

“Rules of Law” and Lex Mercatoria Determination Under the Auspice of ICC Arbitration

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Abstract

The ICC arbitration, being one of the most common ones in international commercial arbitration, is also one of the most benevolent to the application of supranational substantive rules, including the *lex mercatoria*. While it has not always been the case, since 1998, the arbitrators may less focus on complex reasoning as to why the *lex mercatoria* might be applicable, and rather may fully concentrate on the rightful adjudication of the dispute. This article presents a summary of changes in ICC arbitration stance on the applicability of *lex mercatoria*, as voiced by the permission to *inter partes* elect, or *ex post* determine, substantive “rules of law” rather than just a “law”. Connotations of ICC jurisprudence towards applicable *lex mercatoria* and its relationship to state law is also discussed and evaluated.

Keywords

ICC; Arbitration; Lex Mercatoria; Rules of Law; Lex Arbitri.

1 Introduction

International commercial arbitration is deemed to provide many opportunities for the parties involved. To name a few, confidentiality, case management, no appeal process or ultimate benefit of wide recognition and enforcement under the New York Convention. Nowadays, the parties to the International Chamber of Commerce (“ICC”) arbitration are also given broad discretion to choose applicable rules of law, rather than just a state law. Should they absent in exercising such an opportunity, the arbitrators must select an appropriate set of substantive rules to apply to the dispute’s merits.

This paper discusses the application of *lex mercatoria* being one of the said rules of law in the ICC arbitration. While not the only possible rules of law to be chosen, the *lex mercatoria* prove difficult to foresee the extent to which it will be applied – particularly considering its non-unified reflection in the current doctrinal approach.

This paper will analyze the ICC jurisprudence immanently before the point of ICC Rules 1998¹ entry into force and following as well as the newly taken approach to the choice of law after ICC Rules 1998, as retained throughout the years and mirrored in Art. 21 para. 1 ICC Rules 2021².

The second chapter of this paper presents a general overview of French *lex arbitri* to the ICC which allowed for the change in perception of substantive applicable law – from state law to the “*rules of law*”.

The third chapter then presents the various paths to the substantive *lex mercatoria* pursuant ICC Rules 1988³, rules which mark the last time the parties, arbitrators respectively, were bound to elect solely the applicable state law.

The fourth chapter will then firstly present the current stance on the applicability of *lex mercatoria*, focusing on the changes following ICC Rules 1998 entry into force. Secondly, the application of *lex mercatoria* in cases of its explicit or interpreted choice, in the absence of a choice of law, and cases of choice of state law will be assessed and evaluated.

Following the aforementioned, one should become aware that the scope of *lex mercatoria* application will ultimately vary based on who is in charge of the choice of law determination. A choice which, when not exercised properly, might convey more problems than benefits. It will be presented that a simple *lex mercatoria*, as the law of international trade, may become an unforeseen double-edged sword.

2 Background of the ICC Arbitration

To tackle the doctrinal approach which gives rise to the applicability of transnational law, one must follow the French roots of ICC arbitration.

¹ ICC Rules of Arbitration, in force as from 1 January 1998.

² ICC Rules of Arbitration, in force as from 1 January 2021.

³ ICC Rules of Arbitration, in force as from 1 January 1988.

Arbitral proceedings before the ICC will be conceptually oscillating somewhat between contractual and mixed theory.⁴ The ICC arbitration, wherever the place of arbitration is, has its seat in France. Hence French law is the *lex arbitri* and conferred by French national law the tribunal(s) enjoy a large discretion to determine the applicable law. The ICC thus tends to be more amenable to the application of transnational law as a transnational dispute resolution independent of the state.⁵ The differentiation of the theories⁶ has a major impact on specific procedural issues and the state's role in relation to arbitration.⁷

Concerning the "rules of law", Art. 1511 of the French Code of Civil Procedure provides for the application of the *lex electa* or appropriate rules of law in the absence of choice, however taking into account the commercial practice at all times.⁸ This embodied power is currently reflected in Art. 21 para. 1 and 2 ICC Rules 2021. The presumption of choice of a set of rules, not a choice of state law, thus gives parties the option to elect applicable law other than state law.⁹ The explicit use of the phrase "rules of law" instead of mere "law", as employed in the past in ICC Rules 1988, is purposely aimed at removing the restriction of the necessity to choose state law¹⁰ and, therefore, the necessity to strictly apply conflict of laws rules¹¹. According

4 ROZEHNALOVÁ, N. *Instituty českého mezinárodního práva soukromého*. Praha: Wolters Kluwer, 2016, p. 234.

5 ROZEHNALOVÁ, N. Hlavní doktríny ovládající rozhodčí řízení. In: SEHNÁLEK, D. et al. (eds.). *Dny práva – 2009 – Days of Law*. Brno: Masaryk University, 2009, p. 1860.

6 LEW, J. D. M. *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards*. Dobbs Ferry: Oceana Publications, 1978, p. 52 et seq.

7 ROZEHNALOVÁ, N. Hlavní doktríny ovládající rozhodčí řízení. In: SEHNÁLEK, D. et al. (eds.). *Dny práva – 2009 – Days of Law*. Brno: Masaryk University, 2009, pp. 1858–1860.

8 «Le tribunal arbitral tranche le litige conformément aux règles de droit que les parties ont choisies ou, à défaut, conformément à celles qu'il estime appropriées. Il tient compte, dans tous les cas, des usages du commerce.»

9 GAILLARD, E. and J. SAVAGE (eds.). *Fouchard Gaillard Goldman on International Commercial Arbitration*. The Hague: Kluwer Law International, 1999, p. 802.

10 FRY, J., S. GREENBERG and F. MAZZA (eds.). *The Secretariat's Guide to ICC Arbitration*. Paris: International Chamber of Commerce, 2012, p. 222, para. 3–760; EISEMANN, F. Le nouveau règlement d'arbitrage de la Chambre de commerce internationale. *Droit et pratique du commerce international*, 1975, Vol. 1, no. 3, pp. 355–356.

