ABSTRACT  Over the past four decades, the transnational business community has successfully built a private system of transnational governance: the new Lex Mercatoria. The actors who operate this system – firms, their lawyers, international arbitrators, and legal academics – have evolved, and use, ‘a-national’ principles of contract and a system of private ‘courts’ to organize and regulate cross-border commercial exchange. National legal systems have adapted to the Lex Mercatoria, thereby enhancing the latter’s autonomy, and the EU has begun to move in the same direction.

KEY WORDS  arbitration; conflict of laws; contract law; judicialization; law merchant

Practices that are today essential to the expansion of transnational commerce are driving the piecemeal construction of a new legal system – what I will simply call the new Lex Mercatoria. This legal system – replete with its own ‘a-national’ law of contract and a system of private ‘courts’ – is parasitic on state authority. It uses state authority where necessary, essentially for enforcement purposes, while otherwise working to reduce the reach of sovereign control over transnational business. To the extent that national law and courts impose rather than reduce transaction costs of traders, they are identified as obstacles that the Lex Mercatoria seeks relentlessly to overcome. National legal systems, for their part, have steadily adapted to the Lex Mercatoria, thereby altering, among other things, the relationship between public and private power in Europe. Finally, European institutions have taken notice, for the obvious reason that market integration and trade in the EU cannot be dissociated.

This view, while not unique (see Berger 1999; Carbonneau 1997), is deeply controversial. A ‘war of religion,’ as it has been politely characterized (Berger 1999; Teubner 1997), is being waged in the legal academy about the underlying nature and scope of the Lex Mercatoria. While I will discuss this controversy further, my broader purpose is to convince social scientists that the evolution
of the new *Lex Mercatoria* deserves their attention, not least because it is central to governance in a globalized and Europeanized context. Assuming that many social scientists will not be familiar with my topic (but see the pioneering papers published by Mattli (2001) and Shapiro (Shapiro and Stone Sweet 2002)), some preliminary remarks may be in order.

First, my empirical focus is on the development of a private system of governance for transnational business, with special attention paid to Europe. One must distinguish the ‘transnational space’ described here from the ‘supranational space’ constituted by arenas of governance within the European Union (EU). The latter is public space, created originally by the member states. The sovereignty claims that have been made for supranational governance — the supremacy of European law within national legal orders, for example — are delimited by state boundaries. The former is private, and it makes no sovereignty claims, at least not formally. The growth of transnational exchange, especially intra-EU trade, has been crucial to sustaining the processes through which supranational governance in the EU has emerged, widened, and deepened (Fligstein and Stone Sweet 2002; Sandholtz and Stone Sweet 1998; see also Mattli 1999). In this preliminary account of the *Lex Mercatoria,*\(^1\) I will also focus on rising cross-border commerce, as a functional — a necessary but not sufficient — condition for the evolution of a new system of managing transnational economic exchange. Further, if distinguishable as autonomous domains, the transnational and the supranational are nonetheless linked to one another causally, a point discussed further below.

Second, I define the term, ‘governance,’ in a broad, generic way, as the mechanisms through which the rules that govern social exchange in any community are adapted, on an ongoing basis, to the needs of those who live under them (Stone Sweet 1999). In its heyday, the so-called Westphalian state constituted the center of gravity for regulating trade, including trade across borders. Governance was largely hierarchical, authoritative *government*, or the administration of agreements between governments. In the past three decades, a growing community has been successful at creating a private system of governance that has, in turn, generated a host of policy problems that nation states have little choice but to confront.

Third, because this article attempts to provide a relatively general, synoptic overview of a complex subject to non-specialists, I have simplified (sometimes grossly) certain highly technical matters. Moreover, this research builds on my own theory of how new legal systems evolve, a theory which mixes ‘rationalist’ and ‘constructivist’ elements, staging them in analytically precise ways (Stone Sweet 1999). Although this article is partly motivated by the theory, I will not rehearse the latter here. Instead, I begin with a brief survey how long-range commercial exchange was governed prior to the contemporary period. I then trace the main features of the new *Lex Mercatoria*, focusing on the development of an ‘a-national’ legal system. In the conclusion, I discuss how this new system is currently being ‘institutionalized’ and with what effects.
I. ANTECEDENTS

As is well understood in the social sciences, long-range commercial exchange is only viable if certain basic problems of co-operation, commitment, and institutional design are overcome (Greif 1989; North 1990; Stone Sweet 1999). For our purposes, what is important is how actors who would trade across borders are able to contract with one another and to enforce their contracts when trading disputes arise. The functionality and social legitimacy of the Lex Mercatoria derives almost entirely from the fact that it is designed to solve these problems.

The Lex Mercatoria – also called ‘the Law Merchant’ – is a multi-faceted term which serves both to draw boundaries around a community and its practices, and to denote a legal system. It describes the totality of actors, usages, organizational techniques, and guiding principles that animate private, transnational trading relations, and it refers to the body of substantive law and dispute resolution procedures that govern these relations. I will use the term in the narrower second sense. The renaissance of ‘the Law Merchant,’ taking place during the final decades of the twentieth century, is the focus of the rest of the article. For comparative purposes, I nonetheless begin by summarizing how contract and enforcement problems were managed, first, prior to the emergence of the Westphalian state and, second, by the Westphalian state.

