extra rights to participants, it is only normal to consider also whether the expansion of the law in this manner remains always purely national and territorial in nature. To repeat, the appeal could be to much broader and much more general values, of which human rights or human rights-related considerations may be the most obvious examples. But, especially in commerce and finance, appeals to rationality, reason or efficiency in this connection would neither be state-specific nor imply a narrow national cultural bias.

At least in the communitarian view, under which, in the opinion of some,<sup>31</sup> the notion of communities may claim moral primacy over the notion of states, it is only logical to question whether the state or the nation, and therefore the community at a national level, can remain the only true source of law and its values. No less important is the conception of an important strand in modern Law and Economics that posits that the decentralization of the law is a modern necessity.<sup>32</sup> Here the idea is that when economies become more complex and information and incentive constraints increasingly frustrate public policy, efficiency demands decentralized non-statist law-making. I shall come back to how in this approach the process of private law-making is perceived to function in practice—which is then connected with the already-mentioned psychological process of internalization. It may also be observed that any law must have a self-propelling force to maintain itself, evolve further, and retain its meaning. It is in this connection only too obvious that states, in their intervention in the law through statute or otherwise, often get it wrong or produce for political reasons something that is innately unworkable, obscure, *ad hoc*, unstable, or perceived

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30. In defining the fundamental concept of good faith, Article 3.12 refers for its interpretation to generally recognized legal principles, the convictions living in the population at large, and the social and personal interests involved. See *infra* note 38 plus accompanying text for a similar approach in the United States.

31. See PHILIP SELZNICK, *THE COMMUNITARIAN PERSUASION* 64 (2002). Some French legal scholarship insisted on the internal sovereignty of all social groupings much earlier. See G. GURVITCH, *L'IDEE DU DROIT SOCIAL* 84 (1932); *SOCIOLOGY OF THE LAW* (1942). They were even within nations considered to create their own law, which limited that of states and was, in principle, superior to it. For a similar approach in The Netherlands, see H. J. VAN EIKEMA HOMMES, *HOOFDLIJNEN DER RECHTSSOCIOLOGIE EN DE MATERIELE INDELINGEN VAN PUBLIEK- EN PRIVAATRECHT [MAIN THEMES OF LEGAL SOCIOLOGY AND THE MATERIAL DISTINCTION BETWEEN PUBLIC AND PRIVATE LAW]* (1983).

32. See Cooter, *supra* note 2.

as fundamentally unfair (and therefore subject to strong erosive pressures), so that the law with the help of practices and the adjudicatory process must continuously correct and purify itself if only to retain its credibility and move forward.

Legal nationalism remains, however, the traditional view on the European Continent as well as in England.<sup>33</sup> In England, nationalism found early support in the quite virulent statist positivism of J. Austin (even if not relying on statutory law *per se*), who perceived all law-making, whether or not statutory, as dependent on the sovereign's command.<sup>34</sup> The modern English theorist, Professor Hart, also finds that law remains in essence statist or at least nationalistic in nature.<sup>35</sup>

Somewhat more surprising, perhaps because of its openly 'realist' and functional approach, nationalism also remains a strong sentiment in modern American legal thought, where it tends to be closely related to American democratic identity and American values. However, there is here no extreme positivism and, in the 'realist' sense, the law may certainly be validated in other ways than by state command or legislation alone. This structure permits of a strong

33. The earlier development of the law in England was very different from that on the Continent. See *supra* note 22. In England, after the Norman Conquest, the law developed through the evolution of a set of writs in a centralized court system in the context of an approach that at first put emphasis on procedural relief in certain cases. By the seventeenth century, the writs had been substantially expanded whilst the central court system had absorbed all competition, notably also that of the commercial and ecclesiastical courts, and started to absorb the commercial and ecclesiastical law itself into its writs and subpoenas. Although it was not meant to be a nationalistic system *per se*, in the absence of competition, it became so early and largely by default.

34. The nationalistic or perhaps more cultural historical element was first articulated by E. BURKE, REFLECTIONS ON THE REVOLUTION IN FRANCE (1993). Subsequently Jeremy Bentham asked for codification on the basis of his utilitarian views, which could have led to a rational, objective, and more coherent universal legal system except for his simultaneous insistence on national codification. See JEREMY BENTHAM, CODIFICATION PROPOSAL, COMPLETE WORKS IV (1854); JEREMY BENTHAM, 'LEGISLATOR OF THE WORLD': WRITINGS ON CODIFICATION, LAW AND EDUCATION 5 (Philip Schofield & Jonathan Harris eds., Clarendon Press 1998). Burke and Bentham thus came together in this nationalistic element, which in the teachings of J. Austin culminated in the view that all law depended on the command of the sovereign. See J. AUSTIN, 2 LECTURES ON JURISPRUDENCE 91-103 (Robert Campbell ed., James Cockcroft & Co. 1875). In this approach, even business custom was considered domestic in nature and was also caught in the system of precedents, but could at least in the U.S. (like law and equity) still survive statutory law if not meant to overrule it. Cf. U.C.C. § 1-103 (a)(2)-(b) (2001 revisions) (articles 1- 102(2)(b) & 1-103 (old)); see also *infra* note 60.

35. It is in the nature of his ultimate rule of recognition, which is identified by the *de facto* operation of the state apparatus of legislature, courts, governmental agencies, police and the like. See Hart, *supra* note 10, at 106. In this view, custom *arises* and is not law proper, which is *made*. Custom is here seen as static, primitive, and inefficient as it misses the necessary modern infrastructure. See *id.* at 45, 91-98. In terms of this paper, it is the international commercial and financial legal order that provides it rather than rules of recognition which themselves presume other rules that identify and sanction them. For a sharp criticism of this view and an emphasis on the dynamic nature of custom and its importance in modern society, see Robert Cooter, *supra* note 2. For the dynamic notion of custom and its evolution, see also DALHUISEN, *supra* note 1, at 138.

For the effects of this statist approach and the resulting present day differences between the American and English approaches, see P. S. ATIYAH & R. S. SUMMERS, FORM AND SUBSTANCE IN ANGLO-AMERICAN LAW; A COMPARATIVE STUDY OF LEGAL REASONING, LEGAL THEORY, AND LEGAL INSTITUTIONS (1987).

secular natural law streak,<sup>36</sup> well know from the work of Lon Fuller but also recognizable in that of Rawls and Dworkin,<sup>37</sup> and for which there is much backing in American idealism and constitutional principle. It is a naturalism that is not primarily based on universal notions or rationality, but rather on an intrinsic public morality or on notions of fairness that could still be considered nationally confined and therefore largely historical or cultural. This insight is sometimes even seen as a major achievement of legal realism in the U.S.<sup>38</sup> In this, Americans are and need be less aware of the modern interaction between nations and cultures than the Europeans may be.

On the European Continent, on the other hand, the eventual supremacy of state law is more in particular associated with the evolution of the idea of the modern state itself and the functioning of a policy-oriented infrastructure and bureaucracy.<sup>39</sup> In Germany, legal nationalism found its philosophical anchor

36. Natural law has had many different meanings and explanations. For its earlier secular development, see *supra* note 22. They have all in common that it is a law that for its force is not, or at least not entirely, dependent on human intervention as positive law is. It is not believed therefore to need for its validity or recognition the support of any authority, whether of a national/statist or supranational character, or the support of an ultimate rule of recognition in the sense of Hart, or apex norm or *Grundnorm* in the sense of Kelsen. In its secular form, it became in its method closely related to rationality and in its value system to human rights considerations which both claim a more universal reach. It is not necessarily to be equated with the demands of morality although there is often a close affinity. For an important reflection on natural law, positive law and historicity, see J. BERMAN, FAITH AND ORDER, in EMORY UNIVERSITY STUDIES IN LAW AND RELIGION 289 (1993).

37. L. FULLER, THE LAW IN QUEST OF ITSELF (1940); JOHN RAWLS, A THEORY OF JUSTICE (1971), POLITICAL LIBERALISM (1993); RONALD DWORIN, TAKING RIGHTS SERIOUSLY (1977). On Fuller, see REDISCOVERING FULLER (W. J. Witteveen & W. van der Burg eds., 1999).

38. Robert Post, *The Challenge of Globalization to American Public Law Scholarship*, 2 THEORETICAL INQUIRIES IN LAW 323, 324 (2001). *But see also* Justice Kennedy, *supra* note 20.

39. Regardless of his universal views in terms of natural law, already in the views of Grotius, see *supra* note 22, the positive law could be more confined. This issue arose in connection with the status of local law and particularly in connection with the relationship between the natural law and the modern state and its law formation powers. It concerned foremost the impact of public policy or the *raison d'état* on the law, its formation and its application. There arose here considerable tension in Grotius' approach and it is less clear-cut in this aspect. This tension became ever stronger in later writers and had to do with the evolution of society into a phase in which the position of the state was clarified and the notion of sovereignty further developed. It is an important development that started in Europe in the seventeenth century, although it leaves open the question whether as part of a more determinist evolution, the nineteenth century 'nationalization' of the law by states was unavoidable. For the (further) development of private law in these circumstances, see JURGEN HABERMAN, THE STRUCTURAL TRANSFORMATION OF THE PUBLIC SPHERE 73, 73-79 (Thomas Burger trans., 1991) and MAX WEBER, RECHTSSOZIOLOGIE 329 (reprint 1967).

In fact, any restraining influence of universal natural law concepts on states increasingly disappeared after Grotius. This is obvious in the work of Thomas Hobbes (1588-1679) in England, but also in that of Grotius' successor in the natural law school in Germany, Samuel Pufendorf (1632-1694). See SAMUEL PUFENDORF, 2 DE JURE NATURAE ET GENTIUM, LIBRI OCTO VII.9.5 (1688). As is well known, in Hobbes' view, rather than there being a natural instinct of people wherever they were or came from to live together in peace and harmony (*appetitus societatis*) in the style of Grotius, the human condition was considered to be one of all against all (*bellum omnium in omnes*), THOMAS HOBBS, 3 DE CIVI L.XII (1651), with the accent on each person being allowed to use his power at will to preserve himself. See also THOMAS HOBBS, LEVIATHAN, ch. 14 (1651). To constrain the right of the strongest, people had to impose laws upon themselves. These were the sole sources of justice that could only operate within a state (after the natural condition had been abandoned). THOMAS HOBBS, DE HOMINE X (Charles T. Wood, trans., Peter Smith 1978) (1658).

early, in nineteenth century romanticism as well as in the related historical school of von Savigny and Puchta, with their reliance on a germanic *Volksgeist* as unifying spirit, followed by the Hegelian demand that all law be systematic and therefore statutory and statist *per se*.<sup>40</sup> Hence, in private law, we see the

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There follows no less the construct of a social contract under which individuals in order to live in peace abandon their personal rights (except those to life and limb).

Thus the accent shifts to the modern state which in this view became eventually the source of all law, including even customary law (by way of state recognition) and then also the law merchant. In this approach, international law, as the law between states, has no autonomous place either and the sovereign does not owe obedience to its own laws whilst natural law constraints are at best a matter of conscience for the sovereign. Thus natural law had a meaning only if it became positive law upon the order of the sovereign and had no normative character of its own. On the other hand, it would follow that the state's reach could not go beyond its borders. At the end of the seventeenth century, in England through JOHN LOCKE, *TWO TREATIES ON CIVIL GOVERNMENT* 1690 (London, George Routledge & Sons 1884), the concept of more universal *inalienable* rights re-emerged as a protection against the all-powerful sovereign under the social contract. At that stage of jurisprudential thought, the effect was, however, mainly in private and criminal law and centered on notions of freedom or autonomy, equality and ownership.

Even in Locke's case, this was all seen within the context of the modern state, which, on the basis of the public good, through legislation, could even affect the inalienable rights, although ultimately the people retained the supreme power to remove the legislature. Only in the teachings of Rousseau (1712-1778) did these inalienable rights acquire a human rights flavor and internationalist or universal status, although in his view these rights were no less given back to the state so as to re-emerge as state protected private right. See JEAN-JACQUES ROUSSEAU, *DU CONTRAT SOCIAL* 3:1 (1762). They would not seem to have force and effect outside that context.

Kant insisted on rational legal principles but did not give them autonomous legal status either. All depended on their incorporation in positive law by a state that could ignore them. IMMANUEL KANT, *GRUNDLEGUNG ZUR METAPHYSIK DER SITTEN* 320 (1785) (1797); IMMANUEL KANT, *METAPHYSICAL ELEMENTS OF JUSTICE* 317, 372 (Lewis White Beck trans., 1965); IMMANUEL KANT, *FOUNDATION OF METAPHYSICS OF MORALS* 424 (Lewis White Beck trans., 1965); cf. ALLEN D. ROSEN, *KANT'S THEORY OF JUSTICE* 112 (1993). The rational legal principles (as distinguished from moral principles) were thus no more than guidelines and had no legal force of their own.

The other dominant early nineteenth century German philosopher, Hegel, confirmed this view in which law could be no more than positive law and had a local character since it depended for its force and effect on a system that could only be produced by the legislator and for its contents on the historical will of a people of which the state became (in this view) the expression (of the objective will) as the only legitimate actor in the march of history. See G.W.F. HEGEL, *GRUNDLINIEN DER PHILOSOPHIE DES RECHTS [THE PHILOSOPHY OF RIGHT]* (1821), reprinted in 46 *GREAT BOOKS OF THE WESTERN WORLD* (1952) at Par. 211ff (1952); see also HEGEL: *ELEMENTS OF THE PHILOSOPHY OF RIGHT* (Allen W. Wood, ed., 1991).

Here enters an *irrational* element and pure nationalism, which was territorial but not necessarily cultural in a national sense as it seemed to represent the sentiment of only some parts of the population. Where a *Volksgeist* was invoked, see SAVIGNY, *SYSTEM DES HEUTIGEN ROEMISCHEN RECHTS*, 22, 24 (1840), it tended to be notoriously anti-big city and anti-industrial. See also Hermann Klenner, *Savigny's Research Program of the Historical School of Law and its Intellectual Impact in 19th Century Berlin*, 37 *AMER. J. COMP. L.* 67, 77 (1989) (referring, however, also to Hegel's rejection of the atavistic unworldly undercurrent in the *Volksgeist* notion). At least on the European Continent, ultimately it left little room for the contemplation of any other legal order and for the validity of any other law (even directory as against mandatory law) outside this statutory system. Human rights, although in principle granted in the Constitutions of those days, were in this approach also purely national and could be overruled by any statute, which in the prevailing consensus could not be tested on its constitutionality in this regard.

40. See *supra* note 39. It is true that the earlier French Civil Code of 1804 and the Austrian one of 1811 preceded this nationalism and were perhaps more products of rational enlightenment thinking, but they were no less national laws, did not claim any other remit, and fitted the subsequent emergence of nationalism in these countries also.

development of the great German Civil Code, or BGB. This progression could also be considered a prime expression of the notion that law is a cultural phenomenon, as long as it is understood that in this manner it was virtually immediately connected with nationality rather than with different social groups or cultures.

Yet it has often been pointed out that there was always a dichotomy: was it the national spirit or was it the modern state ordering technique itself that determined the meaning and shape of the law? Was it therefore custom-oriented or was it state action-driven? In other words, are we talking here of an immanent law or about strategy and policy? Is this law embedded in social cultures or values and economic realities or propelled by the *raison d'état*, and therefore by state public policy? Is there an appeal here to community spirit and its natural justice or is it an imposition of state order? If culture and historicity were the point, how could it be that the *Ius Commune*, meaning the then-prevailing and widely applied variant of Roman law, was not chosen as the point of departure for the German Civil Code, but rather the classical Roman law which had been completely forgotten and after 1500 years was just being rediscovered and had nothing to do with Germanic culture. Or was it mainly an intellectual exercise—private law as icon of German legal thought and intellectual culture—or all of this and more?

Whatever the view, the modern German attitude, even if allowing for a large intake of good faith notions, remains in essence dependent on statutory law, which is statist, systematic, and formalistic in concept. It follows that it relates all statutory and case law, even that which reflects good faith notions, to a system that is supposed to be national, coherent, and substantially the subject of formal interpretation techniques intent on maintaining and elaborating upon this system. That at least would seem the drift of modern German legal scholarship,<sup>41</sup> even if case law may show some freer spirit. Certainly, the whole evolution of the good faith concept in Germany since the 1960s was the result of this greater freedom in judicial decision-making, rather than of any academic or intellectual concern. In fact, academia in Germany appears to this day more interested in systems and system building than in a more functional approach, an attitude for which the now mildly pejorative term *Begriffsjurisprudenz* is commonly used.