11 NAÓN, G. and A. HORACIO. Choice-of-law Problems in International Commercial Arbitration. In: *Recueil des cours 2001*. Leiden/Boston: Martinus Nijhoff Publishers, 2001, Vol. 289, p. 213.

to the ICC, “*rules of law*” attracts an infinite number of sources, including, but not limited to, transnational commercial law, which is also synonymous to general principles of international commercial law or *lex mercatoria*¹², UPICC¹³, PECL¹⁴, INCOTERMS¹⁵, or other applicable sources of public international law (i.e., in the investment arbitration). The parties are therefore free to elect *lex mercatoria* as applicable law. An election which is ought to be upheld by the tribunal. The same then goes for the tribunal itself, if not instructed otherwise by the parties.

The following chapters of this paper will examine (a) the situation regarding application of *lex mercatoria* in the ICC arbitration prior to the ICC Rules 1998 entry into force, and (b) current stance on the *lex mercatoria* application as the applicable law in cases of explicit choice and in absence of choice, in which the parties thus delegate the power of applicable law determination to the tribunal discretion. Secondly, the influence of *lex mercatoria* to otherwise applicable state law will be assessed (irrespectively whether applicable via parties’ choice or determined by the tribunal).

3 Negative Choice of Law Prior to the ICC Rules 1998

While it nowadays seems that the use of *lex mercatoria* as the applicable law to the contract in ICC arbitration is, without a doubt, possible, it has not always been the case. Before ICC Rules 1998, neither the parties nor arbitrators had the liberty to either elect or designate *lex mercatoria*¹⁶ as the applicable law to be applied to the merits of the dispute. Then applicable Art. 13 para. 3 ICC Rules 1988 postulated that the “... *parties shall be free to determine the law to be applied by the arbitrator to the merits of the dispute*”¹⁷ and that in the case of absence of such determination made by the parties, the arbitrators shall “... *apply the law designated as the proper law by the rule of conflict which he deems*

¹² JOLIVET, E. La jurisprudence arbitrale de la CCI et la *lex mercatoria*. *International Chamber of Commerce Digital Library* [online]. 29. 4. 2001 [cit. 25. 5. 2021]. Available at: https://library.iccwbo.org/dr-noaccount.htm?reqhref=/Content/dr/ARTICLES/ART_0462.htm

¹³ UNIDROIT Principles of International Commercial Contracts.

¹⁴ Principles of European Contract Law.

¹⁵ International Commercial Terms.

¹⁶ Or any other non-state or transnational law.

¹⁷ Art. 13 para. 3 ICC Rules 1988.

appropriate".¹⁸ More than ever has the choice of *lex mercatoria* as the applicable law depended on the arbitrator's enthusiasm towards the applicability of transnational law.¹⁹

An evident scepticism may be seen in *ICC Award No. 9419*²⁰, in which the arbitrator evaluated the existing school of supranational *lex mercatoria*. Nevertheless, from his own perspective inclined to find no such law existing and refused to apply it to the subject matter of the dispute. The arbitrator's internal view thus established a predominance in dispute decision.

One of the landmark cases in which the *lex mercatoria* found its way to the merits of the dispute has been the *ICC Award No. 7375*²¹. The dispute concerned the sale of certain air defence radar equipment under nine different contracts concluded during the period of 1971 and 1978 between Iranian and American parties. The ICC Rules 1988, in the absence of a choice of law, allowed the tribunal to determine the applicable law based on an appropriate conflict of laws rule. The tribunal has undergone two different methods in determining the applicable law, even though that by a majority of arbitrators it was deemed only the subjective test holds the key for the right answer for determining the proper law.²² By an objective approach²³, the law of Maryland/USA was to be determined as the proper law based on the conflict of laws rule of closest connection. However, after applying the objective approach, the tribunal proceeded to determine

¹⁸ Ibid.

¹⁹ TOOTH, O. *The lex mercatoria in theory and practice*. Oxford: Oxford University Press, 2017, p. 210; NAÓN, H. G. *Choice-of-law Problems in International Commercial Arbitration*. Heidelberg: Mohr Siebeck, 1992.

²⁰ ICC Award No. 9419 (1998). Final 9419. In: *ICC International Court of Arbitration Bulletin*, 1999, Vol. 10, no. 2, p. 105.

²¹ ICC Award No. 7375 (1996). The Ministry of Defence and Support for Armed Forces of the Islamic Republic of Iran vs. Westinghouse Electric Corporation, ICC Case No. 7375/CK, Award on Preliminary Issues of 5 June 1996. *JUS MUNDI* [online]. [cit. 25. 4. 2021]. Available at: <https://jusmundi.com/en/document/decision/en-the-ministry-of-defence-and-support-for-armed-forces-of-the-islamic-republic-of-iran-v-westinghouse-electric-corporation-award-on-preliminary-issues-wednesday-5th-june-1996>

²² Ibid., para. 241.

²³ "Objective approach does not look at hypothetical or implied intentions the parties may or might have (but failed to express with the required clarity) but will come in with purely objective criteria for determining the legal regime or provisions that is/are to be applied. The objective approach thus rests on the conviction (or hypothesis) that a determination derived from 'hard facts' (rather than from possibly vague intentions of the parties) may provide more certainty and foreseeability and, in an overall analysis, lead to a more appropriate determination of the applicable law." – Ibid., para. 242.

the parties' intent, assessing that the absence of an express choice of law did not equate to the absence of an implied choice.

The tribunal assessed that the absence of a choice of law “*must be viewed as a “shouting silence”, at least an “alarming silence”, “un silence inquiétant”*”; thus, a silence which must ring a bell and requires the tribunal to look “behind” so as to understand why the Parties have failed to include the obvious”²⁴ and must be deemed an expression of the unwillingness to submit to the law of the other party. Thus, the absence of a choice of law is an implied negative choice of law²⁵, thus an integral part of the contract and implied exclusion of the respective contracting parties' national laws. Since such implied choice of law prohibits the use of the law of one of the contracting parties and the objective test has led to selecting the law of one of the parties, the objective approach determination, therefore, could not be used.