The medieval law merchant

The medieval law merchant (MLM), which appeared between the eleventh and twelfth centuries, comprised a relatively comprehensive, relatively efficient, legal regime for trade beyond ‘local’ borders. This legal system was operated by traders and their agents. The functional logic of the MLM is straightforward: it enabled merchants to escape conflicts between various local customs and rules, and to avoid submitting to the authority of judges attached to pre-existing jurisdictions (the courts of feudal manors, city states, local gilds, the Church). By the close of the twelfth century, the MLM governed virtually all long-distance trade in Europe and, through middlemen and their codes of conduct, at critical points along the great Mediterranean and Eastern trading routes (Greif 1989, 1993).

The MLM regime was ‘voluntarily produced, voluntarily adjudicated, and voluntarily enforced’ (Benson 1992: 15–19). The regime embodied certain constitutive principles, including: good faith (promises made must be kept); reciprocity, non-discrimination between ‘foreigners’ and ‘locals’ at the site of exchange; third-party dispute settlement; and conflict resolution favoring equity settlements. In practice, the MLM required traders to use contracts, which were gradually standardized, and to settle their disputes in courts staffed by other merchants (experts, not generalists). Traders and their merchant judges placed a premium on quick judgments, and de-emphasized adversarial procedure. The function of dispute resolution was not so much to declare a
‘winner,’ or punish a ‘loser,’ but to resuscitate the contractual agreement and to cajole the parties to get on with their business, using norms of ‘fairness,’ as between the parties.

The effectiveness of the MLM depended critically on reputation effects, and the fear of being ostracized from the trading community. As Milgrom and colleagues (1990) have it, the crucial problem facing medieval long-range trade was the ‘costliness of generating and communication information’ about the histories of potential trading partners. The MLM performed as a kind of information clearing-house about trading relations, making of reputations a transferable good, or ‘bond,’ within the community of traders. Third-party dispute resolution reinforced this ‘reputation system’ (Greif et al. 1994). Because the results of the merchant judge’s decisions were recorded, traders’ past compliance with decisions could be monitored. The institutional setting supplied by the MLM created the conditions necessary for constructing stable conditions favoring exchange in the absence of a coercive state apparatus, by making promises self-enforcing and by placing future contracting in the shadow of the law. Those who lost reputation lost trading partners and access to the MLM.

The new *Lex Mercatoria* also employs general principles of contract, mediation and arbitration along equity lines, and means of curating reputations.

**The Westphalian state**

Until well into the fifteenth century, the Law Merchant provided the institutional underpinning for most long-distance exchange in the trading world. By the thirteenth century in England, and thereafter on the Continent, governments of states sought consciously, first, to emulate the main features of the MLM, and, second, to subordinate the merchant’s regime to state control. New statutes, designed to ‘move merchants into royal courts, and/or make merchant’s courts less desirable’ (Benson 1992: 19), absorbed large parts of the merchant’s law into the state’s commercial law. At the same time, the European state gradually weaned itself off its more rapacious practices, such as repudiation of public debt and confiscations of property (Veitch 1986). By the close of the sixteenth century, the private commercial law of the nation state and the state’s lawcourts had reduced the significance and scope of the Law Merchant, while never quite replacing it. From the point of view of long-range traders, state building had its advantages. The eighteenth and nineteenth centuries, for example, saw huge reductions in transaction costs, due to improvements in transportation and communication, in physical security and policing, and to the emergence of modern banking and insurance practices. By the end of the nineteenth century, national legal regimes largely governed transnational commercial activity.

Thousands of volumes have been written about how national judges resolve conflicts involving cross-border business deals. In a world of sovereign states, each of which supplies its own authoritative law of contract and courts, it is
not always obvious and may be a point of contention as to which body of legal rules is meant to govern a transaction, or a dispute that arises from it. For one or more reasons, which can fall within dozens of categories, a legal dispute may arise that involves the law of two or more state jurisdictions. If the dispute comes before a national judge sitting on a lawcourt of, say, state X, that judge may choose to assign the law of nation state X to the case, and then proceed to resolve the dispute in the usual way. Frequently, however, the national law of the presiding judge is very obviously not the appropriate law. The parties may have solemnly agreed, for example, that the contract law of nation state Y would govern their relationship; the material dispute may involve business that was conducted outside of the territory of state X (and Y); the deal may involve multiple contracts between a chain of parties, each doing a different thing, in a different location, under different national laws. In such cases, our judge must determine which legal system ought to provide the substantive rules to bear on specific aspects of the dispute, and then proceed to settle the case.

These practices go by two names, ‘Private International Law,’ and ‘Conflict of Laws,’ which, for our purposes, are synonyms. I use the word practices, because conflict of laws has virtually no substantive content (although it is often portrayed as a branch of law). The private international law is, rather, a set of techniques or doctrines that are employed by the municipal law judge to enable the resolution of certain kinds of disputes. These techniques first developed in Italian city states (twelfth to fourteenth centuries), France (fourteenth to sixteenth centuries), and the Netherlands (seventeenth century), and, with the expansion of markets and trade, became widespread across Europe and North America in the nineteenth and twentieth centuries (Lipstein 1981).