Be this as it may, rather than seeing the state as a proxy for legal orders, the

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41. See K. LARENZ, *METHODENLEHRE DER RECHTSWISSENSCHAFT* 5 (5th ed. 1991). *But cf.* J. KOENDGEN, *SELBSTBINDUNG OHNE VERTRAG* (1981); J. ESSER, *VORVERSTANDNIS UND METHODENWAHLIN DER RECHTSFINDUNG* (1970). The situation in France is not much different. *But cf.* LAURENT COHEN-TANUGI, *LA METAMORPHOSE DE LA DEMOCRATIE* (1989); LAURENT COHEN-TANUGI, *LE DROIT DANS L'ETAT* (1985). The same formalism revived in the Netherlands after the enactment of its new Civil Code of 1993. *But cf.* M. W. HESSELINK, *THE NEW EUROPEAN LEGAL CULTURE* (2001). For Europe, legal formalism has sometimes been seen as protecting against political influences and arbitrariness. See DUNCAN KENNEDY, *A CRITIQUE OF ADJUDICATION* 73 (1997). But in the absence of a strong value base in the codes themselves, code interpretation has always been at the whim of the prevailing regime, of which exactly the BGB has provided the clearest example.



reliance on law as a cultural phenomenon, a product of a particular moral, social, and economic environment, which in civil societies many people now accept, would suggest that law is *not* entirely state dependent. Indeed, it would be hard to deny that these basic values, which underpin and expand the law, could also present a more internationalist picture or anchor, expressed at the public law level in more universal concepts of human rights and at the private law level in trade, commerce, and finance law. In private law, this new picture could lead to more fundamental, rational and universal principles of contract, property, and negligence, as we shall see. It then reflects a group normative identity which need not be that of a state and is not nationalistic *per se*.

More particularly, it may be argued that where in commerce and finance the underlying economic aims lead to internationalized commercial and financial structures that have innate logic, they would give rise to similar expression in whatever legal system that means to support them. That would in itself suggest a drive towards uniformity in their legal characterization unless domestic systematic principles of the legal system concerned would prevent it, in which case the validity and usefulness of that system itself would soon become questionable.

It could in this connection even be observed that the modern state and its environment, as well as the law it creates, are themselves products of a much broader, modern, *Western* culture, based on the particular political orientation of modern democracy, and are not truly dependent on a narrower national, territorial, ethnic, religious or linguistic notion of culture at all. In this political orientation, modern states are further subject to an internal rotation of political power between different groups or persons. This constant turnover implies even at the national level a rejection of monolithic values or cultural notions. A related facet of this orientation is acceptance of diversity coupled with a high degree of individualism, albeit subject to a strong organizational framework led by a bureaucracy largely intent on efficiency considerations under shifting political controls in terms of its objectives and the distribution of burdens.

It follows that law, or at least large parts of it, even if seen as a typical cultural phenomenon, is not necessarily statist or even domestically a constant. Law as such may therefore not only have a broader, transnational or Western flavor, but also a *less* than national flavor, as expressed in the internal rules of *smaller* regional communities, or more particularly of families, churches, and similar institutions, domestic types of market organizations (in commodities, for example), other associations or self-regulatory organizations and professions, partnerships, and companies, or even in the rules that contracting parties agree to among themselves. In fact, rules that are considered binding emerge quite naturally all the time wherever people interact in order to achieve some moral, social, economic, or other end and require a sense of order and predictability. This in itself would confirm that legal orders and their laws, and certainly private laws, are foremost *participants and purpose* driven and not primarily or solely *nation or state* related or territorially confined.

It should also be borne in mind that much law is merely technical, and

therefore not cultural in any sense at all, such as budgetary and tax laws in public law, or the law concerning the transfer of chattels and intangibles in private law. Thus, in public law, budgetary and tax laws allow for a number of alternatives which would not seem particularly driven by culture but rather by expediency and practicalities. If there is still a cultural flavor, it is Western rather than national. In private law, whenever still considered cultural, it must be admitted that it is often of an uncertain and in any event a foreign pedigree. Thus, in civil law we still see strong Roman and Byzantine roots and in common law some strong feudal and Saxon features. In this vein, whole legal systems are commonly transferred to other countries, as the common law was throughout the English-speaking world and the French and later German civil codes throughout much of the rest.

It is the perception or axiomatic view of law as state law that needs to be abandoned because it does not correspond with reality and has, at least in international transactions, no longer a sufficiently reliable force and predictive value. In the diverse environment of a civil society, such an outlook is in any event not desirable, and also does not meet modern economic (efficiency and distribution) requirements, especially in international commerce and finance. If the law were merely seen as statist, it would reveal an inner contradiction, at least in the cultural and communitarian or sociological approach to the law, which on the one hand would promote diversity and on the other only favor national cultures and statist laws.

If not so much the defense of national cultures but rather *certainty* in the law and its *clarity* are here the overriding concern, and considerations of efficiency are invoked in this manner leading to a preference for domestic laws as presenting the more elaborate systems, considered therefore to be the more certain, as is still a commonly-held and on its face quite reasonable view, it should be realized and follows that, as already suggested above in the introduction, application of domestic state laws in international transactions may present a certainty and clarity of such a low quality that it may easily destabilize commerce and finance. In fact, less certainty and predictability, and extra cost, could be the result of this attitude.<sup>42</sup> In any event, certainty and clarity are often illusions

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42. Certainty has been traditionally stressed in English case law since Lord Mansfield, especially in mercantile transactions. See *Vallejo v. Wheeler*, [1774] 1 Cowp. 143, 153 (K.B.); see also *Homburg Houtimport BV v. Agrosin Private Ltd., The Starsin*, [2003] 1 Lloyd's Rep., 571, 577 (opinion of Lord Bingham of Cornhill); *Compania de Neviera Nedelka S.A. v. Tradex Internacional S.A., The Tres Flores*, [1974] Q.B. 264, 278 (opinion of Roskill L.J.). In the U.S., see *McCarthy, Kenney & Reidy, P.C. v. First National Bank of Boston*, 524 N.E. 2d 390 (Mass. 1988). But it is to be noted that it concerns here often negotiable instruments and letters of credit, all related to payments, therefore to a narrower strand of commercial law where finality is indeed of special importance. See also *Pero's Steak and Spaghetti House v. Lee*, 90 S.W. 3d. (Tenn. 2002).

In other areas, for example where good faith notions are now commonly used, the emphasis may more properly be on common sense solutions or even on extra rights and duties, although it can also be argued that especially in commerce and finance, it is the intention of the parties that pre- and post-contractual rights and duties (e.g. disclosure duties prior to contract and renegotiation duties in the case of hardship) are to be more narrowly construed than in consumer law.

In England, Lord Justice Bingham, in *Interfoto Picture Library Ltd v. Stiletto Visual Pro-*

that cannot be achieved in domestic private laws either, all the less in a rapidly changing world where national laws are also under great stress and show ever greater inadequacies in their purely domestic applications.

That is not to say that the new international commercial and financial laws are necessarily easy to find, although, as I shall attempt to show in Part V, the problems are often exaggerated. It is true, however, that the search for this new law requires restraint, discipline, and a profound knowledge of how and in what setting the law develops and works, what its basic concepts are likely to be, and how and to what extent they may be transplanted or borrowed from state laws. At the same time, it demonstrates how these concepts may be transformed by the dynamics of another, new, legal order in which they are asked to operate.

### III.

#### THE CONCEPT OF LEGAL ORDERS

Whether law derives from states or from other cultures or communities, it is posited here that law, and certainly private law, always operates in some legal framework or order, even if it originates spontaneously (as through custom or practices). This approach suggests some organizational structure for law formation even if such formation may remain itself entirely informal. If this were correct, it would be for us to say what a legal order is and to find in each instance the relevant legal order whose normativity could then acquire the full status of law if it was meant to function as such. Whatever law results, it would then have to be pleaded and applied as the living law in any court (including state courts and international arbitrations) to any issues properly arising in that legal order. The laws so identified would therefore in principle have to be accepted in respect of such issues by other legal orders and their institutions, including their courts.

It follows that in respect of issues properly belonging to the international commercial and financial legal order, it would be the law of that order, namely the international law merchant or modern *lex mercatoria*, which would then have to be applied by state courts and international arbitrators alike. Decisions properly coming from this legal order, such as international arbitral awards, would subsequently become entitled to the coercive powers of states in en-

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grammes Ltd., [1989] 1 Q.B. 433, 439, while holding that particularly onerous or unusual conditions had to be brought to the special attention of the counter-party and that the conventional analysis of offer and acceptance was not followed in that case, considered in this connection that the English authorities look at the nature of the transaction and the character of the parties to it to consider what was necessary to conclude to a binding contract. See *supra* note 23.

In this context, emphasis on finality is not incompatible with the transnationalization of commercial and financial law. See J.H. Sommer, *A Law of Financial Accounts: Modern Payment and Securities Transfer Law*, 53 BUS. LAW. 1181 (1998). It is submitted it may be enhanced by it. It would also seem misconceived to ask in this context for clearer rules of conflicts of laws and be satisfied even with arbitrary rules and disconnection. That is a step back and contrary to the basic tenants, history, and urgent needs of international commerce and finance. For more modern views on the destabilising effect of custom in this connection, see note 60 *infra*.

forcement as long as states largely remain the repositories of enforcement power. In this sense the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards is only the confirmation of this state of affairs not its originator.

This requires a clearer view of which orders and rules or laws so qualify. That is all the more necessary if the law of other orders, in particular of a state legal order, would be set aside (at least in principle). Even if in international transactions state law would still prevail, there would then have to be a clear justification that most likely would derive from overriding public policy objectives (embodied in mandatory or regulatory rules) of the state concerned in respect of any *effects* of international transactions *on its territory*.<sup>43</sup> This would assume at the same time the existence of some norms of an external or higher order to decide on the relative existence and competencies of each legal order and on any conflicts or competition between them. I shall come back to this aspect in Part IV.

As noted before, these concerns apply not only to the status of the rules in the international commercial and financial legal order which transgress states, but also to the status, intra-state, of the rules of smaller communities, like families, churches and similar groupings, associations or self-regulatory organizations and professions, partnerships and companies, or perhaps even the rules that contracting parties agree to amongst themselves.

It could be intellectually attractive to attribute autonomy to them *all*, and therefore to any grouping no matter how ephemeral or transient, at least to the extent their rules have been *consented* to. It is not that simple, however,<sup>44</sup> not merely because it would make the setting aside, or at least the challenging of state rules a seemingly casual affair, but because, more basically, not every association or community is a legal order.

An important, although more technical argument, is that such a notion of participation or consensus itself presupposes more objective rules that determine when it counts. Such rules would not be of a consensual nature but would concern the whole group and the way it functions. These rules are therefore of a higher, more objective nature. For instance, even simple contracts are embedded in and depend for their binding force on a broader legal framework that is not necessarily voluntary in all its aspects or depends on consent and participation alone.<sup>45</sup> Therefore, participation and consent in this sense would appear to

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43. See *infra* text accompanying note 82.

44. It might thus be thought that an important distinction between state and other legal orders is that the latter are voluntary, the former not. It may be doubted whether that is really so, even in the sense that a participant can always opt out. Her activity or position may prevent it (unless she quits the particular activity or position entirely). In any event, much of (private) state law can also be opted out of; on the other hand, once operating in a legal order, some more fundamental rules cannot be avoided through party autonomy and would not allow for contractual variation, like the rules concerning contractual validity or enforceability itself and the parties' capacity to contract (quite apart from their inability to create proprietary structures at will and to evade public policy considerations through alternative contractual stipulation).

45. There would also be a problem with third party effect, therefore in all proprietary mat-

presume a legal order of some sort and do not seem to be able to create them at the same time. They cannot be the sole determining factors for the autonomy of these legal orders and the law that results in them. Other more objective criteria must be found to delineate them and mark out the positive law that arises in them.

It was already said before that if we think of law as a cultural phenomenon or social event, the discussion of all legal orders in terms of their autonomy must start with a notion of social groupings or, in public international law, with a notion of a community of nations or of smaller groupings of states like the EU that may be more particularly concerned with economic flows or the operation of a single currency. The discussion of legal orders would subsequently seem to require an idea of societal patterns that confirm a rule-creating function, and therefore a notion of how these orders are formed and how the law, as a set of rules with binding effect, emerges within them.

This discussion therefore first requires the identification of the relevant circle of participants in a given range of activities. In international commerce and finance, these are likely to be the professionals in their trade. Second, a willingness and capacity to produce rules must be identified, along with a capability to hold the group together as a group and to make it function better on the basis of these rules. Thus mere communion is not enough; some incipient organizational structure, however informal, would be required. Third, and most importantly, there would likely also be some sustaining economic motive, force, or momentum. For the international commercial and financial legal order this is likely to be the societal energy now created by the force of the modern international flows in professionals, goods, services, and money. Indeed, this increase in the free flow of goods and services at the international level may be the true reason for the recent re-emergence of the international commercial and financial legal order as a law-creating institution and for the consequent revival of the *lex mercatoria*.

Closely connected is an identifiable economic interest in commerce and finance that is in need of encouragement. This suggests in turn a search for some protection leading to some reliance on realistic expectations in this regard. Certainly, in international business, one would further expect some ordering component in terms of efficiency, rationality, consistency, and predictability. In fact, the need to decrease transaction costs and facilitate exchange may become another important motivator in the process of transnationalization of commercial and financial law, and thus may lend additional support to the law-creating capabilities of the international business community.

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ters. More objective community rules that present established practices would be necessary in this area for new proprietary interests to arise. It is not impossible that within the group or order some rules even acquire an immanent public order element and become absolutely mandatory in the order concerned. Such rules might include, for example, elementary rules of justice or acceptable behavior. Not only state orders have public policies! This is obvious where we now often speak of the international public order. *See infra* note 79.

Some consensus will be necessary also on a basic international economic system that, even though in essence relying on a market approach, still will have to accept states as important balancing actors, at least in respect of public interest sensitive transactions in, or with an effect on, their territories. This concerns regulatory issues. Finally, and perhaps somewhat surprisingly to the outsider, another important sustaining factor may have to be found in public morality; that is, in a search for at least some honesty, transparency, and accountability, all vital preconditions for the sustainability of international business.

As just mentioned, the relevant circle of participants in a given range of activities in international commerce and finance are likely to be professionals in their international trades,<sup>46</sup> united in the modern free flow of professionals,

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46. Thus the United Nations Convention on Contracts for the International Sale of Goods, Vienna, Austria, Apr. 11, 1980, 1489 U.N.T.S. 3, art. 1, whilst excluding consumer sales, clearly limits its scope to professional dealings. The UNIDROIT Principles of International Commercial Contracts (1995), available at <http://www.unidroit.org/english/principles/contents.htm>, target such dealings for professionals more generally. In France, already in the 1930s the notion of 'international contract' was more specifically developed in this connection, for which gold payment clauses would be accepted and were upheld even though generally forbidden under domestic law. See DELAUME, *supra* note 1, at 119.

An argument can be made that 'internationality' and 'professionalism' have become inextricably linked in the sense that all professional dealings will come to conform to international standards even if they have in a particular case no international aspects. See DALHUISEN, *supra* note 1, at 26; see also *infra* text accompanying note 84. The distinction is then between the international legal order which is professional and the domestic legal order, which is for consumers.

The notions of 'professionalism' and 'internationality' have been explored more in particular in connection with international arbitrations. They arise when parties come from different countries, when the subject matter is of an international nature, or when the arbitration takes place in an unrelated country. See French Decree No. 80-345 of May 14 1980, JOURNAL OFFICIEL, May 18, 1980 reprinted in SEMAINE JURIDIQUE III 49887 (1980); UNCITRAL Model Arbitration Law, *supra* note 3, art. 1(3).

The U.C.C. in the U.S., although not written for international sales, defines the notion of merchants and dealings between merchants in Sec. 2-104, but *only* in the context of the domestic law of the sale of goods (and not as a broader concept) and has some special rules for them. A merchant is here a person who normally deals in goods of the kind or otherwise holds himself out by his occupation as having knowledge or skills peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill. Dealings between merchants are transactions with respect to which both parties are chargeable with the knowledge and skills of merchants.

It may be of interest in this connection, however, that Article 2 U.C.C. became less professionally oriented than was originally planned. See Zipporah B. Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 HARV. L. REV. 465 (1983). Note, however, that Article 2A (on leases), Article 8 (on trading and holding of modern investment securities entitlements), Article 4A (on payment systems), Article 5 (on letters of credit) and even Article 9 (secured transactions) are substantially geared to professional transactions. See, e.g., U.C.C. §§ 4A-108, 5-102(a)(9), 9-109(d)(13) (2001 revision).