Therefore, the tribunal was forced to select alternative applicable law, for which the tribunal evaluated law of a neutral country, the *tronic commun* doctrine, and the *lex mercatoria*.²⁶ The tribunal also noted that the implied negative choice did not empower the tribunal to rule as an *amiable compositeur*, according to principles of equity or *ex aequo et bono*.²⁷ After its evaluation, the tribunal has chosen the *lex mercatoria* as the only solution that objectively and fairly preserves both parties' rights and subjective expectations. The tribunal, by admitting the existence of an implied negative choice of law, avoided the need to apply a conflict of laws determination. *Obiter dictum* was this approach appropriated in *ICC Award No. 8540*²⁸ when established the legitimate possibility of applying the *lex mercatoria* as the applicable law in situations of absence of a choice of law in which determining the applicable state law would prove difficult, notably in cases where the law of the closest relationship cannot be determined.²⁹

²⁴ Ibid., para. 277.

²⁵ Ibid., para. 283.

²⁶ Ibid., para. 286 et seq.

²⁷ Ibid., para. 318.

²⁸ ICC Award of 4 September 1996, No. 8540. *UNILEX* [online]. [cit. 20.4.2021]. Available at: <http://www.unilex.info/principles/case/644>

²⁹ “*In an international commercial transaction such as this contract between and, where the Parties have not indicated the applicable law and where there are many disparate connections to many different municipal systems of law, we are of the opinion that international arbitrators are fully justified to turn to general principles of law.*” – Ibid.

It is also necessary to say that such circumventing of the arbitrator's inherent duty represented by Art. 13 para. 3 ICC Rules 1988 in determining the *lex mercatoria* as the applicable law, as shown in *ICC Award No. 7375*, is no longer necessary. Current ICC Rules 2021 refrain from the need to apply the law designated by the proper conflict of laws rules. Rather it allows to "... *apply the rules of law which it [arbitral tribunal] determines to be appropriate*".³⁰ Nevertheless, such an approach could be applied to Art. 28 para. 2 of the UNCITRAL Model Law.

Similarly, yet with lesser persuasiveness, the tribunals approached the determination of the *lex mercatoria* as the applicable law through Art. 13 para. 5 ICC Rules 1988.³¹ Art. 13 para. 5 ICC Rules 1988 stipulates that notwithstanding Art. 13 para. 3 ICC Rules 1988 the tribunal "... *shall take account of the provisions of the contract and the relevant trade usages*".³² In *ICC Award No. 8502*³³, the disputed purchase agreement contained a choice of INCOTERMS 1990 for regulation of price matters and UCP 500³⁴ for regulation of *force majeure*. The tribunal has interpreted these choices, given the absence of a choice of other applicable law. The Parties have expressed their mutual intention to have their relationship governed by general principles of international trade. Similarly, in *ICC Award No. 9474*³⁵, the tribunal assessed that should individual contracts in a complex contractual relationship be subjected to non-state sectoral regulations (e.g., CISG³⁶ and UCP 600³⁷), such conduct is an indication of the exclusion of state law not only to the individual contracts but also to the complex contractual relationship (main contract), without being explicitly identified as excluded in the latter one. Should the sector regulation fail to regulate all questions

³⁰ Art. 21 para. 1 ICC Rules 2021.

³¹ ERDEM, H.E. The role of trade usage in ICC arbitration. In: DERAIS, Y. and L. LÉVY (eds.). *Liber Amicorum en l'honneur de Serge Lazareff*. Paris: Editions A. Pedone, 2011, p. 250.

³² Art. 13 para. 5 ICC Rules 1988.

³³ ICC Award No. 8502 (1996). Final 8502. In: *ICC International Court of Arbitration Bulletin*, 1999, Vol. 10, no. 2, p. 72 et seq.

³⁴ Uniform Customs and Practice for Documentary Credits (1993 Revision).

³⁵ ICC Award No. 9474 (1999). ICC International Court of Arbitration (Paris) 9474. *UNILEX* [online]. [cit. 12. 4. 2021]. Available at: <http://www.unilex.info/principles/case/690>

³⁶ United Nations Convention on Contracts for the International Sale of Goods.

³⁷ Uniform Customs and Practice for Documentary Credits (2007 Revision).

of law of the main contract, then the *lex mercatoria* ought to be the applicable law. An analogous approach has been taken in case *ICC Award No. 7235*.

Therefore, as to the implied choice, it should be noted that ICC arbitration practice allows (without any major problem) the presumption of the choice of *lex mercatoria* through a negative choice of law due to multiple factors – the existence of an international element; absence of a weaker party; and the will of the parties to denationalise the dispute by the prorogation of arbitration.³⁸ By denationalising the dispute, the parties express the neutrality of their contractual relationship’s substantive and procedural framework, which allows the tribunal to elect applicable transnational law.³⁹

4 Lex Mercatoria as an Applicable Law After the ICC Rules 1998

Although needed to find a way around the obligation to use conflict-of-law rules in the past, the approach of ICC arbitration has nonetheless changed. The change was neither doctrinal, nor statutory. The change was merely a reinforcement of the parties’ intentions, which is generally and widely accepted in arbitration⁴⁰, provided by the ICC within the boundaries of mandatory laws of its *lex arbitri*. As presented in chapter 2, nowadays, the tribunal need not rely on complex reasoning as to what extent the parties implied *lex mercatoria* or whether trade usage may cover the whole adjudication. Following ICC Rules 1998 stipulating in its Art. 17 para. 1 that parties “... shall be free to agree upon the rules of law to be applied by the Arbitral Tribunal to the merits of the dispute”⁴¹ and in a case of the absence of choice of law

³⁸ BERGER, K.P. International Arbitral Practice and the UNIDROIT Principles of International Commercial Contracts. *American Journal of Comparative Law*, 1998, Vol. 46, no. 1, pp. 144–145.

³⁹ ICC Award No. 7110 (1998). Partial 7110. In: *ICC International Court of Arbitration Bulletin*, 1999, Vol. 10, no. 2, p. 47.