Traders and their lawyers today work consciously to avoid conflict of laws problems in national courts, because such problems generate unacceptable costs. Costs include (1) the expense and time it takes to adjudicate claims in national courts, which are raised if the presiding court has to educate itself about foreign law, and (2) the uncertainty associated with conflict of laws adjudication. To avoid these costs, traders may incorporate specific national rules and procedures directly into their contract, in choice-of-law and choice-of-forum clauses (Farnsworth 1985). The second technique is to avoid national law altogether, by explicitly referencing transnational contract rules (not national contract law) in choice-of-law clauses, and arbitration houses (not courts) in choice-of-forum provisions (see below).

In the early modern period, when regional – let alone national – markets were not well integrated, state building, market formation, the building of highways, canals, and ports, the elaboration of codes of commercial conduct, and the construction of legal systems were linked processes. For long-range merchants, there were obvious advantages to adapting their activities to those of the state, including enhanced security and enforceability of agreements.
Nonetheless, the expansion of transnational activity, especially in the 1850 to 1950 period, put intense pressure on states to recognize and adapt to the special needs of long-distance trade. The development of conflict of laws techniques represents one important way in which state organizations did indeed adapt.

In my view, state-supplied institutions governing trade probably reached their functional limits no later than the 1960s, prompting transnational commercial society and lawyers to begin the work of constructing a new social order. Today, institutions provided by the state system have lost their dominance, and are being displaced.

The priorities of transnational commercial activity remain autonomy, security, certainty, and efficiency, but firms and their lawyers have come to believe that they could, on their own, do better than states. The indicators of dysfunction in national regimes are clear enough. On the one hand, as Newman (1998: 1) puts it, ‘litigation means entanglement with a judicial process that is time-consuming, possibly biased in favor of locals, and perhaps even corrupt.’ Yet, even assuming that judges will always do their best to be as efficient and fair as possible, the various national commercial codes and laws of contract are deeply entrenched, slow to change to inputs from more cosmopolitan environments, and have a lock on too many judges’ imaginations. Further, conflict of laws techniques are in deep crisis. In the absence of such techniques, judges simply nationalize transnational disputes, which would be unacceptable to traders; yet the use of such techniques may produce even worse outcomes from the point of view of transnational society. In private international law adjudication, judges must decide which foreign law is to be assigned to the case, according to a complex set of criteria including policy considerations, which normally leads the litigants to solicit advice (another significant transaction cost) on the relative advantages of various regimes.

Once judges have decided to apply the law of a jurisdiction not their own, they have to behave as if they were a judge trained in another national legal system. In the past two decades, a substantial literature has appeared showing that existing conflict-of-laws techniques lead to wholly unpredictable decisions, even within the same jurisdiction. In Berger’s (1999: 9–31) survey of the contemporary literature, conflict of laws is characterized variously, but always contemptuously: ‘an inveterate evil,’ ‘a murky maze,’ ‘creative chaos,’ ‘alchemy,’ and a ‘dismal swamp filled with quaking quagmires and inhabited by learned but eccentric professors who theorize about mysterious matters in a strange and incomprehensible jargon.’ Juenger (1998: 277), commenting on the American situation, states bluntly that, for proponents of the Lex Mercatoria, ‘it is a happy coincidence that at this time in the United States legal history the conflict of laws lies in shambles.’ Finally, litigation means waiting in line for a judge and then suffering the delays imposed by procedure, whereas the trading environment can change in a matter of weeks or even hours.
Not surprisingly, transnational economic actors increasingly take for granted the notion that national regimes make it more, not less, difficult for them to achieve efficiency and predictability in their relations with one another.

2. **THE NEW LEX MERCATORIA**

In the past three decades, transnational commercial actors have generated their own institutions. Institution building has proceeded on two linked fronts. The first is the intensive effort to ‘unify’ or standardize the general principles of a stable ‘a-national’ contract law; and various standardized, model contracts are in fact increasingly used. Second, a robust system of private, competing transnational arbitration houses has evolved, providing traders with a range of alternatives to litigating transnational contract disputes in state courts. In consequence, national courts and legislators have adapted, most notably, by reducing the scope of their authority to regulate both contracting and arbitration. It is through these processes that the new *Lex Mercatoria* has achieved meaningful (but not absolute) autonomy from traditional, public sources of law, such as national statute and public international law, though how to understand this autonomy is actively debated. I will take each of these processes in turn.

Towards transnational contract law

Today, trade lawyers have the option of selecting something akin to ‘a-national’ contract law, rather than national law, to govern their relationships. They may do so, in part, to insulate their contract, and disputes that might arise, from the control of national judges. The centrality of the *Lex Mercatoria* as a mode of governance is partly enabled by the ‘creeping codification’ (Berger 1999; Ferrari 1998) of this law. The more traders and dispute resolvers actually use this law, of course, the more its autonomy – from national sources of law – is enhanced.

Projects to unify and codify transnational contract law have proliferated in recent years. The most important of these are run by independent institutes of practitioners and academics, which have produced draft commercial codes of global and regional reach. Beginning in the 1970s, for example, the International Institute for the Unification of Private Law began work on what would become the UNIDROIT Principles of International Commercial Contracts, which purports to be a comprehensive code for international commerce (Berger 1999: chs 3–4; Bonell 1998). The Code (adopted by the Governing Council in 1994), organized into seven chapters and 119 articles, deals with the fundamental notions of contract, including *pacta sunt servanda*, good faith and fair dealing, validity, interpretation, performance and non-performance, choice-of-law and forum, and so on. Significantly, the Institute decided not to submit the code to governments or to intergovernmental bodies, for fear that rounds of treaty negotiations would lead to changes and the reassertion of states’, rather than traders’, priorities. In Europe, various projects to unify European private law have been put forward (discussed by Berger...
1999; Bussani and Mattei 1997/98; Ferrari 1998; Lando 1998), the most important of which by the Lando Commission on European Contract Law. The Lando Commission gave its final report, in the form of a code, to EU organs in 1999, and posted online in 2002.  

