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SEPARATE ARBITRAL AWARD RENDERED IN 2001 IN SCC CASE 117/1999

Subject-matter:

Applicable law to the dispute; application of Article 24(1) of the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce.

Finding:

The tribunal determines that the applicable rules of law on the merits are those contained in UNIDROIT Principles of International Commercial Contracts (1994), supplemented by Swedish law if and to the extent the UNIDROIT rules do not give any guidance on a particular issue.

Parties:

Claimant: The European Company, Licensor and Licensee (Luxembourg)
Respondent: The Technical Corporation, Licensee and Licensor (China)

Place of arbitration:

Stockholm, Sweden

Language of the proceedings:

English

Nationality of arbitrators:

Chairman: Swedish
Arbitrator: Swedish
Arbitrator: Chinese

Amount in dispute:

EUR 990 500[1]

Arbitration costs:

EUR 182 000[2]

SUMMARY

In 1980, a Chinese international trade corporation and the Industrial Corporation ("Industrial"), also a Chinese company, and the European Com-

[1]For the reader's convenience, all monetary amounts stated in the excerpts of the awards are approximated and converted into euros.

[2]Amount referring to the arbitration costs of the final award, rendered on 17 October 2001.

pany ("European"), on the other, entered into an agreement concerning technology exchange and technical co-operation ("the 1980 Agreement"). Under the 1980 Agreement, the parties exchanged licenses to parts of their respective industrial technology.

The 1980 Agreement was valid for ten years but was later extended until 1995 through a Supplement Agreement. It was thereafter terminated on the agreed date.

In 1997, a discussion arose between European and the Technical Corporation ("Technical"), as successor to Industrial, on certain alleged infractions by Technical of a secrecy undertaking in the 1980 Agreement.

In February 1998, the discussions resulted in a settlement agreement ("the Settlement Agreement") between the parties whereby the secrecy obligation under the 1980 Agreement was extended until December 31, 2002.

According to European, additional breaches of the secrecy undertaking was thereafter committed by Technical. In November 1999, European filed a request for arbitration with the Arbitration Institute of the Stockholm Chamber of Commerce, claiming damages from Technical on this ground.

On 7 July 2000, the Institute referred the case to the arbitral tribunal.

On 24 October 2000, European filed a partial Statement of Claim, in which it requested that the issue of applicable law be determined in the form of a partial award. The respondent agreed to the request.

Applicable law

Claimant's Position

Claimant held that Swedish law should apply to the dispute or, alternatively, the UNIDROIT Principles of International Commercial Contracts or Luxembourg law.

"The relevant contract is the 1980 Agreement. There was hardly any relevant statutory law in existence in the People's Republic of China in 1980. In these circumstances, the parties cannot possibly have intended Chinese law to apply. The only evidence as to the parties' joint intention as regards applicable law can be found in the dispute resolution clause of the 1980 Agreement, in which the parties chose Sweden as the place of arbitration. It is clear that neither party wished the other party's law to apply.

"The parties chose the Rules of the [Arbitration Institute of the] Stockholm Chamber of Commerce from time to time in force. The current Rules permit the arbitrators to employ the *voie directe* method and applies [to] arbitrations

which commenced on 1 April 1999 or later, unless that the parties have decided otherwise. Under the *voie directe* method, it is appropriate in the circumstances for Swedish law to be chosen by the arbitrators as a neutral applicable law; alternatively, the UNIDROIT Principles of International Commercial Contracts should be applied.

"If choice of law rules were to be applied, Swedish international private law rules and those of the Rome Convention both lead to the conclusion that Swedish law should be applied or, alternatively, that Luxembourg law should be applied to the obligations of [Technical] which are the subject of this dispute, since the 'characteristic performance'—to which the secrecy and non-competition obligations at issue relate—is the license from [European], domiciled in Luxembourg from where the performance emanates."

Respondent's Position

Respondent held that Chinese law should be applicable to the dispute for the following reasons.

"The choice of Sweden as the situs of the arbitration does not suffice as an indication of the parties' intentions with the respect to applicable law. The standard for a finding of an inferred choice of law is, generally speaking, extremely high and only proper where it is reasonably clear that there is a genuine choice by the parties. The choice of a certain jurisdiction for the arbitration proceedings does not indicate an intentional choice of applicable law but can be made for several different reasons. Under Swedish arbitration law at the time of the signing of the 1980 Agreement the conflict of laws system to be applied in an international commercial arbitration is the Swedish one. According to Swedish conflict of laws principles the law with the closest connection to the contract will be applied in matters of commercial contracts.