⁴⁰ UNITED NATIONS. *UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT. Dispute Settlement International Commercial Arbitration. 5.5 Law Governing the Merits of the Dispute*. Geneva & New York: United Nations, 2005, p. 8; also cf. Art. 35 para. 1 UNCITRAL Arbitration Rules as adopted in 2013; Art. 6 IIL (Institute of International Law) Resolution of 12 September 1989; Art. 15 OHADA (Organisation pour l’Harmonisation en Afrique du Droit des Affaires) Uniform Act on Arbitration 11/3/99.

⁴¹ Art. 17 para. 1 ICC Rules 1998.

the tribunal "... shall apply the rules of law which it determines to be appropriate"⁴² current ICC Rules 2021 in its entirety of Art. 21 para. 1 do not differ.

4.1 Explicit and Interpreted Choice of *Lex Mercatoria*

In cases of an explicit choice of *lex mercatoria*, thus omitting any state law, the parties indicate their expectations of the law being unencumbered by norms without an internationally accepted commercial practice support. The advantage sought is a uniform application independent of the peculiarities of individual national orders reflecting international business needs, allowing for a useful exchange between systems that are sometimes overly associated with conceptual differences, and hence seeks fair and pragmatic solutions to particular situations.⁴³

Regarding the interpreted choice, it is established that explicit choice of international law, unless agreed otherwise by the parties during the arbitral proceedings, amounts to the election of *lex mercatoria* as a law applicable to international private contracts.⁴⁴

In cases of cumulation of applicable laws, a perfect interpretation of the choice-of-law clause is necessary to determine the parties' legitimate expectations. A parallel choice of state law and *lex mercatoria*, with the corrective of reasonable assumptions in the light of the objectives and intentions of the contract, amounts to a duty of arbitrator to use those sources of law to determine individual applicable rules. The arbitrator thus needs to determine which norms of the chosen national law correspond to generally accepted rules of the international private law as only such norms may be the applicable law. The corrective of the parties' reasonable assumptions represents a threshold for determining the applicable norms. In *ICC Award No. 8264*, the tribunal compared provisions of the chosen Algerian law against generally accepted principles to determine the application

⁴² Ibid.

⁴³ ICC Award No. 8385, Clunet 1997. *TRANS-LEX.org* [online]. [cit. 19. 4. 2021]. Available at: <https://www.trans-lex.org/208385>; CRAIG, W. L., W. W. PARK and J. PAULSONN. *International Chamber of Commerce Arbitration*. Dobbs Ferry: Oceana Publications, 2000, pp. 332–334; ICC Award No. 14208/14236 of 2008. Partial 14208/14236. In: *ICC International Court of Arbitration Bulletin*, 2013, Vol. 24, no. 2, p. 70.

⁴⁴ ICC Award No. 12111 (2003). Partial 12111. In: *ICC International Court of Arbitration Bulletin*, 2010, Vol. 21, no. 1, p. 78.

of each provision. Moreover, the tribunal reasoned that the individually chosen sources of law do not possess a primacy of application over each other. Therefore, general principles of law and international commercial practice expressed in the UPICC can be applied to the subject matter of the dispute without their reflection in the chosen Algerian law.⁴⁵ Should the parties agree on the complementary and supplementary application of general principles of international law and trade usages, the tribunal will use those solely to question not regulated by the applicable state law.⁴⁶ The state law shall prevail in cases of contradictory regulation between general principles of international law and trade usages and chosen state law.⁴⁷

While it might be common to use trade usage or *lex mercatoria* to fill gaps in state law, should the parties elect *lex mercatoria*, question unregulated by *lex mercatoria* must be settled by other means of adjudication. In *ICC Award No. 11018*, the tribunal instructed to use UPICC 2004 as the applicable law. Contrary to its latter version, UPICC 2004 did not contain an express regulation for invalidity of contract on the grounds of illegality. For such an instance, the tribunal needed to find a suitable solution outside the chosen applicable law.⁴⁸ The arbitrators thus proceeded to determine adjacent standards and chose the French law due to its complex regulation of the subject matter.⁴⁹

In cases of ambiguous choice-of-law clause, the tribunal might refrain from a sole determination of the applicable law. In the case of *ICC Award No. 9474*⁵⁰, the arbitration clause contained a provision instructing the tribunal to decide “fairly”, which could be confused with decision pursuant *ex aequo et bono*. Both parties accepted the tribunal’s proposal to apply “the general standards and rules of international contracts”. In their submissions, the parties pleaded and relied

⁴⁵ ICC Award No. 8264 (1999). Final 8264. In: *ICC International Court of Arbitration Bulletin*, 1999, Vol. 10, no. 2, p. 62 et seq.

⁴⁶ ICC Award No. 7365 (1997). ICC International Court of Arbitration, Paris 7365/FMS. *UNILEX* [online]. [cit. 10. 4. 2021]. Available at: <http://www.unilex.info/principles/case/653>

⁴⁷ *Ibid.*

⁴⁸ ICC Award No. 11018 (2002). ICC International Court of Arbitration 11018. *UNILEX* [online]. [cit. 17. 4. 2021]. Available at: <http://www.unilex.info/principles/case/1420>

⁴⁹ JOLIVET, E. L’Harmonisation du Droit OHADA des Contrats: L’Influence des Principes d’Unidroit en Matière de Pratique Contractuelle et D’Arbitrage. *Uniform Law Review*, 2008, Vol. 13, no. 1–2, p. 143.

⁵⁰ ICC Award No. 9474 (1999). ICC International Court of Arbitration (Paris) 9474. *UNILEX* [online]. [cit. 12. 4. 2021]. Available at: <http://www.unilex.info/case.cfm?id=690>

on international treaties (CISG) as well as on codifications of the *lex mercatoria* (UPICC, PECL, UCC), from which the tribunal then drew its conclusions.