Three points about these codes deserve emphasis. First, the drafters of the UNIDROIT and European Code focused primarily on the identification and codification of general principles of contract law, principles which they could claim were common to developed, or ‘mature,’ national systems of law. On the one hand, they understood that developing bright-line rules would be pointless, since that is what the lawyers for the contracting parties are meant to do. On the other hand, contract disputes that do arise are typically about how to understand negotiated rules in light of (changing) circumstances, and it is here that general principles are used as a guide to interpretation by judges and arbitrators. The drafters of the codes believed that arbitrators needed a set of general principles tailored to transnational commerce – to help them escape engaging in difficult conflict-of-laws choices – and that national judges would be more likely to enforce arbitral awards that used familiar principles.

Opponents of the Lex Mercatoria have questioned whether general principles constitute law, at least as they understand law in their own national context. General principles, by their very nature, are abstract, if not vague; but abstractness has its advantages. National contract law, when read as black-letter law, suffers from the same alleged problems, precisely because so much of it is based on principles. But codified private law has already been substantially ‘completed’ by judicial lawmaking, which is partly what makes it ill-adapted to the needs of modern business. Further, general principles of contract are functional for traders in that they give wide latitude to private arbitrators to tailor arbitration to the specific needs and wishes of the parties. After all, through contracts, parties create their own law; the Lex Mercatoria is meant to provide an independent foundation for this law, not to replace it.

Second, the Lex Mercatoria is increasingly being selected as the controlling law in contracts by traders and arbitrators. The reason is straightforward: a national contract law can lower the bargaining and transaction costs of doing transnational business, including bargaining stalemates wherein neither party will agree to assign the contract to the specific national jurisdiction preferred by the other party. They can also easily access contractual instruments in the virtual space of the Lex Mercatoria. The International Chamber of Commerce (ICC), for example, has long sold inexpensive model contracts in the form of a booklet and floppy disk; the contracts are easily customized for specific needs. The introductory remarks to the ICC’s model international sale contract (International Chamber of Commerce 1997: 6) states bluntly: ‘parties are encouraged not to choose a domestic law of sale to govern the contract [emphasis added].’

Third, what is currently going on in Europe partly reflects an earlier American experience, while being a microcosm of more global processes. The inspiration for the UNIDROIT project was the unification of U.S. contract...
law that was provoked through the labors of the American Law Institute (ALI) – an independent, non-governmental group of scholars and practitioners. In 1932, the ALI first produced a Restatement of the Law of Contracts, which has been updated thereafter. The Restatement, which appears in the form of black-letter law, both codifies existing law (including settled case law), and creatively pushes solutions to unsettled questions, against a background of conflict-of-laws pathology (it is used and cited by state courts). The ALI also oversaw the drafting of a Uniform Commercial Code (concerning sales and leases of goods, credit, funds transfers, secured transactions, and so on), which it invited the states to enact as law. Today, every state but Louisiana has enacted the statute. In this way, the bulk of the law governing contracts and interstate trade was harmonized, without federalization. Like the ALI, UNIDROIT and the Lando Group used comparative methodology and functional analysis (matching general trade problems with solutions) to arrive at codification. The International Chamber of Commerce in Paris (ICC) – which is the center of gravity of the new Lex Mercatoria – has taken the following position on the matter:

ICC believes that, in order to truly harmonize contract law in Europe, it is necessary to elaborate an instrument that is similar in form to the U.S. Uniform Commercial Code (UCC) . . . . The scope of the harmonized contract law in Europe could be enlarged as compared to the UCC and also have enhanced structure and substance. It should be stressed that elaborating an instrument for harmonized law in Europe may entail work for many years. ICC is of the opinion that it is more effective for an instrument to evolve slowly and result in a high-quality product than to implement an instrument that is of poor quality and introduced hastily. To this end, ICC would like to recommend that the instrument be adhered to voluntarily by the Member States and that each Member State could choose to enact the instrument in whole or only in part.

(ICC 2001)

Transnational dispute resolution

Traders desire third-party dispute resolution that will enforce the law they have selected to govern their contract, not a law whose origin is outside the contract. They are further attracted to arbitration, relative to adjudication in national courts, to the extent that they wish to reduce financial outlays and time delays, and to the extent that they care about confidentiality (they prefer not to air the details of their disputes publicly). For these reasons, ‘the tendency to keep transnational commercial disputes out of the courts, and thereby beyond the reach of local laws, is nearly universal’ (Juenger 1998: 266). Today, far more than 90 percent of all transnational commercial contracts contain an arbitration clause (Berger 1999: 111). The explosive increase in international trade since the late 1950s has been the catalyst. Higher levels of
transnational activity have meant more arbitration, and more arbitration has meant a gradual formalization of procedures. As the institutionalization of global arbitration of private commercial disputes has proceeded, the autonomy of the *Lex Mercatoria* has, again, been enhanced.