In terms of internationality and commerciality, there is significant case law from the U.S. Supreme Court that carves out all types of international contracts between professionals as representing a special area where at least forum selection and arbitration clauses are upheld also in respect of statutory (anti-trust and securities) claims. See *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974); *The Bremen et al. v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972).

goods, services, capital, and payments.<sup>47</sup> Indeed, at the more practical level these flows may themselves suggest a connected way of dealing or operating and a pattern of legal rules that has no origin in domestic laws and can often not be satisfactorily explained or covered by them, but must instead be attributed to the operation of the international commercial and financial community itself (as in other times a *Volksgeist* or national spirit may have done to unite the law in all of Germany).<sup>48</sup> Clearly, in these international flows, the dynamics are likely to be quite different from the local ones. Local law is unlikely to have been developed for them and may be deficient or make no sense in international commercial transactions at all, as for example in its limitations on the protection of *bona fide* purchasers or in the type of proprietary rights (and trust structures or agency relationships) it allows to operate against third parties,<sup>49</sup> two issues which are of particular relevance in modern finance.

In this regard, the view has authoritatively been expressed<sup>50</sup> that new law is constantly formed through the sectarian separation of communities. In this view, each legal order perceives itself as emerging out of something that itself is unlawful. Separateness and separation are here identified as crucial constitutive elements of new legal orders, which may require in each case a normative mitosis or radical transformation of the perspective of a group or a completely new life experience to emerge. Sustainability is closely connected. The emphasis moves here to struggle and triumph, to a revolutionary element in the creation of new legal orders that essentially compete with the older ones. In terms of this approach, in commerce and finance, recent increases in international commercial and financial flows could be seen as the fuse for the change of perspective in the participants and the establishment and operation of a new international

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47. See *supra* text accompanying note 15.

48. See *supra* text accompanying note 40. In commerce, the undercurrent of international practices has always remained more obvious regardless of nineteenth century nationalism. That is clear especially in the nature of bearer instruments or instruments to order, the way in which they are transferred and *bona fide* purchasers of them are protected. The basic patterns continued to derive here from what made sense in the international community, even if these traditional instruments (in terms of bills of exchange, bills of lading and bonds or shares) are now of much less importance than they even recently were because of the dematerialization drive, which applies more in particular to shares and bonds. See U.C.C., art. 8 (2001 revision) (setting out the replacement notion of 'security entitlement'). The result is, however, a further reduction in the international flavor of these originally international instruments.

In this connection, it may be also of interest to quote *Lauritzen v. Larsen*, 345 U.S. 571, 581 (1953), in which the U.S. Supreme Court, per Justice Jackson, famously held for maritime law that, [C]ourts of this and other commercial nations have generally deferred to a nonnational or international maritime law of impressive maturity and universality. It has the force of law, not from extraterritorial reach of national laws, nor from abdication of its sovereign powers by any nation, but from acceptance by common consent of civilized communities of rules designed to foster amicable and workable commercial relations.

49. Jan Dalhuisen, *European Private Law: Moving from a Closed to an Open System of Proprietary Rights*, 5 EDINBURGH L. REV. 273 (Sept. 2001); cf. Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1 (2000).

50. See R. Cover, *Nomos and Narrative*, 97 HARV. L. REV. 4, 31 (1980).

commercial and financial legal order between them.<sup>51</sup>

Others<sup>52</sup> put emphasis rather on how the new law can be identified. This is typical for a quite different and more reflective and fact-finding approach connected with Law and Economics. Its supporters suggest that for international commercial law to arise and to count legally in the sense that states must accept its legal status and back it up by coercive power, (a) the norms that arise in the specialized business communities must be empirically identifiable, (b) the incentive structure that produces or internalizes the norms should be analyzed (by using game theory and the notion of equilibrium) in order to determine whether the norms empirically found are more than social convention or moral dictates and are being experienced as legally binding, and (c) the *efficiency* of the incentive structure should be evaluated using analytical tools from economics to avoid harmful laws, like monopolistic practices, which should therefore not be enforced. Here, the emphasis shifts to empiricism, efficiency consideration, rationality, consistency, and predictability. It may in this connection perhaps also be posited that 'modernity' and the 'advanced' nature of the new norms themselves could even become an affirmation of their force in the context of their international validity.<sup>53</sup>

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51. There has only been limited comment in recent American legal literature on the globalization process itself and the creation of international legal norms and the relationship to national orders. See John Yoo, *Globalism and the Constitution: Treaties, Non-Self-Execution, and the Original Understanding*, 99 COLUM. L. REV. 1955 (1999); Patrick Tangney, *The New Internationalism: The Cession of Sovereign Competences to Supranational Organizations and Constitutional Change in the United States and Germany*, 21 YALE J. INT'L L. 395 (1996); Harold Koh, *Transnational Legal Process*, 75 NEB. L. REV. 181 (1996).

52. R. Cooter, *supra* note 2, at 217, 226.

53. Thus, in oil concessions references to the law of all civilized nations used not to be uncommon, although now probably considered offensive to the oil producing country in question. See Iranian Petroleum Agreement of 1954 (referring to "principles of law common to Iran and to the various countries to which the other parties belong and, failing that, by principles of law generally recognized by civilized nations, including such principles applied by international tribunals"). Under *ad hoc* exploration agreements with Libya, the arbitrations that eventually also decided on the nationalization issues were to be governed by the "principles of the 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 these principles as may have been applied by international tribunals." *Texaco Overseas Petroleum Co. & Cal. Asiatic Oil Co. v. The Gov't of the Libyan Arab Republic*, 4 Y.B. COM. ARB. 177, 181 (1979). Especially in the oil and gas industry there were many similar clauses. Thus the Aminoil Concession Agreement of 1979 made reference to the law of the Parties "determined by the Tribunal, having regard to the quality of the Parties, the transnational character of their relations and the principles of law and practice prevailing in the modern world." *Kuwait v. AMINOIL (ICSID)*, reprinted in 21 I.L.M. 976, 980 (1982). Where such a choice of law is made, one must assume the fuller set of *lex mercatoria* norms and their hierarchy to apply. See *infra* Part V.

It follows that the chosen law could itself point in the direction of the *lex mercatoria*. In this vein, the construction contract of the Channel Tunnel provided that it was to be governed by "the principles common to both English law and French law, and in the absence of such common principles by such general principles of international trade law as have been applied by national and international tribunals." *Channel Tunnel Group v. Balfour Beatty Constr. Ltd.*, [1995] A.C. 334, 347. In the international commercial and financial legal order as a newly emerging order, one would expect, however, an attitude to problem solving that is less encumbered by the past even where concepts are borrowed from domestic law in a comparative law search for better solutions.



As a minimum, these differing views would combine in the conclusion that if culture, sociology, or efficiency considerations have so much to do with the formation and implementation of modern business law, legal pluralism would be indicated where the close connection between law and communities is confirmed. Defining and finding these communities in terms of legal orders, that is as law producing entities, and delineating them as such is ultimately a question of criteria and therefore of normative sociology, or, in business, perhaps also of normative economics, and therefore of identifying more precisely the relevant circles of participants in a given range of activities that may qualify as law creators.<sup>54</sup> The manner in which the law develops in such orders and is instilled in

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54. If one takes for the moment the perspective of what law itself is, no more than a working hypothesis may be necessary. In the traditional view, law is mostly thought to embody the rules for the guidance of human conduct that are imposed on or enforced among the members of a given state. That always begged the question whether there was any more in it than state power. In any event, it posits the notion of legal order (if only that of a state) immediately. Broader is the definition that sees law as "the rules of action or conduct duly prescribed by controlling authority and having binding legal force." U.S. Fidelity and Guaranty Co. v. Guenther, 281 U.S. 34, 37 (1929). It still begs the question what controlling authority is and when binding force emerges. Another way of defining law is as "a body of social rules prescribing external conduct and considered justiciable." HERMANN KANTOROWICZ, *THE DEFINITION OF LAW* 79 (A. H. Campbell ed., 1958). This definition still poses the question what is "justiciable" (as distinguished from moral dictates or social conventions) and how the law of the various groupings evolves and can be backed up by state coercive power if not voluntarily complied with. For the important role of this voluntarism, its key function in each legal system, and the over-emphasis on state coercive power in this connection, see *infra* note 74.

Some see the issue of justiciability mainly in terms of the prevailing rule of law and its social prerequisites. See R. Post, *supra* note 38, at 334, 365. This is what the European Court of Justice in its *Les Verts* judgment of 1983 may also have had in mind when it referred to the European Community being a community based on the rule of law, European Court Case 294/83, E.C.R. 1357, 1365 (1986). More importantly, the functioning of this community and its relationship to "law" is in truth only broadly studied, if at all, in terms of legal orders, even in more modern rational schools like the one of Law and Economics. *But see* Cooter, *supra* note 2.

I ignore here the fact that "law" may still offer different perspectives depending on whether one takes the perspective of legislators, judges, subjects or legal advisors and "no doubt others too." See JULIUS STONE, *LEGAL SYSTEM AND LAWYERS' REASONING* 172 (1964). In modern times, Stone probably paid most attention to legal orders in this connection but thought that as law could not be defined, legal orders could not either. However, they could be described to some extent in which connection it was believed that in the description of the law the emphasis unavoidably shifted from the operation of individual rules to the functioning of legal orders as such. Hart rather used the term "legal system" in connection with accepted criteria for testing and certifying the authority by which the law in such a system functions, but it subsequently transpired that only statist legal orders qualified. See Hart, *supra* note 10. Kelsen used the term "legal order" regularly and recognized also an international legal order. See Kelsen, *supra* note 10; *infra* text accompanying note 80. Philip Nonet and Philip Selznick emphasize the aspect of authority that backs up any legal system and the law in it. Nonet & Selznick, *supra* note 27, at 12. They do not uniquely associate it with a state or with other clearly organized political communities.

It is perhaps noteworthy that in international trade negotiations, a pragmatic view of law and its use and formation is normally taken. See, e.g., John H. Jackson, *International Economic Law: Reflections on the "Boilerroom" of International Relations*, 10 AM. U. J. INT'L L. & POL'Y 595 (1995); David Kennedy, *The International Style in Postwar Law and Policy*, 10 AM. U. J. INT'L L. & POL'Y 671 (1995). They focus mainly on the removal of tariffs and quantitative restrictions without a cost analysis *per se* and thus present in essence a pragmatic rather than a theoretical approach to the formulation of new international rules, especially in the issue of re-regulation at an international level (primarily in WTO/GATT/GATS) through treaty law. This approach is thus not concerned with methodology or deeper theoretical insights in what international or transnational law is. See Joel P.

its members may then become at least in part a matter of social psychology. Again, it confirms the need for a broader view and some pre-existing more universal ideas; external or higher notions or principles to identify these legal orders, as noted by Dworkin.<sup>55</sup> We are not likely to make decisive progress in a merely descriptive manner, such as in merely empirical research, even if some considerable importance must be attached to their *de facto* existence and therefore to the apparent actual operation of legal orders.

These challenges pose the questions of whether internal and especially external recognition might be the key and what criteria are used in that connection. Acceptance of the group rules as legally binding by the participants would certainly always be a first requirement, while the recognition of this law by international arbitrators or by other legal orders, like its application in state courts, or the recognition and enforcement of decisions rendered on the basis of that law (for example by international arbitrators, as results in most countries from the New York Convention of 1958) would obviously also be of great significance.<sup>56</sup> Since published cases remain few and far between, it may well be that in more immanent legal orders, and therefore in the non-statist ones, where there is no clear strategic operator like a state, we may indeed have to rely more on internal and external signs of their existence and operation.

This same reliance may be necessary for the identification of the law in such orders. This raises the further question of who would have the power or authority to find, activate, and formulate these rules and principles. In the international commercial and financial legal order, the participants themselves and again international arbitrators must figure prominently,<sup>57</sup> as the International

Trachtman, *John Jackson and the Founding of the World Trade Organisation: Empiricism, Theory and Institutional Imagination*, 20 MICH. J. INT'L L. 175 (1999); Richard Posner, *The Decline of Law as an Autonomous Discipline: 1962–1987*, 100 HARV. L. REV. 761 (1987) (touching on the lack of interdisciplinary work in the area of international economic law and on the dominance of positivism and utopian ideals in this area). For a more recent comment on this discussion, see Martti Koskeniemi, *Letter to the Editors of the Symposium*, 93 A.J.I.L. 351 (1999), noting that lawyers employ the tools of any method they find useful in a particular case and should not be guided by any one in particular.

55. DWORKIN, *supra* note 37, at 48. The study of legal orders in the sense as here proposed requires therefore a more than purely national view of what the constitutive elements of legal orders are and presupposes a broader perspective or framework of what law is and how it operates. Whatever the pretences of natural law, more fundamental legal notions and principles that go beyond pure national laws will implicitly have to be used in this connection or at least some more universal concepts which find their origin in (i) an idea of how communities work and exert themselves, in (ii) a historical framework concerning such communities, in (iii) a much longer view of their evolution, and in (iv) an idea of their energies and realistic expectations.

56. The application of the *lex mercatoria* has found such recognition pursuant to the NY Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 330 U.N.T.S. 3; *see supra* note 3.

57. But there would appear to be a difference. While the participants “make” the law, international arbitrators are left to find and formulate it. Their role is necessarily more passive, even allowing for the fact that stating and restating the law is itself a law creating activity, but it would appear an exaggeration to claim that it is possible for international courts (of this and other types) to create by themselves “global communities of law” as suggested by Laurance R. Helfer and Anne-Marie Slaughter, Laurance R. Helfer & Anne-Marie Slaughter, *Toward a Theory of Effective Supra-*

Court of Justice does in the international legal order between states and the European Court of Justice in the EU legal order. Here again, it is also conceivable that the rules may be considered to exist merely because they work and are accepted.<sup>58</sup> There remains, however, the problem that in that case there would be no material criterion to distinguish between non-obligatory social conventions and legally enforceable rules. As in the case of identifying legal orders themselves, we would then move merely from an elusive material criterion or principle to a *de facto* or empirical analysis. But for their relevance and force, we would ideally still require some broader idea of how such practices came about and became legally normative and binding.

Where law, sociology, economic theory, and social psychology come together, one important strand of opinion depends on the already mentioned notion of *internalization*, a facility connected with game theory and an environment of many participants. It may produce an equilibrium between the cooperating participants and others not immediately so inclined. Those that are willing to invest in a public good (here likely to be the furtherance of their business in the most effective manner), will adjust their behavior and countenance rules to guide future behavior. On the other hand, the so-called appropriators—those who wish to obtain more immediate short term advantages—may not want to commit their future actions. By showing that the longer-term view produces greater benefits for all, even the appropriators may, in this theory, wish to signal a spirit of cooperation leading to a substantial consensus in which international commerce and finance would favor the internalization process (and move the equilibrium towards the co-operators).<sup>59</sup>

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*national Adjudication*, 107 YALE L.J. 387, 391 (1997), although they could more solidly bind legal orders together and are as such important actors in the international commercial and financial legal order.

58. That was Hart's view on international law, see Hart, *supra* note 10, at 231, which, it would seem, could then also be so domestically, at least in respect of custom. *But see supra* note 35 (noting Hart's deprecating view of custom and its formation and recognition).

59. To give an example: in an environment of many participants it will soon become clear that in terms of safety and efficiency it will be widely beneficial to all that roads should be divided into two, with those going one way congregating on the one side and those going the other way on the other. Whether one should move on the right or the left is here a detail that will be determined by historical or coincidental factors. Presently there will be more precise rules on how to overtake and on the precedence of traffic on main thoroughfares, etc. The development of bills of exchange and bills of lading testifies to a similar forward moving process. *See generally* JAMES STEVENS ROGERS, *THE EARLY HISTORY OF THE LAW OF BILLS AND NOTES* (1995). It shows the very close connection between factual behavior and the rules of law that so come to prevail as even the instinctive non-cooperators will soon see that this is the way to go forward. Further detail on this approach in terms of the type and conditions of cooperation or coordination that is required may be found in the work of Robert Ellickson. *See* ROBERT ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* (1991); Robert C. Ellickson, *Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics*, 65 CHI.-KENT L. REV. 23 (1989). There is here a normative progression, not oscillation nor a going backwards and forwards between law and non-law, although there may be between order and disorder as a normal human condition. *Cf.* Eric Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1697 (1996); ERIC POSNER, *LAW AND SOCIAL NORMS* (2000) (arguing that state norms can be more efficient than group norms, especially when groups are small). In the international commercial and financial legal order, there is, however,

It could even be argued that in such an environment the most productive rule automatically wins as long as people are willing to take a longer term perspective of the benefits. Thus it has been said that legal norms (customs and practices)<sup>60</sup> will derive in such an environment from the alignment of private

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no ready legislator.

This does not exclude the possibility that rules are internalized for other reasons than economic benefit. Pressing moral demands or those imposed in the furtherance of social peace may equally present themselves although it may be true that they cannot always be clearly separated from economic benefit.