Also, while a state court is bound to supplement the CISG with an applicable state law pursuant a conflict-of-law provisions following the Art. 7 para. 2 CISG, an arbitral tribunal is not bound in the same fashion. In the case of *ICC Award No. 11849*, the tribunal determined *lex mercatoria* to be the applicable law under the rules of private international law based on Art. 17 para. 1 ICC Rules 1998.⁵¹

4.2 Absence of Choice of Law

The absence of a choice of law represents an advanced level of uncertainty regarding the outcome of the applicable law. Any choice of law represents a determination of the material sources available for determining the applicable rules as an expression of the parties' expectations to control the issues of residual rights, obligations, and risk allocation.⁵² Should parties absent in choice of law the tribunal must resort to other means of determination. Modern arbitral procedural rules regulate the applicable law determination pursuant tribunal's discretion.⁵³ Arbitrators, therefore, tend to decide based on the parties' legitimate expectations rather than applying the conflict of laws rules, following the obligation to act as an agent of parties' intended purpose of the contractual relationship at the time of contracting⁵⁴, as well as having to pay due attention to what the intended purpose was, or would have been,

⁵¹ Ibid.; ICC International Court of Arbitration 11849. *UNILEX* [online]. [cit. 12. 4. 2021]. Available at: <http://www.unilex.info/case.cfm?id=1159>; BERG, A. J. van den. *Yearbook Commercial Arbitration Volume XXXII*. Alphen aan den Rijn: Kluwer Law International, 2008, p. 153.

⁵² ELCIN, M. *Lex Mercatoria in International Arbitration Theory and Practice*. Florence: European University Institute, 2012, p. 185.

⁵³ Art. 21 para. 1 ICC Rules 2021; cf. Art. 22.3 LCIA ("London Court of International Arbitration") Arbitration Rules 2020; Art. 27 para. 1 SCC ("Stockholm Chamber of Commerce") Arbitration Rules 2017; Art. 31 para. 1 ICDR ("International Centre for Dispute Resolution") International Arbitration Rules 2014; Art. 24.2 DIS ("Deutsche Institution für Schiedsgerichtsbarkeit") Arbitration Rules 2018; Art. 27 para. 2 VIAC ("Vienna International Arbitral Centre") Vienna Rules of Arbitration 2018; Art. 36.1 HKIAC ("Hong Kong International Arbitration Centre") Administered Arbitration Rules 2018.

⁵⁴ LA SPADA, F. The Law Governing the Merits of the Dispute and Awards ex Aequo et Bono. In: KAUFMANN-KOHLER, G. and B. STUCKI (eds.). *International Arbitration in Switzerland: A Handbook for Practitioners*. Den Haag: Kluwer Law International, 2004, p. 130.

in determining the applicable law had the parties addressed the issue⁵⁵. Arbitrators are thus empowered to apply various methods of applicable law determination, including the preferential application of trade usage, to the extent that such application does not breach public policy. Two main approaches observed by the ICC jurisprudence are (i) indirect cumulation of conflict of law provisions or (ii) direct choice (*voie directe*).

4.2.1 Indirect Cumulation of Conflict of Law Provisions

In instances of the indirect cumulation approach, an assessment is made into the applicable conflict of laws rules that form a part of the legal systems related to the subject matter of the dispute.⁵⁶ Related legal systems are then any state laws linked to the dispute (e.g., the law of the parties' habitual residence, the place of performance of the contract, the place of the transaction). The tribunal thus seeks the probable legitimate expectations of the parties by combining the conflict of laws rules of several laws. More precisely, what expectations they had and could have had if they had not abstained from choosing the applicable law. This method is a common method used in ICC arbitration. It has the advantage of legitimising the designated applicable law through an accumulation of legal orders that, by their conflict of laws rules, lead to the same applicable law.⁵⁷

The indirect cumulation approach is often based not only on conflict of laws rules of related jurisdictions but also on conflict of laws rules representing a “*general trend*” of private international law – conflict of laws rules generally accepted in state laws, international organisations or in international treaties.⁵⁸ This approach possesses the advantage of introducing the maximum amount of an international element into the dispute, with the consequence

⁵⁵ ICC Award No. 7110 (1998). Partial 7110. In: *ICC International Court of Arbitration Bulletin*, 1999, Vol. 10, no. 2, p. 47.

⁵⁶ GAILLARD, E. and J. SAVAGE (eds.). *Fouchard Gaillard Goldman on International Commercial Arbitration*. The Hague: Kluwer Law International, 1999, p. 872.

⁵⁷ CRAIG, W.L., W.W. PARK and J. PAULSONN. *International Chamber of Commerce Arbitration*. Dobbs Ferry: Oceana Publications, 2000, p. 326.

⁵⁸ *ICC Award No. 7329 (1994)*, in which the tribunal used Hague Convention of 1978 and Rome Convention to establish the “*general trend*” although neither of them has been applicable to the merits of the dispute; BERG, A.J. van den. *Yearbook Commercial Arbitration Volume XV*. Alphen aan den Rijn: Kluwer Law International, 1990, p. 70; ICC Award of 1998, No. 9420.

of eliminating the narrow application of a rule of law which, by its nature, may not be predominant for the subject matter of the dispute.⁵⁹ This approach might be deemed to form a separate approach, resembling rather the discretionary determination of conflict-of-law rule⁶⁰ pursuant UNCITRAL Model Law or Art. 13 para. 3 last sentence ICC Rules 1988.⁶¹ While providing great freedom to the tribunal, it may lead to the application of unpredictable conflict-of-law rules. In *ICC Award No. 12494*, the Rome I Regulation was used to determine conflict-of-law rule that was accepted on an international level, therefore subsuming it under international custom, even for situations in which the parties were not domiciled in, or otherwise connected to, the EU.⁶²

The use of conflict of laws rules in the indirect cumulation approach must lead to a selection of applicable state law, excluding the possibility of applicable *lex mercatoria*.⁶³ The *lex mercatoria* can, however, function as a supplementary law based on the *lex arbitri*. The tribunal in *ICC Award No. 5314*⁶⁴ has determined the Massachusetts law to be the applicable law based on the closest relationship conflict-of-laws rule. However, the tribunal has determined that the *lex mercatoria* is part of the applicable law as a supplementary law under the obligation set out in Art. 13 para. 5 ICC Rules 1988. *Lex mercatoria* may also play a role in the interpretation

⁵⁹ CRAIG, W.L., W.W. PARK and J. PAULSONN. *International Chamber of Commerce Arbitration*. Dobbs Ferry: Oceana Publications, 2000, p. 327.