The international arbitration story has a similar plot, some of the same characters, and much the same ending as the story just told about contracts. In the 1950s, UNIDROIT produced a Draft Uniform Law of Arbitration. This project was followed by the UN Commission on International Trade Law’s (UNCITRAL’s) Model Law on International Commercial Arbitration of 1985. While there are differences, both are model codes meant to unify national rules concerning arbitration, through adoption as national legislation. Both emphasize what transnational business most desires from the *Lex Mercatoria* – the freedom of private parties: to contract; to choose arbitration and their arbitrators; to arbitral discretion in tailoring the law to the case; to procedural fairness on terms acceptable to the traders themselves; and to restricted national judicial review of arbitral awards. Some states have in fact adopted parts of these (and other) model laws in their own internal reforms of codes governing commercial transaction, reforms all but required by the explosion of global trade (see discussion below). As important, the trading community has increasingly treated these rules as part of the customary law governing their relations (*Lex Mercatoria*).

The number of arbitral centers that handle transnational business disputes has grown at an astounding pace. In 1910, there were ten arbitration houses; there were over 100 by 1985; and today there are more than 150. In Europe, the biggest houses are the ICC, based in Paris, the London Court of International Arbitration (LCIA), and the Stockholm Chamber of Commerce (SCC). At the ICC, the oldest, biggest, and most important such institution, traders filed some 3,000 disputes for arbitration during the 1920 to 1980 period, more than 3,500 during the 1990s, and 5,250 during the 1996 to 2005 period. By 2004, the annual number of filings exceeded 550, and the annual number of awards rendered exceeded 350. The ICC is also the most global house: in 2005, 521 requests for arbitration concerned 1,422 parties based in 117 different countries (about 10 percent of the parties are states or public authorities; the rest are private parties). In 1996, the share of West European parties to arbitration fell to below 50 percent of the total for the first time, while the share of Latin American, Asian, and East European parties has risen. Approximately 70 percent of all cases concern ‘inter-regional’ contracts, wherein at least two of the parties involved in the dispute are based on different continents. The SCC specializes in contract disputes among Scandinavian firms and, increasingly, between firms of Western Europe and those of the Baltics and the former Soviet Union. In the 1970s, the SCC processed eleven arbitrations per year on average, twenty-nine per year in the 1980s, 110 in the 1990s – but 169 in 2003 alone. The LCIA, dominated by parties whose origin is the UK (about 30 percent), the USA, and the old EC-12, today receives just over 100 requests for arbitration per year.
From the point of view of traders, arbitrating in an established house makes good sense. In addition to the advantages already discussed, even a complex arbitration can normally be completed within six months, and the price of the service can be selected according to the size of the financial stakes at issue, or the desired complexity of the arbitral procedures. Further, the major houses are constantly engaged in developing new services to increase efficiency and attract firms whose disputes would normally not be worth a full arbitration, given the ratio of costs to the sums involved. Thus, both the ICC and the SCC have developed various forms of mediation and fast-track ‘mini-trials.’ They will also help the parties select mediators and arbitrators, and they keep a list of technical experts in diverse areas of commerce, for the use of the parties and arbitrators (which is viewed as a better solution than the parties paying their own experts to testify on their behalf). The relaunched Venice House – the Venice Chamber of International Arbitration – which is making a bid to capture the business of European firms engaged in trading with the Middle and Far East, offers one-day arbitrations to their customers.

Adaptations

The rise of the new *Lex Mercatoria* raises deep questions about the nature of law, and about the relationship of law to state power. Since the mid-1960s, scholars and practitioners have generated a voluminous literature on these questions, with no resolution of the main problems in sight. Much of it will seem ferociously complex to outsiders, precisely because it is written by and for insiders. The insiders are lawyer-practitioners, arbitrators, executive officials of arbitration houses, and the academics who specialize in the law of international commercial. Traditionalists tend to portray the *Lex Mercatoria* as a set of practices enabled by states. In their view, over time states have granted, within realms constructed through treaty law and national statute, more rather than less contractual autonomy to transnational economic actors, while retaining ultimate regulatory authority over these practices. Underlying this view rests a theory of law according to which only public authority – the commands of a sovereign – can produce law, or confer legal validity upon private acts. In contrast, proponents of the *Lex Mercatoria* argue that state authorities have largely ‘relinquished their authority to regulate’ transnational contracting and arbitration, permitting both ‘to function autonomously’ in what is, in effect, an ‘a-national’ way (Carbonneau 1997: 293).

Traditionalists tend to focus less on what traders, their lawyers, and arbitrators are actually doing, and more on the linked problems of validity and enforcement of contracts and arbitral decisions. Their strongest argument for the continuing relevance of national law and courts to transnational commercial activity is a straightforward one: traders need the coercive state for enforcement purposes. Through various international instruments, the most important of which is the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, states have agreed to limits on the reach of their own
jurisdiction. The New York Convention is a short treaty, with narrow but important purposes. It provides that states ‘shall recognize’ the validity of arbitral agreements, and that states shall, through their courts, enforce arbitral judgments subject, *inter alia*, to the exceptions of ‘inarbitrability’ and ‘public policy.’ At present, 137 states have ratified the Convention.