For a somewhat different slant on the positive *lex mercatoria* and its origin, see G Teubner, *Breaking Frames*, *supra* note 1, at 158, 163. Its origin is here seen "in the close structural coupling with non-legal rule production" (in terms of a paradox not of a dialectical process between fact and norm) in an evolutionary progression that, in this view, seems in its origin to rely on an imaginary or fictitious legal environment in which there is mostly a pretence of legal rights and obligations fed by expectation. This ultimately is believed to lead to ready acceptance of the binding nature of the new law, even though non-political and factual, but also to a concern about the supposed destructive role of practicing lawyers and their distortion of business realities in their alleged search for a static system of rights and obligations. It suggests an enmity that would not appear necessarily to exist. If there is law here, lawyers must and will learn to work with it and will eventually come to understand its dynamic nature. I am more confident than this author that business can handle the fall-out and that international arbitrators will do their educational job in this respect, but it may be a long process unless the business community better grasps the nettle and simply insists that its *lex mercatoria* be applied and enforced and that their lawyers behave accordingly.

60. It may also be of some interest to research how customs and practices are seen in modern positive domestic laws. In civil law, it became normal only to take custom into account (except as implied contractual term) if the codes specifically referred to it. It was largely considered an issue of contract law and custom which normally figured besides good faith notions in interpretation. See C. Civ., art. 1135 (Fr. 2004); CIVIL CODE (BGB) § 157 (Ger.). As it is now mostly accepted that such good faith notions may in pressing cases also be used to adapt the contract, it is conceivable that in the normative or teleological interpretation method custom may sometimes play a similar corrective role as § 157 BGB in Germany clearly suggests, although parties may normally deviate from it when the clear provisions of the agreement prevail. Article 6(2) of the new Dutch Civil Code, BW, art. 6(2) (Neth.), always gives good faith a leading role and allows it to overrule not only the wording of the contract but also the effect of custom and equally of statutes impacting on the contract. This is a unique approach, so far not followed elsewhere. It suggests that notions of good faith can be absolutely mandatory. In the U.S., U.C.C. § 1-302(b) (2001 revision) (§ 1-103(3) (old)) refers in this connection to parties still being able to set good faith standards amongst themselves unless they are manifestly unreasonable.

A related question is whether custom may be subject to strong policy considerations when expressed in statutes. On its face that would seem so, but if a practice or custom continues notwithstanding contrary statutory law, it may be considered to have overturned it. There is much dead letter law, especially in older statutes, even in those that may have been intended as mandatory. In fact, many mandatory newer laws are constantly undermined through widespread continuing old practices, like in health and safety standards. Their complexity may be another reason why established practices may survive and eventually prevail. The fact that such new statutes are often not taken seriously and that local practices continue may thus fatally affect the status of these laws even if invoked in the courts. These laws may also lack the appropriate responsiveness to the ills they mean to cure or be so impractical that they cannot function.

In the U.S., the U.C.C. avoids the term "custom" at least in the context of the sale of goods. It is used, however, (but not defined) in the general part (as is the law merchant), see U.C.C. § 1-103(a)(2) (2001 revision) (§ 1-102(2)(b) (old)), where its overriding importance in commercial law is made plain and accepted (unless specifically modified or abolished). That is very different from the European approach, both in England and on the European Continent. The U.C.C. otherwise refers to the course of business or usage of trade, at least in the context of the interpretation and supplementation of agreements for the sale of goods. Cf. U.C.C. §§ 2-202(a), 2-208 (2001 revision). They may not be invoked to contradict the express terms. U.C.C. § 1-303 (§ 1-205 (old)) defines

incentives signaling cooperation for a particular public good in a self-reinforcing process.<sup>61</sup> However, open defectors could still destabilize such norms, which

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the usage of trade and also contains a statement as to the role of the course of dealing.

Under U.C.C. § 1-303 (§ 1-205 (old)), the usage of trade is "any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question." A course of dealing "is a sequence of previous conduct between parties to a particular transaction which is fairly regarded as establishing a common basis of understanding for interpreting their expressions and other conduct." U.C.C. § 1-303 (2001 revision) (§ 1-205 (old)). It is further stated that "a course of dealing between the parties and any usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement." *Id.*

In England, the emphasis remains in this connection often on the implied term and presumed consent. As a consequence, custom may be considered subjective and has to be proven. It must then be more than a course of action habitually followed, has to have consistency and regularity, and must be recognized as binding by the parties. It shows sensitivity in English law to overruling the parties' stated intentions, especially in the professional sphere. The subjective approach appears to limit the effect of custom in proprietary matters. Yet in other contexts, objective custom is accepted. Thus the UCP and URC have found a status in England on the basis of custom current amongst banks and not as implied conditions between the parties. *See infra* note 64; *see generally Custom and Usage, in* 12(1) HALSBURY'S LAWS OF ENGLAND 601 (4th ed. 1998) [hereinafter HALSBURY].

Sensitivity to accepted practices and custom is particularly important in international trade. Yet the Vienna Convention on the International Sale of Goods avoids any reference to custom and uses the terms "usages" and "practices" instead. *See* Vienna Convention, *supra* note 46, Articles 4, 8, and 9. According to Article 9(1), the parties are bound by any usage to which they have agreed and by any practices that they have established between themselves. This is simply an extension of the contract and intent principles. It implies a subjective approach to custom. Article 9(2) tries to undo some of the impact by accepting as an implied condition all usages of which the parties knew or ought to have known and which in international trade are widely known to or regularly observed (but not merely widely operative) between the parties to contracts of the type involved in the particular trade concerned. It is not, strictly speaking, possible for the Convention to be conclusive in this matter as the force of international usages and practices may derive from other sources or from custom itself, especially if they operate generally, therefore also amongst other parties, as indeed the force of fundamental legal principle. This seems accepted in Article 4 of the Convention.

On the other hand, there is a more recent view in the U.S. that the U.C.C. was mistaken in its reliance on custom, course of dealing, course of performance and trade usages and their unifying force. *See* Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation through Rules, Norms and Institutions*, 99 MICH. L. REV. 1724 (2001); Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710 (1999); Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765 (1996).

Here, the view is presented that custom, course of dealing, trade usages, and so on are first often replaced by trade organization rules that are more precise and dispute-avoiding and may play therefore a more fundamental role than the U.C.C. and its reference to customs when a dispute arises. It is further argued that usages have validity mainly outside the area of litigation, therefore only in an environment where cooperation is productive. In litigation, it is believed parties want to rely only on state rules as a matter of end game. This may be so in all areas where the emphasis is on finality as in payments and property transfers. But custom and practices will support this too. In any event, to obtain in this manner greater legal clarity in certain areas of international business through statist laws, would not seem to condemn the use of custom and similar practices in others. But more importantly, it would seem strange to perceive state rules as absolutely mandatory in litigation judging behavior that was earlier prescribed by other rules.

In the modern literature notions of custom and industry practices and their meaning are receiving renewed attention. *See* Richard A. Epstein, *Confusion About Custom: Disentangling Informal Custom from Standard Contractual Provisions*, 66 U. CHI. L. REV. 821 (1999); *The Path To "The TJ Hooper": The Theory and History of Custom in the Law of Tort*, 21 J. LEGAL STUD. 1 (1992); David Charney, *The New Formalism in Contract*, 66 U. CHI. L. REV. 842 (1999).

61. *See* Robert Cooter, *Law and Unified Social Theory*, 22 J. L. & SOC'Y 50, 64 (1995).

may then require the backup of institutionalized (legislative) power if social opprobrium or other peer group pressures fail. In the absence of an adequate institutional infrastructure, this potential destabilization may motivate the international commercial and financial community to ask states to intervene by facilitating treaty law. UNCITRAL and UNIDROIT may be seen here as the facilitators of this approach. Such a backup in which states act as agents for the benefit of the international legal order is, however, limited to situations in which the participants or their transactions are connected with the territories of co-operating states. So-called uniform treaty law, for example the 1980 Vienna Convention on the International Sale of Goods, is therefore always second best from the perspective of the international commercial and financial legal order, although it may put more cooperation pressure on defectors in non-participating states.

Somewhat more curiously, those who argue more directly on the basis of efficiency sometimes still prefer a contractual choice between domestic laws and see this as a useful competitive tool.<sup>62</sup> Here there is no concept of efficiency in an international sense or of transnationalization of the law and its cost benefits as compared to the potential uncertainties, inequalities, and disparate costs arising from application of domestic law to international transactions for which it was never made. Neither is there much of an idea of the spontaneous nature of the new law that has efficiency as a key root. As was pointed out before, the need to decrease transaction costs and facilitate exchange are themselves important motivators of the new transnational law and would stop the earlier situation in which the costs of a fractured legal system were shifted to weaker and less informed parties. Even though the benefits of uniformity would not necessarily be the same for all, this does not justify by itself different diversified menus.

At least in property, especially in respect of financial products and their bankruptcy resistance, transnationalization would appear the only solution (even if it may at first mainly come from state intervention through treaty law or in the EU through Directives and Regulations). In any event, the existence of transnational law itself would appear to increase the choice. Another cause of the confusion may be in the continuing failure of U.S. legal scholarship to properly distinguish between default or directory rules on the one hand, which parties can always opt out of, and regulatory law on the other, which they cannot freely ignore. In regulatory matters, a choice between state systems might indeed be desirable from an efficiency point of view for heterogeneous parties, but precisely in these matters such a choice is not normally given to them,<sup>63</sup> although aggres-

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62. See Paul B. Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 VA. J. INT'L L. 743 (1999). Fear that private interests or private interests groups dominate any formal unification process is here often at the heart of the concern. Others question more generally the usefulness of commercial law unification, also within the U.S. See, e.g., Peter A. Alces & David Frisch, *On the U.C.C. Revision Process: A Reply to Dean Scott*, 37 WM & MARY L. REV. 1217 (1996); Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1995).

63. See also notes 75-77 *infra* and accompanying text for the distinctions between public and

sive legal structuring and the use of offshore facilities might still help.

Returning to the essence of what makes a legal order create its own law, it is in my view foremost the energy in the relevant community, its sense of purpose, its willingness to organize itself and produce and follow its own rules; its creative force therefore but also its realistic expectations and discipline. These are prerequisites for an effective and sufficiently strong communication within the group, which is the key. Only thereafter is it useful to consider how the necessary consensus is built and how rules are internalized. As for the internalization process, there may as yet be no complete understanding of it. It may well be intimately connected with or supported by a more innate knowledge of fundamental legal principles in a natural law sense, principles of such a nature therefore that the knowledge of them might be presumed in all participants, either as a matter of rationality or morality or both. But there are also other rules, like those based on more general (rather than high) principle or found in existing practices, expressed even now in the positive laws of major commercial nations, which may not need this internalization for their effectiveness. Ultimately there is also the evolutionary aspect: the law changing under pressure of a changed environment, therefore by outside forces, here the internationalization of the business flows, which may itself contribute to the transnationalisation of the applicable laws.

This complex of questions can perhaps best be followed and studied in the international commercial and financial legal order with its clear idea of its par-

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private law, mandatory and directory or default rules. In terms of choice, the applicable legal regime in respect of prospectuses and the possibility to choose has been much debated in recent years in the U.S. but has not found a response from the SEC. On this regulatory competition and issuers' choice of regulatory alternatives, see M.H. Wallman, *Competition, Innovation, and Regulation in the Securities Markets*, 53 BUS. LAW. 341 (1998); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998); and Stephen Choi & Andrew Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998). Earlier, some authors had already expressed serious doubts on the fairness and efficiency of mandatory disclosure systems. See Frank Easterbrook & Daniel Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669 (1984); John C. Coffee, *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717 (1984) (replying to Easterbrook and Fischel, *supra* this note). The true questioning of the traditional regulatory attitudes towards securities activities in the U.S. goes back to George J. Stigler, *Public Regulation of the Securities Markets*, 37 J. BUS. 117 (1964).

Note, however, in the EU a recent incidental pro-choice provision in the Takeover Bid Directive of Dec. 16 2003, available at [http://europa.eu.int/comm/internal\\_market/en/finances/actionplan/index.htm](http://europa.eu.int/comm/internal_market/en/finances/actionplan/index.htm), allowing parties a small margin for opting for a more neutral EU regime in respect of *specific* takeover restrictions (rather than a whole regime) if Member States opted to retain their own defensive regime in this respect. How well considered it was remains to be seen; it was introduced at the last moment and may not be indicative of a new trend. In fact, in the Financial Services area there is ever less of a choice in the EU and therefore less regulatory competition under the latest EU harmonization directives, especially under the new Prospectus Directive of Nov. 4 2003, 2003/71/EC, 2003 O.J. (L 345/64) (Dec. 31 2003); the Directive of Dec. 15 2004, 2004/109/EC, 2001/34/EC, 2004 O.J. (L 390/38) (December 31, 2004), on the Harmonization of Transparency Requirements in Relation to Information about Issuers Whose Securities are Admitted to Trading on a Regulated Market and Amending Directive; and, the amendments to the Investment Services Directive, now Markets in Financial Instruments Directive of Apr. 21 2004, 2004/39/EC, 2004 O.J. (L 145/1) (Apr. 30, 2004).

ticipants and the forces that propel them. Its more positive rules are most likely to be found in the continuous dialogue in this community and are ultimately articulated by those who are appointed or acknowledged as the decision-makers (*ad hoc*) within it. In some important areas, that has so far been the International Chamber of Commerce, the authority of which is attested to by the UCP, URC, Incoterms and other sets of rules it has formulated. Other trade associations and their rules are conceivable for other parts of the business world: they were often common in the commodity trades, insurance, and now also in international finance industries, or at least in the Eurobond market as the success of the International Primary Association (IPMA) and the International Securities Association (ISMA) suggests.

These may prove to be sound models and a way forward, and it is no coincidence that increasingly the rules formulated by the ICC have been recognized by state courts as good law. The role of other trade associations might also have to be more carefully considered in this context.<sup>64</sup> What these rules also show is that they do not depend on longevity for their force and effect. Usage in this sense (which is here not distinguished from custom) can change overnight if

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64. The idea of the UCP being transnational law is associated with the views of the Austrian Frederic Eisemann, Director of the Legal Department of the ICC at the time, and was first proposed by him at a 1962 King's College London Colloquium. See *Le Credit Documentaire dans le Droit et dans la Pratique* (Paris 1963), 4. This approach was followed in England by Clive Schmitthoff, although in his views always in the context of some national law. See *THE SOURCES OF THE LAW OF INTERNATIONAL TRADE* 15 (Clive M. Schmitthoff ed., 1964). Eisemann's view was later also followed in France. See YVON LOUSSOUARN & JEAN-DANIS BREDIN, *DROIT DU COMMERCE INTERNATIONAL* 48 (1969).

In France, their status as international custom is now well established. See J. Puech, *Modes de paiement*, in LAMY, *TRANSPORT TÔME II*, No. 324 (2000); see also Berthold Goldman, *Lex Mercatoria*, in *FORUM INTERNATIONALE*, No. 3 (Nov. 1983); Trib. de Commerce de Paris, Mar. 8 1976; 28 *Le Droit Maritime Francais* 558 (1976) (Fr.); Cour de Cass., Oct. 14 1981, *Semaine Juridique II* 19815 (1982), note Gavalda & Stoufflet (Fr.); Cour de Cass., Nov. 5 1991, *Bull Civ.*, IV, no. 328 (1992) (Fr.).

In Belgium their status as international custom was also accepted by the Tribunal de Commerce of Brussels, Nov. 16 1978, *reprinted in* 44 *REV. DE LA BANQUE*, 249 (1980). In Germany, see Norbert Horn, *Die Entwicklung des internationalen Wirtschaftrechts durch Verhaltensrichtlinie*, 44 *RABELS ZEITSCHRIFT* 423 (1980); but, the German doctrine remains uncertain, especially because of the written nature of the UCP and its regular adjustments which is seen there as contrary to the notion of custom. See C.W. CANARIS, *BANKVERTRAGSRECHT* Part I, 926 (3d ed. 1988).

In the Netherlands, the Supreme Court has not so far fully accepted the UCP as objective law. See Hoge Raad, no. 153, May 22, 1984, N.J. 607 (1985). The lower courts are divided. So are the writers with PL WERY, *DE AUTONOMIE VAN HET EENVORMIG PRIVAATRECHT*, 11 (1971) and this author in favour. See Jan Dalhuisen, *Bank Guarantees in International Trade*, 6033 *W.P.N.R.* 52 (1992).

English law does not require any incorporation in the documentation. See *Harlow and Jones Ltd. v. American Express Bank Ltd. & Creditanstalt-Bankverein*, [1990] 2 *Lloyd's Rep.* 343 (concerning the applicability of the ICC Uniform Rules for Collection (URC) which are less well known, but nevertheless subscribed to by all banks in England); *Power Curber Int'l Ltd. v. Nat'l Bank of Kuwait S.A.K.*, [1981] 2 *Lloyd's Rep.* 394 (Denning, L.) (considering UCP, also with reference to the fact that all or practically all banks in the world subscribe to them, which seems the true criterion in the UK). For the U.S., see *Oriental Pac. (USA) Inc. v. Toronto Dominion Bank*, 357 *N.Y.S.2d* 957 (N.Y. 1974), in which the force of law of the UCP was accepted "to effect orderly and efficient banking procedures and the international commerce amongst nations." *Id.* at 959.



business starts requiring it; as such, it is the epitome of legal dynamism<sup>65</sup> which is in my view at the heart of the international commercial and financial legal order and of its laws.