⁶⁰ ICC Award No. 17507 (2016). Final 17507. In: *ICC Dispute Resolution Bulletin*, 2016, Vol. 27, no. 1, p. 125.

⁶¹ GAILLARD, E. 2018 LALIVE LECTURE: The Myth of Harmony in International Arbitration. *ICSID Review – Foreign Investment Law Journal*, 2019, Vol. 34, no. 3, p. 564.

⁶² MAYER, P. The Laws or Rules of Law Applicable to the Merits of a Dispute and the Freedom of the Arbitrator. In: DERAIS, Y. and L. LÉVY (eds.). *Is Arbitration only As Good as the Arbitrator? Status, Powers and Role of the Arbitrator*. Paris: International Chamber of Commerce, 2011, p. 54.

⁶³ BRIGGS, A. *The Conflict of Laws*. Oxford: Oxford University Press, 2013, p. 28.

⁶⁴ ICC Award of 1988, No. 5314; BERG, A.J. van den. *Yearbook Commercial Arbitration Volume XX*. Alphen aan den Rijn: Kluwer Law International, 1995, p. 38 et seq.

of intention, the conduct of the parties, and the individual provisions of the contract.⁶⁵

4.2.2 Direct Approach (*Voie Directe*)

The direct approach (*voie directe*)⁶⁶ is described as the latest and prevailing phase of evolution in the international approach to the applicable law determination in arbitration.⁶⁷ Giving the arbitrator the discretion to choose the applicable law, thereby replacing the conflict-of-laws rule entirely.⁶⁸ Mechanical conceptual subsumptions prove to be insufficient in the arbitration setting⁶⁹, and cross-border relationships require more attention than conflict-of-laws rules can in many cases offer.⁷⁰ *Ipsa facto* direct approach is not bound by conflict-of-laws norms, which are a manifestation of national sovereignty.⁷¹ The direct approach can lead, within the limits of *lex arbitri*, to the application of either state law or *lex mercatoria*. Therefore, from the perspective of litigation, the approach in applicable law determination according to (i)

65 INTERNATIONAL BAR ASSOCIATION. *Perspectives in Practice of the UNIDROIT Principles 2016, Views of the IBA Working Group on the practice of the UNIDROIT Principles 2016*. London: International Bar Association, 2019, p. 231; also, BERG, A.J. van den. *Yearbook Commercial Arbitration Volume XXXIV*. Alphen aan den Rijn: Kluwer Law International, 2009, pp. 82–83.

66 TOTH, O. *The lex mercatoria in theory and practice*. Oxford: Oxford University Press, 2017, p. 206; LEW, J. D. M., L. A. MISTELIS and S. KRÖLL. *Comparative International Commercial Arbitration*. Alphen aan den Rijn: Kluwer Law International, 2003, pp. 434–436; GAILLARD, E. and J. SAVAGE (eds.). *Fouchard Gaillard Goldman on International Commercial Arbitration*. The Hague: Kluwer Law International, 1999, pp. 876–877; BORN, G. B. *International Commercial Arbitration*. Alphen aan den Rijn: Kluwer Law International, 2014, pp. 2646–2647; GAILLARD, E. The Role of the Arbitrator in Determining the Applicable Law. In: HILL, D. R. and L. W. NEWMAN (eds.). *The Leading Arbitrators' Guide to International Arbitration*. Huntington: Juris Publishing, 2014, pp. 456–457.

67 DERAINS, Y. and E. A. SCHWARTZ. *A guide to the ICC rules of arbitration*. Hague: Kluwer Law International, 2005, p. 240.

68 BĚLOHLÁVEK, J. A. *Rome Convention – Rome I Regulation*. Huntington: Juris Publishing, 2010, p. 414.

69 PETSCHKE, M.A. International Commercial Arbitration and the Transformation of the Conflict of Laws Theory. *Michigan State Journal of International Law*, 2010, Vol. 18, no. 3, p. 453; GOODE, R. Rule, Practice, And Pragmatism In Transnational Commercial Law. *International & Comparative Law Quarterly*, 2005, Vol. 54, no. 3, p. 543.

70 BLESSING, M. Choice of Substantive Law in International Arbitration. *Journal of International Arbitration*, 1997, Vol. 14, no. 2, p. 42.

71 LEW, J. D. M. Relevance of Conflict of Law Rules in the Practice of Arbitration. In: BERG, A.J. van den. (ed.). *Planning Efficient Proceedings, The Law Applicable in International Arbitration X, Vienna, 1994*. Alphen aan den Rijn: Kluwer Law International, 1994, p. 447.

the subjective will of the parties, and (ii) in the absence of (i) the objective mechanical application of the forum conflict-of-laws rules, ICC arbitration has moved to a modern approach in which the subjective will of the parties still prevails, but in its absence, the determination of the applicable law through the arbitrator's objective discretion comes into play.⁷²

While prior to ICC Rules 1998 was the tribunal forced to provide abstract reasoning as to the extent of implicit choice should it want to apply the *lex mercatoria*, the direct approach allows for the undisguised application of *lex mercatoria*. In *ICC Award No. 9875*, the tribunal considered it difficult to find decisive factors qualifying any state law as applicable to the contract, thus revealed the inadequacy of the choice of a domestic legal system to govern a case concerning licencing agreement performed worldwide. The tribunal thus found the most appropriate "rules of law" to be applied to the merits of this case to be those of the *lex mercatoria*, that is the rules of law and usages of international trade.⁷³ The analogical outcome is observed in *obiter dictum* of *ICC Award No. 8540* relating to a pre-bid agreement for which a non-disclosure agreement ("NDA") has been concluded. Whereas the pre-bid agreement in dispute absented in choice of law, the NDA stipulated applicable New York law. The tribunal assessed that choice of law in supportive contracts ought to amount to the most proper applicable law in the main contract. Furthermore, the tribunal stated: "*In an international commercial transaction such as this contract between and, where the Parties have not indicated the applicable law and where there are many disparate connections to many different municipal systems of law, we are of the opinion that international arbitrators are fully justified to turn to general principles of law.*"⁷⁴ Since the supportive contractual relationships provided the needed connection to state law, *lex mercatoria* was merely used to provide rules for trade usages. It can thus be inferred that in cases where subordinate contractual agreements do not exist and the closest relationship cannot be properly

⁷² TOTH, O. *The lex mercatoria in theory and practice*. Oxford: Oxford University Press, 2017, p. 206.