"It was common practice in China at the time of the signing of the 1980 Agreement that no provision on applicable law was included in the agreement. However, Chinese parties naturally favoured Chinese law as the applicable law, and this was reason for the preference by Chinese parties to international contracts of negotiating and signing agreements in China, thereby increasing the possibility of subsequent application of Chinese law. In this case, the 1980 Agreement and the subsequent agreements were negotiated and signed in China and the 1980 Agreement was also to be largely performed in China. In addition, the only portion of the Agreement in dispute and the entirety of the Settlement Agreement relate to performance that also take place principally in China. There is no connection to Sweden in the negotiation, execution or performance of any of the contracts relevant in the dispute. Consequently, the Tribunal should apply Chinese substantive law to the dispute."

Findings of the Arbitral Tribunal

The arbitral tribunal took note of the fact that the 1980 Agreement was signed in Beijing and contained no provision on applicable law to the dispute. The Supplement and the Settlement Agreement were also signed in Beijing without any provisions on applicable law. No evidence had been submitted with respect to the intentions of the parties on applicable law at the signing of the various agreements.

"The present arbitration is governed by the Swedish Act on Arbitration which entered into force on April 1, 1999 and the present rules of the Arbitration Institute of the Stockholm Chamber of Commerce that entered into force on the same day. The Swedish Arbitration Act does not contain any provision on applicable law to a dispute under an international contract in Swedish arbitrations. The Rules of the Arbitration Institute, however, stipulate in Article 24 (1) that the tribunal, in the absence of an agreement between the parties, shall apply the law or rules of law which the tribunal considers to be most appropriate, a principle often referred to as *voie directe*. This rule, like the other Rules in force since April 1, 1999, applies to all arbitrations commenced thereafter, irrespective of the date of the agreement in dispute. Thus, this Tribunal is free to determine the applicable law on an assessment generally of the appropriateness of the chosen law or rules of law.

"However, this does not mean that the Swedish conflict rules—which in the case of an international arbitration that, according to the parties wishes, takes place in Sweden are, *in dubio*, applicable—can be disregarded out of hand. Therefore, the Tribunal will first investigate whether there are Swedish conflicts rules that will effectively designate the applicable law for the present dispute.

"Sweden has ratified the Rome Convention on the Law Applicable on Contractual Obligations which since July 1, 1998 has the status of law in Sweden. The governing principle under the Convention, as by and large was also the case under Swedish law before Sweden's ratification of the Convention, is that the applicable law shall be the law of the country to which the agreement has the closest connection. The Convention contains rules on certain contracts where the closest connection can be inferred from the nature of the contract, none of which, however, is relevant in the present case. There are also references to such circumstances that traditionally have been assumed to indicate a special connection to a certain jurisdiction, such as the nationality or residence of the respective parties, the place where the contract was entered into, the place of performance, agreed currency, the language of the contract etc. In the present case, only the place of negotiating and signing the Agreement is indicative of a certain jurisdiction among these various circum-

stances. This could, in the absence of other circumstances, indicate that the Agreement (as well as the subsequent Supplement and Settlement Agreement) has its closest connection with the People's Republic of China.

"However, this can, in the opinion of the Tribunal, in itself not be decisive in the present case. The 1980 Agreement is of special character in that it is, as it were, a form of barter agreement. The parties to the 1980 Agreement agreed to exchange technology and know how without any simultaneous arrangement for payments by either side to the other. Although the terms of the licenses are slightly different, the Agreement is a contract on a cross licence arrangement where performance and obligations are, on the face of it, evenly distributed and symmetrical in nature. As a consequence, the Agreement lacks the distinctive element of an unilateral, characteristic performance by one of the parties that sometimes can lend itself to conclusions or presumptions on the closest connection to any particular jurisdiction.