Clearly the development of the *Lex Mercatoria* has been spurred by ratification of the New York Convention. Its broad function has been, in Carbonneau’s words (1997: 392), to ‘eradicate systemic hostility to arbitration . . . stemming from the view that arbitration amounts to a usurpation of judicial adjudicatory authority.’ At the same time, the nation state has adapted far more to the *Lex Mercatoria* than vice versa, going far beyond the black-letter dictates of the Convention. One sees a broad pattern of ‘sovereign acquiescence’ to the construction of the new Law Merchant (Carbonneau 1992: 119).

While I will turn to the specific situation in the U.S. and Europe below, three general trends merit discussion in advance. First, in the law of most advanced industrial states, the recognition and validity of a contract, before a national judge, are now presumed, even if the contract law in question has no relationship to the law of that judge’s jurisdiction. Second, national statutes and judicial case law concerning arbitration have been dramatically transformed, in ways that enhance the autonomy of the Law Merchant. To take three examples, arbitral clauses are today commonly treated as separable from the main contract (they constitute agreements within agreements), the scope of judicial review of arbitral awards has been radically reduced, and issues of *Kompetenz–Kompetenz* have been largely resolved in arbitrators’ favor (arbitrators determine the scope of their own jurisdiction). Third, the public policy and inarbitrability exceptions to the recognition and enforcement of arbitral awards, contained in the New York Convention and thus in most national statutes, are being constructed narrowly by national courts and, in some countries like the United States and France, have little practical relevance.

In the United States, the law on international commercial arbitration is entirely a matter of how the Federal courts have interpreted the New York Convention, which the U.S. ratified in 1970. In this case law, American judges have appeared anxious to support arbitrators *vis-à-vis* disgruntled parties, and to reduce the scope of substantive review afforded the latter in American courts. In Mitsubishi v. Soler Chrysler (U.S. Supreme Court 1985), the Supreme Court all but abolished the role of American courts in reviewing the substance of what arbitrators do. The post-Mitsubishi era shows the Federal courts favoring the wider interests of transnational society rather than the specific interests of American business, even when public policy considerations raised by the dispute could be interpreted as overlapping with national security interests. The Sun Oil v. Libya case is a good example.

In 1990, a Federal district court forced an American company, Sun Oil, to pay a $20 million ICC award to a Libyan company (U.S. Supreme Court 1990), after Sun terminated its participation in an oil exploration program in Libya. Sun was required to do so, pursuant to the U.S. government’s decisions
prohibiting any travel to that country on U.S. passports, and banning imports from Libya, including oil, and exports of goods and technical information. Further, the government denied Sun Oil’s application for a license to export data and technology to Libya. Libya won the case in the ICC, prompting Sun to refuse compliance. Libya sued in American courts to enforce the award, and the district court sided with the Libyans. Sun claimed that to affirm the award would effectively ‘penalize Sun for obeying... its government,’ and weaken ‘the ability of the U.S. government to make and enforce policies with economic costs to U.S. citizens and corporations.’ The court rejected the plea, declaring that “public policy” and “foreign policy” were “not synonymous.”

The court admitted that ‘Libya itself is not a signatory to the New York Convention... and [that] if the tables were turned... a U.S. company would not necessarily be able to enforce an arbitral award against a [Libyan company] in Libyan courts.’ But, the court continued, ‘Libya’s terrorist tactics and opportunistic attitude towards international commerce are simply beside the point.’

Since 1970, it appears that U.S. courts have only twice refused to enforce foreign arbitral awards, and then only in part (Stewart 1992: 191–2).

In Europe, national adaptation to the Lex Mercatoria is most visible in legislative revisions to the relevant code law (commentaries and assessments of these revisions are regularly published in the international arbitration journals). By the end of the 1990s, nearly all states in Western Europe, Central Europe, and those formed after the breakup of the Soviet Union had adopted new legislation aligning their law with the UNCITRAL’s model law of 1985 on international arbitration (the exceptions are the Netherlands and Switzerland, which have maintained their own models, and France and Belgium, which reformed their legal regimes before UNCITRAL finished its work). Reforms have been in one direction: to enhance the autonomy and a-national character of the Law Merchant. While there remain important technical differences, the new statutes treat international arbitration more liberally than they do domestic arbitration; confer upon the contracting parties a wider scope to choose procedures and the controlling law of contract and arbitration; codify a doctrine of separability (n. 5); recognize at least implicitly the Kompetenz–Kompetenz of arbitrators as well as their capacity to resolve conflict of laws issues (n. 7); and reduce the grounds for judicial review of awards to a bare minimum. In France, the new code aligned itself with ICC priorities (Carbonneau 1992: 121), even placing the Lex Mercatoria on an ‘equal footing’ with national and international sources of law as legitimate bases for awards (see Delaume 1995: 9–10). ‘The common thrust of the recent European statutory law,’ Drobnig (1998: 195) writes, ‘elevates arbitration to the status of a true alternative to the traditional court system for dispute resolution.’