⁷³ ICC Award No. 9875 (1999). ICC International Court of Arbitration 9875. *UNILEX* [online]. [cit. 1. 5. 2021]. Available at: <http://www.unilex.info/principles/case/675>

⁷⁴ ICC Award No. 8540 (1996). ICC International Court of Arbitration, Paris 8540. *UNILEX* [online]. [cit. 17. 5. 2021]. Available at: <http://www.unilex.info/principles/case/644>

determined due to the balance of the synallagmatic obligation, the tribunal is entitled to determine the applicable *lex mercatoria*.⁷⁵

4.3 Choice of State Law

In the case of a parties' choice of applicable state law, the arbitrator's ability to adjudicate under the *lex mercatoria* will be severely limited.

In *ICC Award No. 9473*, the tribunal outlined the difference between the arbitrator vis-à-vis the judge when the arbitrator does not possess the mandate nor function of applying and developing the law in question. Considering Art. 13 para. 5 ICC Rules 1988 presenting the necessity of considering contractual arrangements, the tribunal determined the need to apply the doctrine of parties' legitimate expectations, thus refusing to apply the state law that is contrary to the text and objectives of the contract itself.⁷⁶

Correspondingly, the question of whether the arbitrator, unlike the judge, may neglect the distinction between dispositive and mandatory provisions of the chosen state law arises. In the sense of ICC arbitration, the arbitrator assesses the appropriateness of the chosen rules of law. Hence, shall a mandatory rule of chosen law be contrary to trade usage or contract itself, such a rule ought to be replaced by another rule which, considering the doctrine of legitimate expectations of the parties, takes precedence. However, this position might eventually infringe on the duty to issue an award that is materially enforceable pursuant the New York Convention. The ICC jurisprudence hence settled on respecting the differentiation of mandatory provision of the chosen law. An arbitration, which has no *lex fori* of its own⁷⁷ and derives its inherent jurisdiction from the parties' will⁷⁸, is not tasked with

⁷⁵ ICC Award of 2004, No. 13012; JOLIVET, E. L'Harmonisation du Droit OHADA des Contrats: L'Influence des Principes d'Unidroit en Matière de Pratique Contractuelle et D'Arbitrage. *Uniform Law Review*, 2008, Vol. 13, no. 1–2, p. 137; Partial and Final 9875. In: *ICC International Court of Arbitration Bulletin*, 2001, Vol. 12, no. 2, p. 97.

⁷⁶ NAÓN, G. and A. HORACIO. Choice-of-law Problems in International Commercial Arbitration. In: *Recueil des cours 2001*, Leiden/Boston: Martinus Nijhoff Publishers, 2001, Vol. 289, p. 276.

⁷⁷ BANSAL, S. The Dampening Effect of 'Foreign' Mandatory Laws. *Asian International Arbitration Journal*, 2018, Vol. 14, no. 2, pp. 168–169.

⁷⁸ CORDERO-MOSS, G. Limitations on Party Autonomy in International Commercial Arbitration. In: *Recueil des cours 2014*, Leiden/Boston: Martinus Nijhoff Publishers, 2015, Vol. 372, pp. 129, 194.

guardianship of public policy mandatory rules of foreign state law⁷⁹ but the law chosen by the parties.⁸⁰ However, such obligation does not *a priori* preclude the possibility of reflecting other mandatory norms. Choice of law is not unlimited and may be subject to transnational public policy⁸¹ or other mandatory rules⁸². The arbitrator may particularly take note of mandatory norms of the state of enforcement of the award⁸³, notably including the place where the enforcement is presumed through legitimate expectations – the habitual residence of the losing party⁸⁴.

The possibility of regulation of existing relations according to norms outside the chosen law seems to be excluded in cases of explicit choice of applicable state law.⁸⁵ The choice of the state law leads to an agreement on its application with all probable consequences, including idiosyncratic norms present at the time of contracting. Unlike in the absence of a choice of law, the arbitrators do not possess the discretion to substitute the chosen applicable state law.⁸⁶ *“Where parties have agreed on a substantive law, the arbitral tribunal must respect that choice. If it fails to do so, this might be considered as a failure to conduct the procedure in accordance with the parties’ agreement, which would undermine*

⁷⁹ CARDUCCI, G. The Impact of the EU ‘Rome I’ Regulation on International Litigation and Arbitration, A-National Law, Mandatory and Overriding Rules. *ICC International Court of Arbitration Bulletin*, 2011, Vol. 22, no. 2, p. 35; HOLTZMANN, H. M. and J. E. NEUHAUS. *A Guide to the UNCITRAL Model Law on International Commercial Arbitration. Legislative History and Commentary*. Alphen aan den Rijn: Kluwer Law International, 1995, p. 764.

⁸⁰ ICC Award No. 16981 (2012). Final 16981. In: *ICC Dispute Resolution Bulletin*, 2016, Vol. 27, no. 1, p. 119; LEW, J. D. M. *Transnational Public Policy: Its Application and Effect by International Arbitration Tribunals*. Madrid: CEU Ediciones, 2018, p. 11.

⁸¹ TERAMURA, N. *Ex Aequo et Bono as a Response to the ‘Over-Judicialisation’ of International Commercial Arbitration*. Alphen aan den Rijn: Kluwer Law International, 2020, pp. 141–143; cf. ICC Award no. 15972 (2011). Final Award in Case 15972. In: *ICC Dispute Resolution Bulletin*, 2016, Vol. 27, no. 1, p. 92.

⁸² ICC Award No. 16981 (2012). Final 16981. In: *ICC Dispute Resolution Bulletin*, 2016, Vol. 27, no. 1, p. 120.