I should like to avoid here a discussion of an ultimate or apex norm (or *Grundnorm*), or of rules of recognition. There are no such things. It is clear in my view that the development of legal principles and rules in the immanent legal orders, and especially of those which determine the relationship between the laws of various legal orders when in conflict, shows the close relationship between fact and norm and that the higher up we go the more likely it is that the ultimate justification for the system as it operates becomes indeed purely fact and should (in principle) be legally accepted as such.

Non-statist immanent legal orders and laws are likely to rely on common tradition or natural law views in terms of fundamental principles (like notions of *pacta sunt servanda* and a few others that underpin the entire system as we shall see in Part V), on comparative law in terms of general principle,<sup>66</sup> on internalization processes when it comes to customs and practices, on treaty law when states are asked to help, and on the practical view that the law exists and operates in this order because it works and is as such accepted. Again, the proper concern is not here to find some super- or world-laws *per se*, but rather first to identify the competent or pertinent legal orders in respect of the particular inter-

65. This is not always the more current view of custom, which continues to put emphasis on its longevity, in England even on legal precedent. See HALSBURY, *supra* note 60.

66. Not much further attention can be given here to the aims of comparative law. Some look for a common core while rejecting any mythical search, including Rudolf B. Schlesinger, *The Common Core of Legal Systems: An Emerging Subject of Comparative Law Study*, in 20TH CENTURY COMPARATIVE AND CONFLICTS LAWS: LEGAL ESSAYS IN HONOR OF HESSEL E. YNTEMA 65 (K.A. Nadelmann et al. eds., 1961). This interest in a common core leads to a search for universal, non-structural, fundamental principles common to all legal systems. In K. ZWEIGERT & H. KOTZ, AN INTRODUCTION TO COMPARATIVE LAW 40 (Tony Weir trans., 3rd ed. 1998), there is even a presumption of similarity, at least in the less politically driven areas of private law, because the needs are very similar everywhere. However, it remains a fact that even in commerce and finance there are great differences especially in important equity law concepts like trusts, beneficial ownership interests, conditional ownership rights, or security interests and floating charges where any common core becomes so general or superficial that it has hardly any distinctive or guiding meaning.

See also JOSEF ESSER, GRUNDSATZ UND NORM IN DER RICHTERLICHEN FORTBILDUNG DES PRIVATRECHTS. RECHTSVERGLEICHENDE BEITRAEGE ZUR RECHTSQUELLEN- UND INTERPRETATIONSLEHRE, (4th ed. 1990) (emphasizing more in particular the role of fundamental principles common to all legal systems in the further development of national laws); Ernst Rabel, *International Tribunals for Private Matters*, 3 ARB. J. 209 (1948). It should be noted that much of the search for common principles by these authors took place in a somewhat different context and tended to be directed towards showing that the differences between common and civil law were not as great as sometimes assumed. They would not appear to have searched for transnational normativity.

In the context of the *lex mercatoria*, the emphasis should foremost be on legal issues that commonly arise in different legal systems, and therefore on an inventory of problems that normally surface in more advanced economies in respect of certain structures (like security interest, conditional and beneficial ownership, assignments, etc.) rather than on common solutions as these solutions are more likely to be dictated by the evolving needs of international commerce and finance itself than by examples in existing national laws.

For the post-modern attitudes to comparative law, see Anne Peters & Heiner Schwenke, *Comparative Law Beyond Post-Modernism*, 49 INT'L & COMP. L.Q. 800 (2000).

national actors or actions, the law of which would then prevail in respect of their activities, and subsequently to determine any competition between them.

Finally, it may be obvious that in the international commercial and financial legal order, acceptance of the new principles and rules may be easier to consider where international arbitrators are called to determine the issue than when the international law merchant is invoked in state courts. But in a more enlightened environment, state courts may equally function in the international legal order as decision-makers, an idea indeed not so long ago quite rationally accepted by the English Court of Appeal (even though rejected at the time in the House of Lords).<sup>67</sup> It is not dissimilar from state courts in the EU countries sitting as European courts when deciding EU issues.

#### IV.

#### MUTUAL RECOGNITION AND ENFORCEMENT OF LAWS BETWEEN LEGAL ORDERS AND COMPETITION BETWEEN LEGAL ORDERS

Turning now to the question of why and under what conditions modern courts and their states must respect and back the new *lex mercatoria* and the de-

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67. For the idea of local courts operating as international commercial courts, see the English case of *Amin Rasheed Shipping Corp. v. Kuwait Ins. Co.*, [1983] 1 W.L.R. 228, 241. The case is especially of interest in view of the important cast of judges expressing their (minority) views in the lower courts with the House of Lords ultimately re-establishing orthodoxy. The facts in this case are not of great import. There was an insurance contract concerning an insurer in Kuwait, drafted much along the lines of the relevant standard English policy, yet without a choice of law and competent forum clause. There thus arose concern about the applicable law and about the jurisdiction of the English courts.

In the lower courts, Judge (as he then was) Bingham, [1982] 1 W.L.R. 961, thought that the contract could be covered by an international regime inspired along English lines (although not so in this case), so that under the applicable English rules of international jurisdiction the competency of the English courts could be established on the basis of the application of English law. In the Court of Appeal, the Master of the Rolls Sir John Donaldson thought that English courts could have jurisdiction over an unwilling defendant because the English courts could in cases like these function as *international commercial courts*. In the House of Lords, Lord Diplock thought, however, that contracts could not operate in a vacuum as they would then be only scraps of paper. [1984] 3 W.L.R. 241. International law was clearly considered a vacuum in this connection and the implication was that only a domestic law could apply which in this case was eventually thought to be English law, a view supported by Lord Wilberforce. Lord Diplock further thought that English courts could not operate as international commercial courts and thus force themselves on unwilling defendants. Also for English jurisdiction in cases like these, there would have to be a solid base, which could be, but need not be, and was in this case *not* found to be in the application of English law, especially since there was a Kuwaiti court available.

Note in this connection also Judge Wilkey speaking for the majority in the Court of Appeals in the American *Laker* case at the same time as the English judiciary in *Amin Rasheed*. *Laker Airways Ltd. v. Sabena, Belgian World Airlines*, 731 F.2d. 909 (D.C. Cir. 1984). The Court stated in note 158:

Despite the real obligations of courts to apply international law and foster comity, domestic courts do not sit as internationally constituted tribunals. Domestic courts are created by national constitutions and statutes to enforce primarily national laws. The courts of most developed nations follow international law to the extent it is not overridden by national law. Thus, courts inherently find it difficult neutrally to balance competing foreign interests.

*Id.* at 951 n.158. It is submitted that these views are out of date.

cisions based thereon regardless of its origin, we necessarily must confront the issue of recognition. Recognition acquires a special aspect if the recognizing legal order or state also has an interest in the solution of a legal issue or problem arising in the international commercial and financial legal order.

As a general proposition, in a civil society we must accept the law as presented, from whatever source, whether national or international, in respect to factual situations properly within its domain. But the acceptance and application of law of competing orders does not by itself exclude threshold standards when states are asked to respect such laws alien to them, including in appropriate cases human rights and due process considerations, the more so where state enforcement or coercive power is ultimately asked to back-up foreign decisions.

As just mentioned, these standards are likely to vary when the state concerned has or does not have an interest or policy implicated in the matter. In situations where the conflicting interests are such that there is *competition* between the international commercial and financial order and a state legal order, state courts in the countries most directly concerned will be mindful of their state's position, but even international arbitrators or state courts in other states may not be indifferent to this competition, although the outcome may not be the same.

There are long-standing standards of precedent regarding the recognition and execution of judgments rendered in other states or of arbitral awards, and the conditions normally attached to such recognition. They show that when enforcement of such decisions involving public policies is sought in other states, it is not impossible (and not necessarily unreasonable) that more stringent criteria may be applied by that state and its courts before they lend their enforcement power to such decisions, especially if they went against that state's own interest. This problem raises questions of public order and the specter of international comity.

It is relevant in this connection to accept that these recognition standards themselves must be of a higher, more universal nature to be truly meaningful, and not to reduce the recognition process merely to the will or sufferance of states. These higher rules determine the conflicts between the international law merchant and state laws and are therefore not part of the new law merchant either. The relevant objective criteria may here foremost emerge from a rule of law test. It is possible to refer in this connection to the rule of law both in an institutional ('law of rules') and substantive ('set of values') sense. The rule of law, of course, is the common yardstick by which in the modern world the exercise of power is more generally channeled, constrained, and informed, not only at the national level but, it is posited here, also internationally. As it mediates the relationship between states and society, it also mediates between states and other legal orders.<sup>68</sup>

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68. See M. Krygier, *Rule of Law*, in 20 INT'L ENCYCLOPEDIA OF THE SOC. & BEHAV. SCI. 13403 (N.J. Smelser & P.B. Bates eds., 2001); Philip Selznick, *Legal Cultures and the Rule of Law*, in THE RULE OF LAW AFTER COMMUNISM, 21, 26 (Martin Krygier & Adam Czarnota eds., 1999).

In doing so, the rule of law may not only protect the weak, but it may also promote the successful settlement of disputes, facilitate economic transactions, create a framework for enterprise nationally and internationally, and support an outward-looking perspective. As such, it may play a significant role in the allocation of competencies between legal orders and, when it comes to mutual recognition between them, in the setting of standards for the recognition of their laws and any decisions based thereon.<sup>69</sup> Again, the fact that there are here concepts at work that have to be more universal does not need to mean that they are also static, immutably determined by rationality, unchangeable values, or meta-physical truths.

At least in international business, recognition is a mundane concept and may not go so far as to require high-minded moral standards in order for legal orders to operate and be recognized, even if in an ideal world this might be better. In particular, legal orders need not be democratic or supported by more advanced values in order to function; it has never been a precondition for their operation at national levels.<sup>70</sup> It is clear, however, that these values (or the

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69. This is also the underlying theme in the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, even if still wedded to the idea of national considerations only, aligned in the meantime, however, to narrower notions of international public policy. See *infra* note 79.

To support the new transnational law in the professional sphere, it would not be a bad idea—or too far-fetched a proposal—to set up an international court system for professional dealings operating in a similar manner as the commercial courts once did in regionally divided countries. Their judgments should be universally enforceable again much as international arbitration awards now are under the New York Convention. Such a system, which could have some lay judges, should have a central highest appeal court which might also supervise the recognition and execution of international arbitral awards or of domestic court judgments in international business cases.

Besides the role of local courts acting as international commercial courts, as suggested in note 67, *supra*, it could be an important aid in the development of transnational commercial and financial law. It is at this stage probably more important than codifying the transnational law itself which, in the absence of sufficient direction in theory and a sufficient platform amongst legal practitioners, must be found in other ways as shown in Part V.

For a discussion of how such a court would operate as an appellate court in the supervision and recognition of arbitral awards internationally, see MAURO RUBINO-SAMMARTANO, *INTERNATIONAL ARBITRATION LAW AND PRACTICE* 980 (2001). See also Herman M. Holtzmann, *A Task for the 21st Century: Creating a New International Court for Resolving Disputes on the Enforceability of Arbitral Awards*, in *THE INTERNATIONALISATION OF INTERNATIONAL ARBITRATION, THE LCIA CENTENARY CONFERENCE* 109 (Martin Hunter ed., 1995) [hereinafter *LCIA CONFERENCE*]; Martin Hunter, *The Impossible Dream*, in *LCIA CONFERENCE*, *supra* at 157; S.M. Schwebel, *The Creation and Operation of an International Court of Arbitral Awards*, in *LCIA CONFERENCE*, *supra* at 115.

The prime concerns of these latter authors are the recognition of foreign awards under the New York Convention of 1958 and the possible bias of local judges. The idea is to replace their involvement with that of an international court, which would acquire exclusive jurisdiction in the matter. Enforcement of recognition orders of such an international court would of course still remain a domestic affair. It would be logical that such a court would also become solely competent in setting aside petitions, which are now normally brought in the domestic courts of the place of the arbitration. Other forms of ancillary proceedings could be added, like interim protection measures and compelling the attendance of witnesses. See Hunter, *supra* at 157. The proposal is important although more limited than what is proposed here, but the international court should be the same.

70. Jurgen Habermas notes correctly that even though the great codes in Europe were never democratically sanctioned, they were subject to some participation process which might have made them substantially reflective of their times. HABERMAS, *supra* note 39, at 76. This may or may not

absence thereof) may play a role in the recognition of the operation of other legal orders, their laws, and decisions based on them, even if there is no direct competition with the existing public order.<sup>71</sup>

In other words, there may be limits as to what may be recognized and accepted elsewhere as law from whatever legal order, including that of states, although there will have to be a large margin available for any legal order to operate in its own ways, if only to give the concept of different legal orders any meaning. That has always been clear when a foreign (national) private law is applied elsewhere as a matter of conflict of laws. How such laws came about and what their contents are is not then normally the issue. It is obvious, for example, that the recognition of rogue states may ultimately also favor the acceptance externally of their internal domestic legal order for matters properly arising in them, whatever its values and laws,<sup>72</sup> unless matters get totally out of

convince but it is true that in the international commercial and financial legal order the resulting rules are the very result of a participation process that may not be democratic in the formal sense but that could be seen as the ultimatum in participation in terms of consensus building and internalization.

71. Again, it would suggest the existence of more universal values that have an effect in all legal orders, their operation, the legal force of their rules (also internally), and that may be even more relevant in connection with the respect for these rules by other legal orders.

72. The operation of competing international orders is not a race to the bottom but may reinforce standards and be instrumental, at least on occasion, in containing local cabals even in democracies and expose them to more openness and better practices or in an economic sense to more rational decentralized approaches or privatization. Globalization thus contributed to the demise of many inefficient state controls, to more choice, lower cost, perhaps lower inflation, more openness and diversity, a better informed public, less jingoism, more cooperation (whether in G-7, IMF or WTO). Nobody claims perfection, but what may be a-statist or a-nationalistic in the international order is not per definition anti-democratic or devoid of modern values at the same time.

In the meantime, much has been written on the democratic deficit of these latter organizations and also of the EU, both in Europe and the U.S. However the fundamentally participatory nature of (private) law formation in the international commercial and financial legal order remains. See *supra* note 70. The traditional view is that (in international policy issues) democratic control is best exercised at the level of the participating governments, therefore nationally. That was also the EU's original stance and is still the reason for the limited powers of the European Parliament.

There is a special problem here. The highly technical nature of much of the parliamentary discussions at the international level escapes the public and it is difficult therefore for an international parliament, even at the EU level, to profile itself, acquire credibility, and inspire the masses. For the WTO similar arrangements are sometimes suggested but unlikely to work better for similar reasons. The alternative is greater openness in the negotiation processes and more reliance on public opinion and input of non-governmental organizations besides that of local politicians. This raises the question of who may legitimately talk in the various international legal orders whilst it is not clear whether the results would be any better.

In many of the international organizations there seems to be a bureaucratic phase that precedes further democratization and appears to be necessary to get things off the ground. The EU is the best example but it is not different in the WTO. Of course if the international community was truly serious and willing in the matter, the democratization process could easily be taken a step further. It is not beyond present day technical means to call international 'constituantes' in the election of which all participants in a particular community could participate and which would devise a framework that at an institutional level could deal with, for example, globalization issues more democratically. But it would be a further serious inroad into the remit of the nation state and also mean the *de iure* end to the influence of NGO's, reasons why this option may not gain much ground.

In the international commercial and financial legal order, the participatory process is likely to be of a distinctly different nature in the absence of a formal legislature. That does not make it less participatory, however. In fact, the essence of immanent legal orders is the participation of all partici-

hand, and the same may go for other legal orders.

Naturally, it is only to be expected that in the recognition process there may be a preference for legal orders that recognize similar values, notions, and ideas as those prevailing in the recognizing legal order. In this acceptance or recognition of the law of other immanent orders, and therefore also of that of the international commercial and financial legal order, the minimum requirement could be the free interaction of participants in the formation of their laws, customs and practices, the active pursuit of above-board commerce, responsible corporate governance, transparency, and a lack of anti-competitive behaviour or other market abuse. I take this foremost as a working hypothesis to avoid a broader discussion on the values of the commercial and financial legal order or the absence thereof, on the redistributive powers or the unfairness of its system (as may be compounded by globalization), and on any rightful or erroneous claims of the international commercial and financial law to (some) objectivity and formal effectiveness in supporting international trade, commerce, and finance.<sup>73</sup> Such a discussion is not in the least irrelevant, but is beside the point insofar as demonstrating the very idea of the operation and recognition elsewhere of an international and commercial legal order and its laws are concerned.