"This conclusion in its turn leads the Tribunal to exclude the general application of Chinese law to the Agreement. The location where the Agreement was negotiated and signed can in the present case not reasonably be assumed to be in itself decisive for the law that should govern both the licence granted by [European] and the licence received by [European]. Nor can such conclusion be drawn from the fact that the subsequent Supplement and the Settlement Agreement were signed in the People's Republic of China. The fact that the last mentioned agreements are unilateral in the sense that they deal only with matters relating to the licence granted by [European] to [Technical] does not alter this, since they still concern performance and obligations arising out of the cross licence in the 1980 Agreement, which contains the arbitration clause that both parties also find applicable to the present dispute. Therefore and although the Settlement Agreement is a separate agreement in the sense that it could be separately governed by a law or rules of law on issues relating to its binding nature or suchlike, the unilateral nature and the place of signing of the Settlement Agreement is not, in the Tribunals opinion, a valid reason for applying a different law to the Settlement Agreement than that which is found applicable to the 1980 Agreement. In fact, the very nature of a settlement agreement relating to a contractual obligation will, in the absence of a separate governing law clause, *in dubio* make it fall under the applicable law according to the contract in dispute.

"For the same reasons as stated in the foregoing Luxembourg law cannot be considered to be the exclusive governing law for the 1980 Agreement.

"In exceptional cases it may be possible to separate one part of a contract with a particular connection to a certain jurisdiction and apply the law of that jurisdiction to such part while at the same time applying another law to other

parts of the contract with the closest connection to another jurisdiction (so called *deçepage*). In the Tribunal's opinion this is not possible in the present case. In a contract where the parties exchange licences it cannot be a reasonable assumption that the alleged breaches of one party should be treated differently than the breaches of the other party, as a result of different laws or rules of law being applicable to each party's obligations.

"The only relevant indication of any jurisdiction other than the People's Republic of China or Luxembourg is Sweden, chosen by the parties as the situs for arbitration. This is not of relevance for a finding of the closest connection of the Agreement to any particular jurisdiction, but goes rather to the issue of the parties' intentions or implied choice of governing law on the merits. But even in a case where all other relevant elements for identifying the governing law are missing, it is highly debatable whether a preferred choice of the *situs* of the arbitration is sufficient to indicate a choice of governing law. There has for several years been a distinct tendency in international arbitration to disregard this element, chiefly on the ground that the choice of the place of arbitration may be influenced by a number of practical considerations that have no bearing whatsoever on the issue of applicable law. The Tribunal agrees in principle with that approach, and notes, in addition, that the choice of location and rules for the arbitration in this case conforms to a fairly long and well-established practise in contracts between Western parties, on the one hand, and East European or Chinese parties, on the other. This practise is mainly based on perceptions of Sweden and the Arbitration Institute as a neutral and adequately regulated ground for arbitration proceedings and not on a preference for Swedish substantive law.

"It seems obvious to the Tribunal that the parties in this case deliberately refrained from agreeing on the applicable law to the 1980 Agreement, which otherwise bears the mark of a well prepared and qualified approach to contract drafting. It may well be that either or both of the parties had hopes or expectations on the application of a law, in case of a dispute between them, with which they would feel comfortable. But there is no indication that they at the time contemplated the actual effects of any particular law on hypothetical instances of breaches under the contract; nor have any such effects so far been presented by the parties in the arbitration. In the Tribunal's view, it is reasonable to assume that the contracting parties expected that the eventual law chosen to be applicable would protect their interest in a way that any normal business man would consider adequate and reasonable, given the nature of the contract and any breach thereof, and without any surprises that could result from the application of domestic laws of which they had no deeper knowledge.

"This leads the Tribunal to conclude that the issues in dispute between the parties should primarily be based, not on the law of any particular jurisdiction, but on such rules of law that have found their way into international codifications or suchlike that enjoy a widespread recognition among countries involved in international trade. Apart from international conventions such as the Convention on International Sales of Goods (CISG) and other conventions that are not directly applicable on a licence agreement, the only codification that can be considered to have this status is the UNIDROIT Principles of International Commercial Contracts. The UNIDROIT rules have wide recognition and set out principles that in the Tribunals opinion offers a protection for contracting parties that adequately reflects the basic principles of commercial relations in most if not all developed countries. The Tribunal determines that the rules contained therein shall be the first source employed in reaching a decision on the issues in dispute in the present arbitration.

"If and to the extent the UNIDROIT rules do not provide an answer to any question of substantive nature raised in the arbitration, the Tribunal has to resort to domestic laws. Since none of the parties has yet presented its case or its arguments in a way that enables the Tribunal to identify any such question, the Tribunal does not know in which areas such secondary sources of law will be required. It follows from the foregoing that the Tribunal does not find it appropriate to chose the domestic law of either party. Instead, the Tribunal will, in view of the lack of distinctive elements for a choice of any other law and in spite of the arguments in foregoing, apply Swedish substantive law, unless both parties then agree otherwise.