⁸³ ICC Award No. 15977 (2011). Partial Award in Case 15977. In: *ICC Dispute Resolution Bulletin*, 2016, Vol. 27, no. 1, p. 95; TERAMURA, N. *Ex Aequo et Bono as a Response to the ‘Over-Judicialisation’ of International Commercial Arbitration*. Alphen aan den Rijn: Kluwer Law International, 2020, p. 138.

⁸⁴ ICC Award No. 11761 (2003). Final Award in Case 11761. In: *ICC Dispute Resolution Bulletin*, 2016, Vol. 27, no. 1, p. 112.

⁸⁵ ICC Award No. 9029 (1999). Final 9029. In: *ICC International Court of Arbitration Bulletin*, 1999, Vol. 10, no. 2, p. 88.

⁸⁶ *Ibid.*, p. 90.

the enforceability of a subsequent award.”⁸⁷ While this notion might be theoretically correct, the need to reflect contractual provisions and trade usages through ICC Rules “requires the arbitral tribunal to place the parties’ contract, if any, centre stage in the resolution of contractual disputes. [...] contractual terms are often considered to have greater importance than legal requirements and technicalities.”⁸⁸ This is not to say that applicable law needs to provide merits for the application of trade usage. On the contrary. In *ICC Award No. 8873*, the tribunal assessed whether a provision allowing the predominant use of trade usages must be present in the chosen applicable law or whether a restrictive approach as in *ICC Award No. 9029* ought to be exercised. The contract concluded between a Spanish and a French entity contained a choice of Spanish law. While one party proposed Spanish law as the applicable law solely for matters not governed by trade usages and provisions of the contract itself pursuant Art. 13 para. 5 ICC Rules 1988, the other party proposed the primacy of Spanish law without regard to trade usages due to the absence of a statutory provision of Spanish law to apply trade usages predominantly. The tribunal assessed, based on Art. 13 para. 5 ICC Rules 1988 and Art. VII, second sentence European Convention on International Commercial Arbitration 1961 that explicit mandate in state law needs not be present. The European Convention on International Commercial Arbitration 1961, through its ratification in the states of both parties’ habitual residence, constitutes a direct unified rule of their respective state laws. The tribunal thus applied trade usage preferentially to the chosen applicable law within the limits of the mandatory rules of the Spanish law.

5 Conclusion

Before the ICC Rules 1998 entry into force, applicable law outside the framework of the relevant conflict of laws rules was not a legitimate choice. However, even the explicit wording did not prevent arbitrators from applying the applicable *lex mercatoria*. By assessing the absence of a choice of law as an implicit negative choice, the arbitrators escaped the need for

⁸⁷ FRY, J., S. GREENBERG and F. MAZZA (eds.). *The Secretariat’s Guide to ICC Arbitration*. Paris: International Chamber of Commerce, 2012, p. 220, para. 3–752.

⁸⁸ *Ibid.*, p. 228, para. 3–777.

a secondary determination of the applicable law; hence there was no obligation to apply the applicable conflict-of-laws rules. Nonetheless, this workaround became obsolete under the ICC Rules 1998 as arbitrators are free to choose the applicable *lex mercatoria* in full compliance with the Rules and French *lex arbitri*. At the same time, the use of the *lex mercatoria*, especially if not directly chosen by the parties, always depends on the arbitrator's subjective optimism towards supranational law. Just as an arbitrator may always find a way and reason to apply the *lex mercatoria*, he too may find a way to the contrary despite an express choice given by the parties. The non-appellate setting of international commercial arbitration is thus tested and might prove to be the parties' downfall as non-compliance with chosen applicable law does not constitute a legitimate defence under Art. V of the New York Convention.

Prior to ICC Rules 1998, in cases in which the arbitrators did not evade the conflict of laws determination through an implicit negative choice, the indirect cumulation approach was the common practice. This approach allows the arbitrator's ideas about the general trend of private international law to be applied, as he is not forced to apply solely the conflict-of-law rules with a direct relationship to the subject matter of the dispute or the parties themselves. On the contrary, the arbitrator may use any fitting conflict-of-law rules, including those which become available after the effectiveness of the parties' contract. Conversely, a contemporary shift from conflict-of-law determinations towards the *voie directe* method is evident as *voie directe* is believed to be more responsive to the specificities of international arbitration.

One aspect, however, never changed. Either by ICC Rules 1988 or ICC Rules 1998, ICC Rules 2021, respectively, trade usage may be superior to the chosen or determined applicable state law. This fact follows not only the arbitration practice but also most state laws and international treaties.

The parties will as to the hierarchy of applicable sources of law is also an important factor. A different approach may arise when the parties choose the *lex mercatoria* in parallel with state law, another when the *lex mercatoria* is subordinate to state law. In the former case, the state law is most likely to be applied to the extent that it is consistent with international practice,

with state norms inconsistent with that international practice being replaced by other *lex mercatoria* norms. In the latter, even state law norms inconsistent with general international practice will be used, and the *lex mercatoria* will be applied solely in cases where the chosen state law fails to sufficiently regulate the legal issue, e.g., the foreseeability of damages arising from breach of contract. Another manifestation of parties' intent may be the relevant conduct in related contractual relationships. The choice of applicable *lex mercatoria* in the related contracts to the main contract may be deemed to be an implicit choice of the *lex mercatoria* for the whole relationship.

While it is presumed that ICC arbitrators will follow the parties' intention regarding the applicable *lex mercatoria*, one could be surprised how much the outcome relies on either the misunderstanding to the scope of *lex mercatoria* or the arbitrator's subjective views of such. The parties should always pay great attention to the thorough specification of the applicable law, its sources, and its relationship to the otherwise applicable state law(s). As one is careful of explicit prorogation of the dispute settlement to the arbitration body, the question of substantive rules of law should not be a question to be settled once the dispute arises. A diligent contractual relationship contains the distribution of rights, obligations, and risk as to the date of conclusion. It is in all parties' interest to be aware of the possible outcome. Every *ex post* adjudication made by the arbitrator as to the substantive aspects will bring surprises to every party involved.

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