In subscribing to this working hypothesis, we are helped by the fact that, at least for the economic benefits it brings, our present decentralized, more or less democratic, and market-supported socio-economic system finds some broad support worldwide, or at least in the developed world. As for the international commercial and financial order, we should also be helped by the fact that the daily business of trade, commerce and finance is in any event not so politically and culturally sensitive as, for example, labor and environmental issues or the much broader large-scale commercial and financial stability issues with which the G-8, the World Trade Organization (WTO), and the International Monetary Fund (IMF) must grapple. These issues, when dealt with at those levels, might then also have an effect on the international commercial and financial legal order itself, assuming some legal form and expression can be found for such an intervention in that order. Barring such intervention, it should perhaps be accepted that the international commercial and financial legal order operates at a lower level of political consciousness, as in fact trade and commerce also do domestically. Although regulation plays a role, and social factors cannot and need not be eliminated in the international legal sphere, private ordering remains here paramount, although it remains subject to legitimate state interests, especially if expressed as domestic regulation of the effects of international transactions in the country concerned.

Indeed, the minimum degree of shared values this hypothesis assumes ac-

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pants in the law creating process. As such it could be argued that its nature is more fundamentally democratic.

73. Critical Legal Studies in particular have always been skeptical of the objectivity and effectiveness of black letter law in pursuing social ordering. See generally CRITICAL LEGAL STUDIES (Allan C. Hutchinson ed., 1989); see also Roberto Unger, *supra* note 25.

quires a more material meaning when decisions reached in one legal order are asked to be enforced in another legal order (or state) that wishes for its own policies also to be considered. Such a situation raises the issue of *competition* between legal orders. I leave alone here the issue of voluntarism,<sup>74</sup> as, voluntarism or not, we must in such cases unavoidably deal with the practical side of the interaction or competition between the law of the international commercial and financial legal order and that of others, especially that of states, if only to determine how the relevant parties must act in a particular situation (and therefore regardless of any litigation).

Here enters a strong public order element in the application of private law, which commercial and financial law normally is.<sup>75</sup> This public order element will normally present itself domestically through forms of regulation; for exam-

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74. Voluntary compliance is a substantial element of the operation of any law that would collapse if its enforcement would depend on coercion or state power alone. It is therefore not true that the essence of the legal norm is its enforceability by state power. For the survival and operation of the living law, a high voluntary compliance rate is necessary for which the innate quality of the norms, their persuasive force and internalization by large parts of the participants are vital factors. In the case of unresolved conflict, it would of course still require some adjudicatory process, either in state or other panels like that of arbitrators. But even most of their decisions still require voluntary compliance for such a dispute resolution system to be viable, so that state coercive power would always be a last resort. In this connection, the possibility of ostracism, ejection from new deals, loss of respect and reputation are important internal group sanctions. See *supra* text accompanying note 59. For the importance of voluntary compliance and its mechanics in a modern business environment, see Robert Cooter, *supra* note 5, at 15.

Somewhat different is the view that commercial relationships are dispute-avoiding for relational reasons and that participants accept the inherent possibility of a loss in the expectation of future benefits from a particular relationship for themselves directly or from the undisturbed continuation of their trading environment more generally. It would suggest that they may accept as a consequence the rough justice meted out by more formal clear cut legal answer when disputes arise. In such cases the accent would be on predictability whilst avoiding judicial discretion. Bernstein, *supra* note 60. This is no doubt true in matters concerning negotiable instruments, bills of lading and letters of credit and perhaps even in certain parts of the commodity trade and in shipping matters (for example, in terms of the 'expected readiness' of the ship, demurrage claims, etc.) more generally, see *supra* note 43, but is as a general proposition for all of commercial and financial law probably overstated. It may still be true, however, that in commerce and finance predictability is more important than fairness, which could be associated more in particular with consumer transactions. Yet it could still be argued that what makes sense rather than what is fair drives dispute resolution in business transactions, which would no less suggest a measure of discretion for arbitrators or the courts whilst reaching their decisions on the basis of the law merchant.

75. In civil law, the distinction between public and private law is traditionally more fundamental than in common law. Private law is the law between non-governmental entities and may even be the law of the dealings with and between them when no public policy issue is involved. This law is often thought of as merely directory and *not* injunctive or mandatory or public policy oriented. Parties could set it aside. That is only partly true, however, and not really the distinguishing feature of private law.

In the first place, as just mentioned, in private law there may be imperatives or inherent mandatory rules, whether obligatory or prohibitory, governing the relations of private people which cannot be set aside. In modern times, in private law, public policy driven mandatory or regulatory rules arise domestically especially in consumer transactions, but may also be important in civil procedure and company law. They express an overriding public interest, domestically normally resulting from statutory intervention. Earlier property law was mentioned as another part of private law where parties have little choice because of the effect of their property dealings on others (who must respect the results).

ple, in consumer protection, products liability, and the like. In respect of foreign relations, it presents itself quite naturally in import and export restrictions and foreign exchange restrictions, but it may also present itself in an attempt at the application of domestic laws, like anti-trust and securities laws in transborder transactions.<sup>76</sup>

It should be repeated, however, that even where states formulate private law through legislation like they do in codification countries, it is not all public policy.<sup>77</sup> Where statutory private law is merely facilitating or directing, and

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76. For the special status of U.S. federal statutory (anti-trust and securities) claims in international cases in connection with forum selection and arbitrability issues, see the discussion regarding the U.S. Supreme Court, *supra* note 46. The fact that these claims are now arbitrable in international arbitrations acknowledges the special status of international professional dealings also in the U.S. The European Court of Justice case law has followed a similar vein. See Case C-126/97, *Eco Swiss China Time Ltd. v. Benetton Int'l*, 1999 E.C.R. I-3055.

77. Civil law is comfortable with the operation of mandatory rules in private law in this manner (leading in the case of breach to private law remedies), although most private law rules remain of course merely directory. In codes or similar statutes, these directory rules will figure as *default rules* even if there developed the approach in practice making them applicable *per se* if not expressly set aside by contract. It does not truly follow and these rules could in my view be more easily tested on their making sense in the circumstances of the case. Of course that applies to all legal rules, but more and openly so here, as these directory rules of private law are meant to be facilitating norms first.

Perhaps more important is in this connection that there may be some greater myopia in American legal writing and thought, in which there is a strong assumption that all rules are policy driven and *therefore* public or semi-public in character. From this, it is then readily believed to follow that they must all in essence be statist or at least nationalist in nature. See Post, *supra* note 38, at 324. This seems to have a long tradition in the U.S., even if as such hardly discussed but it has not remained unnoticed and unchallenged. See, e.g., Avery Katz, *Taking Private Ordering Seriously*, 144 U. PA. L. REV. 1745 (1996). It does not do justice to most of private law. This view nevertheless early started to dominate the interstate conflict of laws theories (at least as from the 1950's), which increasingly talked of governmental interests only. For a recent discussion, see DAVID CURRIE ET AL., *CONFLICT OF LAWS* 132 (6th ed. 2001). It is indeed obvious that in the relevant case law public policy questions are often the major issues, but that is not always so and it would seem strained to reduce all conflicts of private laws to those situations. Any temptation to do so in the U.S. may be more in particular connected with the fact that, outside these policy conflicts, the private state laws are mostly in harmony because of their origin in the common law and of the existence of a multitude of uniform laws, even if, for example, within the U.C.C. there is still a conflicts rule for differences in implementation at the state level. See U.C.C. § 1-301 (2001 revision) (§ 1-105 (old)).

This public policy attitude even towards private law has a sequence in the Law and Economics school. In fact, in the U.S., in most of the "Law and . . ." movements, there is little attention for private law issues in terms of custom, practices, party autonomy and beyond. It depends of course on how public policy is defined but it remains true that much of private law has in essence a *facilitating* function and is, whether derived from statutory or case law, in business foremost meant to enforce some rationality, common sense, efficiency, consistency and predictability. Also in the U.S., much of it can be set aside by party autonomy. It may well be that for the validation, effectiveness or binding force of legal rules in each order some *general interest* in that order must be served, but that is *not necessarily* a governmental interest or political issue and could more properly be the *well-being* of the particular parties in their own orbit or particular trade. See *supra* text accompanying note 59; see also Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989).

Why should, for example, the protection of the *bona fide* purchaser of bills of exchange or promissory notes be seen as a public policy issue or a politically driven redistribution issue? It has made the development of these negotiable instrument possible, but it was a market development and presents a facilitating legal support function, not the pursuit of a governmental or public interest. The same can be said for so much else in trade and finance. What public policy could be involved in the



therefore functioning as the default rule, it does not have any special status merely because it happened to be formulated by states rather than in case law or in local practices. This is clear even in codification states when state law gets out of date and case law or practices must take over if no updating is attempted. Statutory private law is therefore not public policy *per se*, and does not on that score automatically prevail over the international legal order and its laws in situations properly governed by them.

It should in this connection also be realized that public order or similar mandatory requirements could equally emerge—in that case spontaneously—in international legal orders themselves (or in smaller legal orders within a particular state), even if it may be somewhat more difficult to articulate. We may think here of the infrastructure of the law of contract in the modern *lex mercatoria*, or of the notions of ownership and possession,<sup>78</sup> or of procedural and other safeguards, especially those that counter anti-competitive behavior or market

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development of order paper besides bearer paper in negotiable instruments, except the demands of the trade? So it was with the development of the CIF trade term after the FOB trade term. The same may be said for the development of the notion of independence in letters of credit and in all forms of payment (as a finality issue). The set-off principle and contractual netting devices are in finance risk limitation facilities without which much financial business could not be done very well, but does that make them public policy driven? Is there really a great public interest involved in the development of indirect agency besides direct agency except in the more remote sense of facilitating commercial intercourse that always used both?

78. Above it was already noted that where in the new legal order transnationalized ownership and possession notions start to operate, we have to accept in principle that they are not merely directory, even if private and not immediately public policy related either. They cannot be freely varied by contract or party autonomy. The same is true for the contractual infrastructure, for example, questions of contractual validity and the extent of the binding force of agreements. These matters can per definition not be settled by agreements alone or by the parties themselves.

Where tort rules emerge in that order, standards may be set and liability may be curtailed but may not altogether be avoided by contract either, not even between consenting parties. It is here of interest also that the EU uses its own concept of tort in connection with Member State liability for the non-implementation or late or partial implementation of Directives to the detriment of individuals. See Joined Cases 6/90 & 9/90, *Francovich v. Italy*, 1991 ECR I-5357.

Good faith may acquire a similar transnational flavor where it is referred to in EU Directives. It may contain mandatory aspects also, especially when in extreme cases it may overrule the contractual content. See DALHUISEN, *supra* note 1, at 268.

Perhaps there is also a mandatory concept of unjust enrichment in the new legal order, at least in the EU the European Court of Justice operates a transnationalized (or at least an EU) concept when using this notion from time to time in tax and other restitution cases. This issue tends to arise when under local law payments are made in respect of certain charges (perhaps health inspection charges in respect of imports) that are illegal under community law but cannot be reclaimed under domestic law. See Case 199/82, *Amministrazione delle Finanze dello Stato v. SpA San Giorgio*, 1983 E.C.R. 3595.

From the EU Collateral Directive, there emerges even a transnational concept of security interest that is also underlying the UNIDROIT Mobile Equipment Convention. See the Commission of the European Communities' draft of the Proposal for a Directive of the European Parliament and of the Council on Financial Collateral Arrangements of March 27, 2001, COM(2001) 168 final; from the Convention on International Interests in Mobile Equipment, Cape Town, S. Afr. (2001), *available at* <http://www.Unidroit.org/english/conventions/mobile-equipment/mobile-equipment.pdf>, deriving similar transnational principles for security interests in mobile equipment. Both have strong proprietary and therefore mandatory elements as has the UNCITRAL Receivable Financing Convention. See U.N. Convention on the Assignment of Receivables in International Trade, U.N. Doc. A/RES/56/81 (2004), *available at* <http://www.uncitral.org>.

abuse.<sup>79</sup> These notions, when they develop, are likely to be related to fundamental principles, sometimes also referred to as the international public order. So not only may a state want its own policy to prevail, but other legal orders, including the international commercial and financial legal order itself, may have similar or conflicting public order or policy requirements, or may simply insist on non-interference (especially where there is too little contact with states) as a public policy issue of its own.

Thus, domestic mandatory state law, even within its own territory, may still have competition from the laws of other organizations or groupings which may be just as competent to set their own rules, even if having an effect on that state's territory, and which the relevant state may have to respect and apply to the members of the organizations or groupings in question. It means that in the competition of public policies, local governmental interests will have to be weighed against each other and against policy interests that in the international legal order may be at least as legally relevant and even prevail. One could even argue in this connection that also a hippy community, humble as it may be, will have its own rules recognized in state courts unless they conflict with overriding state laws which may objectively be considered to prevail over them. But if it has its own ways of contracting and its own proprietary arrangements, e.g. in respect of who shall have her or his stall where, it should not be affected by state laws unless there was major discrimination, race, gender, or other abuse or a serious infringement of property rights of others including the use of public property.

In international cases, a higher rank for the international or transnational law would be supported by the status of public international law and EU law, which is normally considered to prevail over domestic laws. Here the true issue may rather be one of first determining to which order the activity properly be-

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79. International public order requirements proper are well known from the international arbitration practice in the context of determining *arbitrability* issues. For U.S. and EU cases, see *supra* notes 46 and 76. In connection with the recognition and enforcement of arbitral awards under the New York Convention, The Paris Court of Appeal dealt with the issue of arbitrability of public policy related issues (which are normally not considered arbitrable) in a judgment of *Ste Ganz*, Mar. 29 1991, Rev. Arb. 478, 480 (1991) and held that, while international arbitrators determine their own jurisdiction including the matter of arbitrability, they could use an internationalized concept of public order. See J.-P. Ancel, *French Judicial Attitudes Toward International Arbitration*, 9 ARB. INT'L 121 (1993); see also VESNA LAZIC, *INSOLVENCY PROCEEDINGS AND COMMERCIAL ARBITRATION* 149, 278 (The Hague, Kluwer Law International 1998).

For a discussion of the public policy bar to recognition of arbitral awards under the New York Convention, see Pierre Lalive, *Transnational (or Truly International) Public Policy and International Arbitration*, in *COMPARATIVE ARBITRATION PRACTICE AND PUBLIC POLICY IN ARBITRATION* 257 (Pieter Sanders ed., The Hague, Kluwer Law International 1987).

These are only two instances in which public policy plays a role at the international level. It may also in other instances and it would appear that there are also mandatory transnational competition rules operating that may void contracts directly in that order. Jan Dalhuisen, *The Arbitrability of Competition Issues*, 11 ARB. INT'L 151 (1995).

For a more recent study on the issue of international public policy in arbitrations, see Richard H. Kreindler, *Approaches to the Application of Transnational Public Policy by Arbitrators*, 4 THE JOURNAL OF WORLD INVESTMENT 239 (2003).

longs, and subsequently of what to do with the interests of other orders, especially of state legal orders on whose territory there is sufficient effect. Thus, in a conflict of public policy between legal orders, there is not necessarily a higher or lower order. The key is that if an activity properly belongs to one legal order, it is not for other legal orders to dictate the outcome unless they have an objectively prevailing interest. It should at least be accepted that in a world in which law means anything at all, national, statist legal orders, however powerful, are not to dictate to the other legal orders unless they can show a legitimate policy interest protected under what would indeed be a higher norm, which interest can be independently evaluated, identified as such, and then deemed to prevail in the circumstances.<sup>80</sup>

It follows that a principal first question is to determine the proper legal order in which a particular activity takes place. Traditional conflict rules may be of some help here in determining centers of gravity, as well as the closest connection or place (or legal order) of the most characteristic performance.<sup>81</sup> A more advanced view is that *all* professional business dealings are increasingly likely to operate in the international legal order even if they have no international connection, as it is ultimately unlikely that they retain different dynamics locally.<sup>82</sup> Much more could be said on this issue, but to make the basic point, it is not necessary to elaborate further for the purposes of this Article.