There are at least three underlying motivations for deregulation. First, legislators and judges find it in the national interest to encourage transnational commerce. Second, court systems are overloaded. Providing for the autonomy of private international law arbitration drains off much complex litigation for which national law is less and less relevant, and for which (generalist) judges...
are less and less prepared. Third, there is now international ‘competition for the “business” of . . . international arbitration,’ and liberalizing is essential to attracting this business (Drobnig 1998: 196). In updating their own codes, German and Italian legislators claimed to be working to make their systems as hospitable to arbitration as France, and the United States. Such efforts feed back on arbitration in obvious ways. Here is how the new Venice House, on its website (www.venca.it), describes its own renaissance:

The adoption by the Italian Parliament, on January 5, 1994, of legislation on international arbitration was the decisive element in our taking a fresh approach to arbitration. The Chamber and its Rules are a creative response to the lessons read from the long experience of the International Chamber of Commerce in Paris and its rules and case-law, and the principles and rules [of contract and arbitration] recently developed by UNCITRAL.

The Chamber means to offer to commercial operators an agile and . . . speedy . . . procedure. For this purpose, the Chamber has adopted Rules of Arbitration suitable to avoid and to limit delays and, above all, to contain proceedings’ expenses, by keeping registration, administrative and arbitrators’ fees low.

The Lex Mercatoria and European integration

For many readers of this journal, the discussion so far may be useful only insofar as it leads to this question: What has all of this got to do with European integration, or public policy? I have several (linked) responses.

First, it is the growth of cross-border trade, undertaken by private firms, that has driven the transformative processes discussed above. If European integration has been heavily conditioned by transnational activity (Sandholtz and Stone Sweet 1998; Stone Sweet 2004), it must be that integration processes and the rise of the new Lex Mercatoria are causally linked to one another. Stone Sweet and Brunell (1998) showed that the expansion of intra-EU trade activated the EU’s legal system, and the operation of the EU’s legal system led to the further expansion in trade. The finding has been subjected to more rigorous testing by economists and found to be extraordinarily robust (e.g. Pitarkis and Tridimas 2003). Put simply, the rise of the Lex Mercatoria and the operation of the EU’s legal system have both facilitated an expansion in trade; more trade means more contracting across borders, and therefore more demand for third-party dispute resolution (assuming that the ratio of disputes to contracts is constant or falls less than the marginal growth in total contracting). A complex double feedback loop is constituted.

Second, the European version of the Lex Mercatoria – in the form of the Lando Code and the rise of a system of arbitration houses that compete with one another and with national courts for business – was provoked by the Single Market program. Indeed, Lando and elements within the Brussels Commission do not believe that a Single Market can be declared to be ‘completed’
without the harmonization of European private law. This view is a matter of some debate, of course, but it is vigorously supported by, among others, the ICC (2001).

Third, we have already seen that national legal systems in Europe have been steadily adapting to the new *Lex Mercatoria* over the past twenty years, and this adaptation accelerated as the twentieth century drew to a close. It should be obvious that the more national law comes to recognize the contractual freedom of transnational firms, and the arbitral freedom of private courts, the more pressure there will be on the EU’s bodies to co-ordinate what should remain in the public interest to regulate. The EU has long regulated aspects of private law, such as consumer protection, but we should expect it to move more aggressively into other areas. In 2003, the Commission submitted its ‘Action Plan’ for ‘A More Coherent European Contract Law’ (Commission of the European Communities 2003), and this initiative is currently organizing intensive debate on whether the EU needs a European civil code and unified contract law and, if not, just what it needs. It is worth noting that in a 2005 survey of 175 firms, of different size and kind, across Europe, 80% of respondents stated that they would welcome an EU contract law as a means to help overcome obstacles to trade, but only if it is optional. ‘The same proportion of businesses regarded it as important to be able to choose the governing law of their contracts.’ This view is, again, supported by the ICC (2001).

3. CONCLUSION: INSTITUTIONALIZATION

In a brief account such as this, little is lost in emphasizing functional logics—such as the relative institutional efficiencies of cross-border commercial activity—as the catalyst for the rise of the new *Lex Mercatoria*. The *institutionalization* of arbitration as a system of governance, however, is quite a different matter. By institutionalization, I mean the process through which arbitral practices are consolidated as stable rules and procedures. The growing popularity of arbitration houses, as substitutes for national courts, has pushed arbitrators to maximizing values other than the parties’ private right to contract. Most important, they are increasingly moved by considerations of legal certainty—arbitrators use the word *justice*—not simply for the parties involved in a specific case, but also for future users of the system. In other words, arbitrators are becoming—if with some hand-wringing and reluctance—default lawmakers for traders.

To be sure, the arbitral concern for justice can be expressed in the language of efficiency, that is, as yet another drive to reduce transaction costs. Producing just and fair decisions, after all, helps to elicit compliance from the losing party, and to reduce the animosity of national judicial systems to the exercise of arbitral power, if enforcement becomes necessary. Reducing enforcement problems means attracting more customers. In this way, everyone in the system is made better off. To achieve just results is to enhance legal certainty; and legal uncertainty is one of the reasons why national systems (with their arcane conflict of
law methods) had come to be avoided in the first place. A great deal could be said about these issues, but one point is clear. The balance between (1) procedural efficiency, and (2) predictability of outcomes (i.e., a concern for justice and legal certainty) is being recalibrated to the advantage of the latter. The more arbitrators care about justice, the more arbitration will be judicialized (Lillich and Brower 1992); and the more arbitration mimics litigation, the more costly the system will be to run (Holtzmann 1992; Okekeifere 1998).