The crux in a clash of public policies, assuming that the relevant legal orders can be found, would subsequently be the attribution of competences between the various legal orders. In trade and commerce, article 7 of the 1980 EU Rome Convention on the Law Applicable to Contractual Obligations may at least for that type of obligation be of some guidance, even if it remains rule-rather than interest-oriented.<sup>83</sup> More instructive are sections 402 and 403 of the

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80. It should perhaps be noted that in Kelsen's approach this type of conflict cannot truly arise. See Kelsen, *supra* note 10. Legal normativity is here firmly distinguished on the one hand from the will of some authority or other force that may be at its origin, which is factual, and on the other hand from moral normativity. In this view, the legal norm derives its legitimacy not from some authority or from the moral order but from higher legal norms that confer it and which themselves are ultimately derived from a theoretical apex norm (*Grundnorm*). This apex norm may be found in a national or in the international legal order depending on one's political preference or instinct. Wherever it is put, it creates the dominance of that order so that there could not truly be a conflict between them. Because there is only one (theoretical) *Grundnorm*, legal orders are always connected but cannot compete. It does not explain very well the unavoidable strife between domestic legal orders, particularly when domestic public policies come into conflict in international cases.

81. See DALHUISEN, *supra* note 1, at 156. There was probably never much wrong with the basic conflict of laws' notion that all legal relationships have a seat in a legal order as long as that could also be the international legal order or others that are not territorially defined or confined. For the notion of 'internationality' see *supra* note 43.

82. In other words, all professional dealings, whether local or international, will increasingly aspire to similar legal standards. Such an evolution in thought would simplify the issue of finding the appropriate legal order for them and their dealings greatly. Of course, if all the contacts were local, the impact of the pertinent national or statist public order requirements in respect of the transaction would have to be accepted and there would remain an important difference in that respect. That idea is clearly expressed in Article 2 of the European Communities' Convention on the Law Applicable to Contractual Obligations, 19 I.L.M. 1492 (1980) [hereinafter Rome Convention].

83. The problem is in Europe usually identified as one of *règles d'application immédiate*.

Restatement (Third) of Foreign Relations Law in the U.S.<sup>84</sup> Again, much more could be said on this and there is a substantial body of case law especially in the U.S., but further elaboration is not necessary to make this basic point.<sup>85</sup>

Finally, this decentralist approach steers particularly clear of the idea, even domestically, that modern wealth and well-being is largely due to a socio-economic infrastructure in which only the contributions of states count. Under this framework, states would therefore be entitled to dominate all, at least within their own territories, or to dominate as much as they think they are entitled to domestically or can get away with elsewhere. In other words, in the views here represented states are only one type of actor that must, in international cases and relationships, respect other, sub-national, actors as well. Again, this is a rule of law requirement.

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*See* DALHUISEN, *supra* note 1, at 91, 93, 165. It is true that the notion of balancing public policy interests in the context of determining the extraterritorial reach of policy directives or prescriptive jurisdiction is a more typical American approach, not followed by the ECJ in the Woodpulp case. Case 89/85, *Ahlström Osakeyhtiö et al. v. Comm'n of the European Communities*, 1988 E.C.R. 5193. The notion was even in the U.S. not without its early critics. *See* *Laker Airways Ltd. v Sabena, Belgian World Airlines*, 731 F.2d 909 (D.C. Cir. 1984) (criticizing the idea of balancing interest mostly on utilitarian grounds in the sense that courts are ill equipped to do so). The more modern American view is, nevertheless, that when there is in the home state a *direct, substantial and foreseeable effect* of action taken in another legal order, the home state may have a justified interest in pursuing its own policies but they will still have to be balanced against those of the other legal order in terms of the closer link, the importance of the relevant public policy to the competing orders, the justification of the domestic policy in the light of international standards and convictions, justified protection expectations, and so on. *See* *Hartford Fire. Ins. Co. v. California*, 509 U.S. 764 (1993) (Scalia, J., dissenting in part); RESTATEMENT (THIRD) OF FOREIGN RELATIONS §§ 402-03 (A.L.I. 1987).

84. In this approach, if a domestic law is chosen by the parties as applicable to an international transaction, even such a choice cannot go beyond what makes sense in the international legal order and is always subject to the higher fundamental or other mandatory principles in that order preceding party autonomy. *See infra* text accompanying note 87. It does in any event not normally mean to include a preference for the public policy rules of the domestic law so chosen. It cannot opt out of public order requirements of the international legal order either. Also it cannot be meant to undermine the essentials of the deal itself, except if there are very good reasons. In the U.S. the clear reference to this issue in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), in which it was assumed that the contractually selected Swiss law would not cover the American anti-trust claims. Arbitrators may indeed be presumed to engage here in a balancing of governmental interests and policies in international cases between professional participants and may be better able to do so than non-American domestic courts. For the problems in this connection in the English courts, see *British Nylon Spinners, Ltd. v. Imperial Chemical Industries, Ltd.*, [1953] 1 Ch. 19.

85. The applicable law can in these cases only be established on a case-by-case basis. Examples are the effect of domestic import/export and foreign exchange restrictions, although these are generally of less importance today and substantially lifted in most modern countries. The reach of other policy-oriented domestic rules may simply be *excessive* in international terms or in a given situation and they may in such cases not be considered at all.

## V.

THE LEGAL NORMS OF THE INTERNATIONAL COMMERCIAL AND FINANCIAL  
LEGAL ORDER: THEIR ARTICULATION AND RANKING, AND THE EFFECT OF THE  
ABSENCE OF LEGISLATIVE POWER

Our last task is to identify the *lex mercatoria* itself. Its assumed vagueness has often been used as an argument against its validity,<sup>86</sup> but it is in truth an issue not all that difficult to resolve. In my recent book on International Commercial Financial and Trade Law (2d ed. 2004), I mention the sources of law in the international commercial and financial legal order, and therefore of this *lex mercatoria*, and give their hierarchy as follows:

- (a) fundamental legal principle;<sup>87</sup>
- (b) mandatory custom;
- (c) mandatory uniform treaty law (to the extent applicable under its own scope definition and in its own territory);
- (d) the contract (or party autonomy in matters at the free disposition of the parties);
- (e) directory custom;
- (f) directory uniform treaty law (to the extent applicable under its own scope definition and in its own territory);
- (g) general principles largely derived from comparative law, uniform treaty law (even where not directly applicable or not sufficiently ratified), ICC Rules and the like; and
- (h) residually, domestic laws found through conflict of laws rules.

This hierarchy should be strictly applied in the order in which it is given. Thus only if there are no higher rules or principles, should rules or principles that are lower in the hierarchy be applied.

As to the *fundamental* legal notions or principles, which come first and form the basis of the whole system, they are

- (a) the principle of *pacta sunt servanda*, as the essence of all contract law;
- (b) the principle of ownership including the transferability of assets, as the essence of all property law.<sup>88</sup> In international business and finance, we are here concerned mainly with chattels and intangible assets like receivables and similar claims;
- (c) liability for one's own actions, especially (i) if wrongful (certainly if the

86. See L.J. Mustill, *The New Lex Mercatoria*, *supra* note 1, at 149.

87. No fundamental distinction is here made between principles and rules. At least in the 'realist' schools, it is thought that even rules are in practice never more than guidelines, at least if they cannot be literally applied through syllogism. See Llewellyn, *supra* note 25. I follow that lead for which there are many other reasons not here directly relevant. It is not to say of course that the fundamental and general principles may not benefit from more precise formulation in contract, custom and practices.

88. It was not considered fundamental in the natural law school but is increasingly considered a human rights-related notion. See Protocol One to Convention for the Protection of Human Rights and Fundamental Freedoms, Nov. 4, 1950, art. 1, Eur. T.S. No. 5, available at <http://www.echr.coe.int/Eng/BasicTexts.htm>; see also *supra* text accompanying note 19.

wrong is of a major nature) as the essence of tort law, (ii) if leading to detrimental reliance on such action by others, as another fundamental principal of contract law, (iii) if resulting in principals creating the appearance of authority in others, as an essential tenet of the law of agency, or (iv) if resulting in owners creating an appearance of ownership of their assets in others, as an additional fundamental principal in the law of ownership and the heart of the protection of the *bona fide* purchaser.

There are other fundamental principles in terms of

(d) fiduciary duties in contract and in agency leading to special protections of counterparties, especially where those parties are weaker or in a position of dependence (including consumers against wholesalers, workers against employers, individuals against the state, smaller investors against brokers), and duties of disclosure and faithful implementation of one's commitments;

(e) the notion that one should give back what is owned by others leading to notions of unjust enrichment and restitution;

(f) respect for acquired or similar rights, traditionally particularly relevant to outlaw retroactive government action, but also used to support owners of proprietary rights in assets that move to other countries;

(g) equality of treatment between creditors, shareholders and other classes of interested parties with similar rights unless they have postponed themselves or acquired better proprietary interests in the debtor's assets;

Then there are also the:

(h) fundamental procedural protections in terms of impartiality, proper jurisdiction, proper hearings and the possibility to mount an adequate defense, now often related to the more recent (and also internationalized) standards of human rights and basic protections (in Europe Article 6 of the 1950 European Convention on Human Rights).

(i) fundamental protections against fraud, sharp practices, excessive power, cartels, bribery and insider dealing or other forms of manipulation in market-related assets (also in their civil and commercial aspects) and against money laundering;

Finally there may also be fundamental principles of

(j) environmental protection, although this is developing; and

(k) labor law protections.

There may be other fundamental principles, and the above list is not meant to be exhaustive,<sup>89</sup> but in commercial and financial law there are not many pos-

89. One may see here some symmetry with Article 38(1) of the Statute of the International Court of Justice, which enumerates the basic sources of international public law. See Rome Statute of the International Court of Justice, July 17, 1998, art. 38(1), U.N. Doc. A/Conf.183/9 (1998), 37 I.L.M. 999, available at <http://www.icj-cij.org/icjwww/ibasicdocuments/basetext/istatute.htm>; cf. Goode, *supra* note 1. It is clear that in public international law the problems concerning the sources of the law discussed here play a much smaller role than in private law. The text of Article 38(1) is as follows:

The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

sible others. The purpose here is only to show that fundamental legal principles are likely to be at the heart of *all* civilized modern legal systems and also in matters of commerce and finance. In domestic laws, especially of the codified variety, they are often hidden, but they come into their own again in the international sphere.

Whether or not these fundamental principles may be considered innate in all human endeavors, or themselves result from a process of internalization, they are fundamental and legally the basis of the whole system and as such likely to be mandatory or matters of public order in the international commercial and financial legal order (*ius cogens*). They might, in international commercial transactions, even adjust the balance between the parties on the basis of fundamental (often social or public policy) considerations, although in the commercial sphere it is less likely that there will be such considerations. Nevertheless, they may be incorporated in an international concept of good faith (in that case mandatory) or public order when called upon to adjust major imbalances or prevent abuse.

More important is the realization that the fundamental principles of protection in this manner are *not* static and, even if mandatory in principle, they may not result in the same protection being afforded different parties, even in the same or similar types of deals. Thus, lesser refinement of the law may result between professionals in commercial matters, and even greater legal formalism may result as an overriding requirement connected with the continuation of the normal commercial flows and the imperatives imposed on all participants.

In the traditional subjects of mercantile law, like negotiable instruments, bills of lading, letters of credit and the traditional transportation insurance policies, there is also likely to be a restrictive approach to interpretation. The idea of certainty is here sufficiently developed in an international sense to generally prevail. This may also apply to international payments and their finality, which may mean a substantial limitation of defenses in respect of such payments once they are completed.<sup>90</sup>

It is natural and necessary for the law to be sensitive to these various requirements and practicalities that may also emerge in the form of implied conditions rather than as industry custom or norms. As a consequence, the impact of overriding fundamental principle will quite naturally still vary depending on the type of relationship and nature of the transaction and will in any event only give the basic legal structures in terms of rights and obligations.

Indeed, fundamental principles must be supported and further directed by

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- a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
  - b. international custom, as evidence of a general practice accepted as law;
  - c. the general principles of law recognized by civilized nations;
  - d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.

90. See *supra* note 42.

established practices or custom, which in their supporting role could then also become mandatory. Where these practices or customs are connected to property, it is possible that they will prevail over contractual arrangements or a contractual choice of law, as occurs for example in the proprietary aspects of international negotiable instruments like eurobonds.<sup>91</sup> The same may be true in cases where an automatic return of title upon default is demanded in the contract; such an arrangement may not always prevail internationally for commercial reasons.

Also, specific performance of sales agreements normally available in civil law might be deemed against the commercial practice or realities, and common sense may thus rule out the possibility. For foreign direct investments, codes of conduct are increasingly formulated on the basis of established practices and some may even acquire a mandatory flavor. Wherever international practices or customs acquire such a mandatory aspect, it is in fact likely that there is a close connection with fundamental legal principles. These international practices in any event have supplementary force, even if they are not mandatory in themselves.

International conventions with uniform law further supplement the fundamental principles and international customs, like those on sales, transportation and payment methods. These Conventions contain so far only occasionally mandatory law; for example, that contained in Article 12 of the Vienna Convention. If the UNCITRAL Receivable Financing Convention (2001) or the UNIDROIT Mobile Equipment Convention (2001) became law, there would be much more mandatory treaty law as much of them concern property law. Even then, however, it is unlikely that they would prevail over fundamental legal principles or mandatory customs in the international legal order. It is no wonder that proprietary law concerning chattels and intangible assets in a financial context is moving to the forefront in this area. That is where the greatest differences and the greatest needs are, connected as they are with the bankruptcy resistance or the proprietary status of modern financial products internationally.

As already mentioned before, this treaty law has a peculiar aspect in the international commercial and financial legal order because it is in truth normally only binding on participants from (or transactions having an effect in) ratifying states, and is therefore territorial and always limited in its scope, and not truly transnational. Treaty creation is an instance where states assert legislative power in the international commercial and financial legal order. It is incidental and its force could only extend to the international order more generally if general principles were involved that could, as such, have standing throughout that order. It was already pointed out before that uniform treaty law of this nature should only be entered into at the request of the international legal order itself. Without such a request, it is unlikely to succeed; this is the reason why so many UNCITRAL projects are not adopted while even participants often exclude the

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91. See DALHUISEN, *supra* note 1, at 201.



widely ratified Vienna Convention.<sup>92</sup> It means that the search for projects by UNCITRAL and UNIDROIT is misguided. It is for the international business community to ask for them.

In all this, the wording of the contract and the intrinsic logic of the transaction itself are of course also to be considered, if necessary under standards of good faith, which, as just mentioned, may sometimes appeal to fundamental principles. Indeed, fundamental legal principles, and mandatory international customs or mandatory uniform treaty law would prevail over the structure of a contract.

Common legal principles will have further effect in defining international legal relationships where the contractual terms, fundamental principles, customs and treaty law fail or need further elaboration. These principles may be deduced from national laws if there is a wide consensus between them. Here comparative law may aid the inquiry, but its ambit would appear to be limited as it is not similarity at the domestic level that is key, but normativity in an international sense.<sup>93</sup>

The search for general principles of contract law derived from national insights may therefore not be all that relevant. The substantial compilations that are appearing in Europe, within UNIDROIT and within the EU, must from that point of view also be considered with skepticism.<sup>94</sup> Yet they do provide some lists from which it may be possible to select the most responsive norms.

If the applicable law were still not sufficiently established under the above layers of principles and rules, domestic laws could remain relevant as a matter of private international law. Even where a domestic private law would thus obtain, there would still be a discretionary element, however, to allow for different dynamics and needs in the international legal order. Another important insight is that the applicable domestic laws lose here their purely domestic character and become law in the international legal order. This is in fact the underlying reason and justification for the discretionary element.

The transplantation of domestic laws into the international legal order may remain very relevant as long as legal concepts are not yet sufficiently tested and elaborated in that order. It was already said that this may particularly be the case in the area of proprietary law in respect of chattels and intangibles, although conflicts of laws rules are traditionally insufficiently developed to deal with moving assets or assets that have no proper location like intangible claims.

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92. The lack of success may at the level of detail also be due to an attitude of trading mere domestic concepts in the relevant conferences, a serious impediment compounded by the lack of interest of the international community. See J. Basedow, *The Renaissance of Uniform Law: European Contract Law and Its Components*, 18 LEGAL STUD. 121 (1998).

93. See *supra* text accompanying note 66.

94. See DALHUISEN, *supra* note 1, at 305, for a more detailed critique also as to the confusion in these compilations on the notion of and dynamics behind the modern *lex mercatoria* and on the relative status of public policy, mandatory laws, customs, general principles, private international law and other sources of law. Another serious criticism concerns the consumer protection ethos in these Principles which nevertheless pretend to also cover international commerce and finance, therefore professional dealings.

In any event, one would expect domestic law concepts, including those of property law in movable and intangible assets, increasingly to lose their normativity in the international legal order when it develops further. It shows nevertheless that there need not be any enmity between the *lex mercatoria* and domestic laws. The former still depends on the latter. What is happening is that in international transactions many more rules of the various kinds need to be tested *before* domestic laws enter and that, even if such law does enter, it becomes part of the transnational law itself. The result is thus a layering of norms and their hierarchy, which, it is posited, is the essence of the modern *lex mercatoria*. No set of black letter rules exists here *per se*, nor would that seem to be necessary. The new law needs to be analyzed and discovered in each situation and must be pleaded in litigation. In fact, it is upon proper analysis no different in domestic courts. This per case analysis leaves the matter of domestic public policies, which in their allotted territories may compete with the law of the international legal order and introduce the element of balancing of the various interests per case as explained in Part IV above. These public policy considerations cut through the hierarchy of norms of the *lex mercatoria*, and require no less an *ad hoc* or per case approach.

Even now, much more can be said on the development and application of the new international law merchant or *lex mercatoria* and on the legal concepts that it can readily use or that it is developing.<sup>95</sup> Yet, for our purposes, the key

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95. See generally DALHUISEN, *supra* note 1, ch. I. I first raised these issues in my inaugural address at Utrecht in 1991. See JH DALHUISEN, WAT IS VREEMD RECHT [WHAT IS FOREIGN LAW] (1991).

Many of the concepts discussed here in terms of fundamental principles (in which connection good faith is sometimes seen as mandatory especially in the UNIDROIT and European Contract Principles, see below), customary law and practices (whether of the mandatory or directory type), uniform treaty law (whether mandatory or directive), party autonomy, general principles, and private international law rules pointing to domestic laws in international cases, are also used in one form or another in the 1980 Vienna Convention on the International Sales of Goods (Articles 7 and 9), and in the UNIDROIT and European Contract Principles, but there is no sense of order or hierarchy so that the relative priorities and relationships between these concepts remain unclear.

Thus Article 7(1) of the Vienna Convention in the International Sale of Goods (CISG) in dealing with the interpretation of the Convention requests that regard must be had to its international character, the need to promote uniformity and the observance of good faith in international dealings. Except for the reference to good faith which is here difficult to place (it has more properly a function whilst interpreting the relationship between the Contracting States under public international law, see Vienna Convention on the Law of Treaties, Article 31, May 22, 1969, 1155 U.N.T.S. 331), and the unexpected absence of any reference to international custom, the language implies at least some reference to the international commercial and financial legal order and its autonomous operation but the consequences appear not to be understood. In Article 7(2) on the supplementation of the Convention in matters not expressly settled thereby, the reference to internationality and uniformity is entirely missing. Here the text relies on general principles (but only those that can be deduced from the Convention of which there seem to be few if any) or otherwise on rules of private international law. There is therefore a direct reference to national laws but without any idea of how they play out in an internationalized environment.

Whatever there may be of the distinction between interpretation and supplementation in this connection, which in itself may be severely criticized, and the limitation of Article 7 to the vertical effect of the Convention whilst avoiding any language concerning contract interpretation itself (except to some extent in Articles 8 and 9) where one would have expected the reference to good faith

(and also to custom), it is not clear why different criteria apply to interpretation and supplementation, why good faith in particular applies only to interpretation (in this case of a Convention) whilst international custom and practices are only made applicable to the sales contract in Article 9 as implied term, therefore not as objective law but as a matter of contract only. See DALHUISEN, *supra* note 1, 373 *et seq.* There is here no clear view either of the rank of mandatory rules of a national character in terms of public policy. Property issues are excluded (Article 4) and any mandatory rules concerning them are no further considered. Issues of validity, legality and capacity must also be considered excluded from the scope of the convention by virtue of Article 4.

Article 7 CISG maintains here a muddled approach, unfortunately copied in all other UNCITRAL Conventions and even in some UNIDROIT Conventions but interestingly not entirely in the UNIDROIT Contract Principles (unlike the European Contract Principles). On the other hand, the Vienna Convention cannot determine what other sources may additionally apply and what their ranking is. It must be assumed therefore that it takes its place as directory uniform treaty law in the hierarchy of *lex mercatoria* as here explained whilst the references to customs, general principles, and private international law (therefore domestic laws) in Article 7 and Article 9 can best be understood and should find their place in that hierarchy also.

In a proper internationalist approach, the appropriate references for both interpretation and supplementation of the Convention itself or more appropriately of the sales agreements operating thereunder should therefore have been to the text of the Convention itself and its general principles, to its international character and the need for uniformity in the application of the uniform law, to international practices and customs which would supersede the Convention to the extent mandatory, to the general principles operating in international sales, to the text of the sales agreements and their good faith implementation which would supersede the Convention (being itself directory) if deviating, and residually to private international law (it being understood that national law so becoming applicable would still be functioning in an international and not a domestic manner, so that the reference to internationality would qualify it), whilst public policy of states that could claim a legitimate interest would also supersede the Convention and the contractual dispositions.

The UNIDROIT (hereinafter UP) and European Contract Principles (hereinafter EP) although non-binding and having at best the status of restatements, present an even muddier approach. The UP are meant to only cover professional dealings, the EP all dealings including consumer dealings which in itself presents important problems as in this manner consumer principles may start to operate in the professional sphere. There are also possibilities of conflicts (where both sets of Principles may differ, the EP only applying in the European Communities, Article 1:101 (1)). Both sets allow for their Principles as well as the *lex mercatoria* to be chosen by the parties. See Third Preamble UP; Article 1:101 (3)(a) EP. In fact they each consider references to the *lex mercatoria* and general principles to include these Principles or in the case of the EP also when no law is made applicable by the parties. So far so good.

Problems arise first when both sets subsequently start to talk about mandatory rules. It suggests that they can create or at least identify mandatory rules. See Article 1.7 UP; Articles 1:102 (1) and 1:201(2) EP. It is submitted that this must imply a reference to the international legal order and its mandatory practices (to the extent existing, e.g. in the property law aspects of modern financial products) rather than consumer law concern with practices and their fairness, but the Principles are not clear in this aspect. A censorious approach is suggested. These mandatory rules may be overruled by contract unless the applicable private international law rules dictate otherwise. See Articles 1.4 and 1.5 UP; Article 1:103(2) EP. But public policy evaluation and balancing is not properly an issue of private international law and any contract is here powerless.

Good faith is here in particular considered a mandatory concept. See Article 1.7 UP; Article 1:201(2) EP. This has consumer law overtones. In interpretation and supplementation of commercial contract that is, however, by no means always the case and parties can often exclude its functioning or at least set standards. Cf. U.C.C. § 1-302(a). It also creates problems with respect to the many references in the Principles to reasonableness and fairness or unreasonable behavior, taking excessive advantage or existence of bad faith, which may or may not be expressions of "good faith" and therefore mandatory (in the perception of these sets of Principles). See DALHUISEN, *supra* note 1, at 307, 315.

Both sets of Principles contain an interpretation and supplementation clause concerning the Principles themselves and make a distinction (following the Vienna Convention, but unlike the earlier Hague Conventions). The UP (Article 1.6) make interpretation subject to the international char-

insight is that the law in this order can be easily determined at the micro level, and can therefore be readily applied.

## VI. CONCLUSION

I believe that it is no exaggeration to say that there is a widespread feeling amongst those who think about these matters<sup>96</sup> that domestic laws can no longer adequately deal with the immense increase in the international flow of goods, services, payments, and capital and that as a consequence, the conflict of laws rules as we still know them—oriented as they are towards always finding a domestic, national, or statist law to be applied—have run their course. In any event, they present at best a fractured system of law if applied to international transactions, creating uncertainty and also inequality as a result. Such a system is also likely to be inefficient. It may have been acceptable when the international flows of goods, services, and money were modest but that is no longer the case. In fact, total value of these flows far supersedes the GDP of any individual country.

Thus, increasingly, a whole range of other rules or principles are superseding the application of domestic rules in international business cases. Even if in my construction of the *lex mercatoria*, in international commerce and finance, domestic law remains the residual rule, much may precede its application. In fact, any domestic law still used as the residual rule in this manner is then incorporated into the transnational law or law merchant itself and operates only in that context.

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acter and purposes of the Principles and the need to promote uniformity. Again this must be some oblique reference to the international legal order and its practices without its meaning being explained. Supplementation is done on the basis of the general principles of UP. Importantly, the CISG reference to private international law is deleted in the UP, the UP clearly being considered to be sufficiently self-contained. The EP maintains this reference to private international law in Article 1:106 in supplementation whilst deleting the reference to internationality in interpretation (but substituting a reference to certainty in contractual relationships, of which it clearly has no concept). Transnationalism is here clearly further removed from the drafters' thinking, the reason probably being that the EP are also meant to apply to consumer contracts and are really being perceived as the new *domestic* law of the EU in all contract matters. It still begs the question why a reference to the law of Member States is then still considered opportune. Both sets refer to usages and practices, *see* Article 1.6 UP and Article 1:105 EP, but (like Article 9 CISG) only in terms of implied contractual obligations.

In both sets, contract interpretation (and supplementation) is a different issue and covered separately by Article 4. *et seq.* UP and Article 5:101 *et seq.* EP in which connection in the UP good faith, fair dealing and reasonableness come only in as supplying additional terms. Usages on the other hand are allowed in interpretation, not in supplementation. The EP does not here distinguish and allows both good faith notions and custom to operate in matters of interpretation and supplementation. In neither set, reference is made in this connection to private international law or uniform treaty law. One must assume that custom or usage is here still considered an implied contractual terms and does not figure as objective law.

Much more may be said on these Principles. For a critique, see DALHUISEN, *supra* note 1, 305 *et seq.* Here the more important conclusion is that neither set has a concept of internationality, the sources of law in this connection, and their ranking.

96. *See* DALHUISEN, *supra* note 1.

As already suggested in the Introduction, it may mean for example that English law applicable in a domestic case may turn out quite differently from English law when applied in an international case where it will meet other sources of law that prevail over it, and in any event it may not be applied in a domestic manner. That is a key realization. That is also so when the applicable law is chosen by the parties unless they make it clear at the same time that they want the international character of their transaction to be ignored. In any event, such a contractual choice of law cannot prevail in proprietary and public policy matters, as these are matters not at the free disposition of the parties. Even in contract, rules concerning capacity and validity cannot be chosen by the parties either unless (perhaps) they opt for another contractual regime altogether.

From a more academic perspective, the re-emergence of a new international law merchant offers us the unique opportunity to observe the operation of a new immanent legal order; as such it is an event of major consequence. The intellectual conceptualization of the new law and the identification of the legal framework in which it operates may still leave something to be desired, but it is—as I hope I have shown—not beyond our capabilities. This task is urgent and requires confidence in the new international realities and acceptance that the evolution of new laws can be a self-creating and self-validating social process. Respect for modern society's plurality, as well as efficiency demands, lead quite naturally to the recognition of different legal orders and their laws, and, at the international level, to the acceptance of a new commercial and financial legal order. It may be seen as the precondition for the understanding and evolution of the new law merchant that international business now requires.

Indeed this law, as any other, needs a framework or context within which it can operate and develop. I have attempted to describe this context. To give this order and its law more stature and to help its development, the articulation or spokesman function needs to be further explored and reinforced. Organizations like the International Chamber of Commerce have so far done important work but only in special aspects, while a similar effort needs to be made in whole other areas, such as international finance. Other trade associations, like the IPMA and ISMA (now combined in ICMA) already do so in the euro-markets and may here be of further help; their role in the process needs more study. Also, international arbitrators and enlightened state courts may play an important role, while even the desirability of a highest international commercial appeals court becomes clear in light of the multitude of possible actors in this process.

It has been shown that we are not here talking of an emerging world law *per se*, which could by definition be considered higher than domestic laws. Rather, we are here concerned first with the proper operation of parallel legal orders that possess disparate competencies in governing relationships or transactions within their reach. Our belief in pluralism finds here its normal sequence in the formation, recognition, and operation of all living law. Only when the issue of conflict and competition, and therefore the issue of precedence must be determined, need we defer to a higher law found in the rule of law itself.

That new legal orders may not immediately emerge as fully-fledged legal systems should come as no surprise. Their law as living law will in any event always be in full evolution. It is no different in domestic laws, and the greater certainty those laws are frequently thought to give has proved only too ephemeral in international dealings, as it now often is even in domestic dealings. International business is likely to be better served by the appropriate transnational law, even if it is less detailed, than it would be by the wrong domestic law even if that domestic law is thought to bring greater certainty within its own territory. I believe that international business can better live with that risk than with the risk of having an altogether improper and unresponsive law applied. It is hard to see what could be a problem with the search for better laws and why it would make a difference if the better laws were transnational.

As was already pointed out before, in truth the legal certainty of which we often speak in this connection and which is, as an objective of the law, of course, greatly desirable, can only result from the behavior and restraint of the participants themselves, and therefore from the legal order itself in which they operate. In the international commercial and financial legal order, therefore, this certainty can only be provided by the international business community.

Naturally, at the practical level the professional international commercial and financial legal order faces evolutionary problems in the further elaboration of its laws, but so do statist legal orders and laws. Although in maritime law and in the areas of negotiable instruments and documents of title, the new *lex mercatoria* may easily recover its old balance and dispense with the hierarchy of norms in favor of a unitary transnational substantive law, and may also be able to deal quite effortlessly in this manner with modern letters of credit or similar guarantees and perhaps with international payments more generally, there are other major parts of private law where this is more difficult, not in the least because domestic laws are equally unsettled in those areas. Reliance on domestic laws, although always in the context of the *lex mercatoria*, may not then be satisfactory either, even if it would allow for adjustment to cater to the international element. The development of a transnational, unitary substantive law regime must then be promoted and will—it is submitted—ultimately have its way.

I take the law of chattels and intangible assets as a major example, in particular with reference to problems of possessory protections, assignments, conditional or temporary sales and ownership rights, collateralized transactions, shifting liens or floating charges, trusts and constructive trusts or tracing facilities, agency, fiduciary duties and transfer facilities, and restitution notions, but no less with reference to the modern ways of payment, modern book-entry entitlements for transferable securities and modern netting facilities, issues with which I have tried to deal extensively and in a more conceptual manner elsewhere.<sup>97</sup> Especially in financial law, these present major problem areas. This is also true

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97. See DALHUISEN, *supra* note 1.

domestically, where common law has, however, long had some advantage.

Indeed, from a comparative law perspective, it is clear that in all of these areas the more modern solutions are mainly found in the equity concepts (contractually and especially proprietarily) of the common law, deriving therefore from a legal intervention facility (originally through the Lord Chancellor) that civil law never had. It is no wonder that in private law we find exactly the greatest practical differences between civil and common law in these areas and therefore the greatest historical divides to bridge in the new law merchant. On the other hand, from a common law perspective the problem is here that equity became formalized and lost its dynamic impulse halfway through. One sees this in the need for modern statutory elaboration of many of these notions, especially in modern trust, corporation, and securities statutes, but no less in the various articles of the U.C.C. in the U.S. From this perspective, it could be argued perhaps that the international law merchant is much like a new law of equity (in a common law sense) that has rediscovered the basic dynamics of reform and can in the process also deal with efficiency considerations and values as a matter of conscience, as well as with the objective needs of the participants that formulate the new law and that must find and adjudicate it in light of their business or judicial experience within the international business community as a whole.

This brings us ultimately not only to the role of international arbitrators but also of national judges when called upon to adjudicate cases under the rules of non-state legal orders, and particularly under the international commercial and financial legal order. We saw that international arbitrators have great freedom in these matters, but they are by no means free in identifying the applicable rules. Domestic judges are here likely to be more uncertain and inhibited at first. Yet they should not be, and if uncertain as to the prevailing business practices should aggressively ask for expert witnesses, as Lord Mansfield once did and international arbitrators often do. This being said, in my view, there will always remain an important difference between international arbitrations and state court proceedings. Although in both cases the issues presented have to be decided on the basis of the applicable law (here the international law merchant), the attitude of each is still likely to be quite different.

To make a generalization, arbitrators are more interested in the facts, judges in the law, and not only those in the civil law tradition. There is nothing wrong with this as long as we understand that arbitrators, in trying to identify the *legally relevant* facts, implicitly interpret the applicable law while judges trying to formulate the applicable rules do so against the background of what they implicitly see as the legally relevant facts. This observation shows another facet of the close relationship between the legally relevant facts and the relevant legal norms; the results should not be different although the argumentation will be.

What binds them together is that in professional business disputes, both arbitrators and judges must in their judicial activity be aware of the facilitating nature of the law merchant and of the need for solutions that make commercial sense and serve the business community, absent overriding policy issues arising

from the international commercial legal order itself or from statist legal orders to the extent domestic governmental interest may be deemed to be objectively justified and therefore to prevail.

In terms of the international commercial and financial legal order and its law merchant, there is little doubt in my mind that we are talking here about an evolution that has long been underway and that will manifest itself ever more prominently in the years to come. The international flow of commerce itself requires it. It usually takes the legal community a long time to identify and become comfortable with new ways. It is not different in this case, and it is a matter of education either in our universities or in the school of life. The first alternative is on offer for our students. Ever more take advantage of that opportunity. The sooner they realize what is going on the better. Much work remains to be done but I am confident that at least the groundwork has by now firmly been laid.