Judicialization is in fact proceeding along three linked dimensions. The first concerns who arbitrates. Whereas a single arbitrator was once commonplace, parties today typically demand three panel members, as 'additional assurance that [they] will not become victims of a single arbitrator's folly' (Newman 1998: 5). This is all the more true for relatively high stakes disputes. Further, as arbitration has increased in popularity, bigger (in terms of money) and more complex (in terms of the contractual instruments) cases have been filed. Arbitration houses have had little choice but to replace the once ubiquitous trade generalist with the technical expert, and to develop more formal and complex procedures to deal with the demands being placed on them (Dezelay and Bryant 1996).

Second, arbitral procedures are developing quickly, and several codes — to be used by 'parties coming from different legal traditions' — governing the taking of evidence, discovery, and the testimony of third parties and other experts are available (e.g., IBA 1999). More complex procedures are, in part, a product of increasing adversarialism, as lawyers use the techniques of litigation to gain advantages, or level the field, in arbitral settings. Partly, it is again related to a concern for justice. Arbitrators wishing to produce the fairest possible decision can hardly allow one or both of the parties to hide relevant facts, or selectively reveal evidence, or lie outright. As Newman (1998: 4) has it, 'the recent trend ... has been to add more complex procedures, thereby providing the parties with greater assurance of a just result.'

Third, and I consider this to be the crucial move, the *Lex Mercatoria* is now being built through precedent. It is a matter of dogmatic orthodoxy in positivist jurisprudence (Hart 1994; MacCormack 1978) that judicial discretion can be counted as a virtue to the extent that judges actually use their discretion to enhance legal certainty (i.e., to reduce normative indeterminacy). They do so by developing and applying rules to govern their own decision-making. The most important of these is the famous principle of formal justice: like cases will be decided similarly. Arbitrators, today, increasingly behave according to the dictates of this model, and self-consciously so. Arbitrators work to generate just decisions, but they are also careful to insist that decisions in equity are possible only if anchored in general principles. Further, if their clients act in ways that introduce adversarial legalism to the proceedings, then arbitrators may be all but required to justify their decisions; that is, to adopt a nascent 'giving reasons' requirement. Arbitrators need to defend their own reputations for fairness, *vis-à-vis* the parties to the dispute before them;¹⁰ they also have a corporate interest in making the law that governs international commerce clear,
transparent, and available to future disputants. Giving reasons for their decisions, and publishing them, allows them to do both.

Today, more and more decisions are being published, and certain kinds of decisions are treated by subsequent litigators as having precedential value. The published rulings of arbitral panels sitting for important, high-profile disputes may be full of dicta, which the panel has designed to make general points about general principles; they do so in order to help codify the *Lex Mercatoria*. Practices associated with precedent, once only implied, are now explicitly applied (see Berger 1999: 57–74, 214–20). Carbonneau (1997: 16–18) refers to the steady emergence of an ‘arbitral common law,’ tailored to the needs of specific types of traders, through case-by-case dispute settlement. Not surprisingly, the question of whether the creation of appellate instances for the arbitral system is being actively debated (Seventh Geneva Global Arbitration Forum 1999; Werner 1999). Each of the major arbitral tribunals has developed institutions charged with reviewing and approving awards, before they may enter into effect.

The dynamics of the overall process should be obvious. In Europe, in certain core domains of commercial activity, the sovereign has declared that it shall no longer govern. A private system has taken over, but the viability of this system may rest on its capacity to manage its own political development (judicialization). Decentralized, transnational ‘governance’ will now begin to take on the features of ‘government.’

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**NOTES**

1 Based in part on Shapiro and Stone Sweet (2002: ch. 5).
2 The Lando Commission’s *Principles of European Contract Law* is online at: http://www.jus.uio.no/lm/private.international.commercial.law/contract.principles.
3 The data reported on these three European arbitral institutions were collected by the author on site.
4 Readers can amuse themselves by calculating the costs of any dispute online: for the ICC, at http://www.iccwbo.org/court/english/cost_calculator/cost_calculator.asp; and for the SCC, at http://www.sccinstitute.com/uk/Calculator/. Note that the majority of disputes concern sums exceeding $1,000,000. Calculating LCIA rates is not as formulaic: see http://www.lcia-arbitration.com/.
5 Art. V.2 of the Convention states that ‘Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition is sought finds that: (a) the subject matter of the difference is not capable of settlements by arbitration under the law of that country; or (b) the recognition or enforcement of the award would be contrary to the public policy of that country.’
National laws increasingly accept what is known as the ‘separability doctrine,’ according to which the validity of the arbitral clause is not affected by the legal nullity of the contract of which it is a part. In essence, the doctrine forecloses moves by one of the parties to the contract to avoid arbitration by pleading the contract’s nullity.

That is, the legal validity, in national law, of arbitral awards is presumed.

Kompetenz–Kompetenz refers to the formal competence of a jurisdiction to determine its own jurisdiction, or the jurisdiction of another organ. Modern arbitration statutes and case law largely accept that the arbitrator possesses the authority to fix the scope of its own jurisdiction, subject of course to the will of the contracting parties.


As Newman (1998: 5) puts it, ‘A reasoned award is one of the only protections the parties have against decisions born of caprice, bias, or intellectual indolence . . . . The practice of rendering awards without explaining them is not suitable for complex international matters.

Important decisions are regularly published in various specialized journals, often with commentaries by eminent arbitrators and scholars. The ICC publishes its own volumes of redacted awards.

REFERENCES


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