SEPARATE AWARD

"The Tribunal determines that the appropriate rules of law on the merits of the issues in dispute between the parties are those contained in UNIDROIT Principles of International Commercial Contracts (1994) supplemented by Swedish law if and to the extent the UNIDROIT rules do not give any guidance on a particular issue."

OBSERVATIONS BY JUAN FERNANDÉZ-ARMESTO

The partial award rendered by the arbitrators in SCC Case 117/1999 addresses a problem which has been described as the "last debated issue" relating to transnational law (or *lex mercatoria*)[1]: in the absence of any choice of law agreed upon by the parties, can arbitrators decide by themselves not to apply any municipal law, and to rely exclusively on transnational rules, whether codified or not?

The importance of the award is that it comes down with an unequivocal and clear cut answer: in such circumstances, arbitrators are free to use "rules of law that have found their way into international codifications or such like that enjoy a widespread recognition among countries involved in international trade." And "the only codification that can be considered to have this status is the UNIDROIT Principles of International Commercial Contracts," which is consequently the rule of law which the Tribunal will apply in the first instance to solve the dispute.

1. The facts

The facts of the case are rather straightforward. A Luxembourg company and a Chinese entity entered in 1980 into an Agreement to exchange technology. The Award describes it as a form of barter: the parties undertook to exchange technology and know-how without any simultaneous arrangements for payments. The Agreement ran until 1995, but in 1997 a discussion arose between the parties regarding an on-going secrecy undertaking. The dispute was set aside by a 1998 Settlement Agreement. According to the Luxembourg party, this Settlement Agreement was breached by the Chinese company, and therefore it filed a request for arbitration with the Stockholm Chamber of Commerce in 1999.

Both the Agreement and the Settlement Agreement were "well prepared," were signed in Beijing, contained a submission to SCC Arbitration in Stockholm, but they contained no provision on applicable law. In the course of the procedure, no evidence was submitted in respect of the intentions of the parties on applicable law at the signing of the various Agreements.

Once the Arbitration was filed and the three member Tribunal seated in Stockholm (a Swedish and a Chinese arbitrator under a Swedish chair), Luxembourg Claimant and Chinese Respondent agreed that the issue of applicable law should be determined in the form of a partial award. In their

[1] E. Gaillard: "Transnational Law: A Legal System or a Method of Decision Making?" (2001), 17, Arbitration International, 60.

submissions, Claimant pleaded that Swedish law should apply, or alternatively the UNIDROIT Principles or Luxembourg law. Respondent argued that Chinese law should be preferred.

In its Separate Award rendered in 2001 (in accordance with art. 34 of the SCC Rules[2]), the Tribunal came down with a decision "that the appropriate rules of law on the merits of the issues ... are those contained in UNIDROIT Principles of Commercial Contracts (1994) supplemented by Swedish law if and to the extent the UNIDROIT rules do not give guidance on a particular issue."

2. The Tribunal's reasoning

The Tribunal was confronted with a situation which is not uncommon in international arbitration[3]: the parties had agreed to arbitration, but not to the substantive law applicable to the dispute. The Swedish Arbitration Act does not contain any provision on applicable law to a dispute under an international contract in Sweden[4]. There is however a clear provision in the Rules of the Arbitration Institute, which in art. 24(1) stipulates that the Tribunal "shall apply the law or rules of law which it considers to be most appropriate."[5] The Arbitrators' reasoning was developed in three steps: first of all they rejected a possible compromise, then they tried to find a "law" appropriate to the case, and failing this they searched for the most appropriate "rules of law."

The two compromise solutions which the Tribunal rejected *ab initio* were the separation of the original Agreement and the Settlement Agreement, in order to apply different legislations to each of such contracts, and the *"depeçage"*, *i.e.* the application of diverse laws to different parts of the two

[2]Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, adopted 1 April 1999.

[3]J. Lew: "The UNIDROIT Principles as *lex contractus* chosen by the Parties and without an Explicit Choice-of-Law Clause" in "UNIDROIT Principles of International Commercial Contracts", Special Supplement (2002) ICC Bulletin, 86, estimates - on the basis of ICC statistics - that 20% of arbitration cases lack a predetermined choice-of-law provision.

[4]Article VII of the 1961 European Convention on International Commercial Arbitration is not applicable, since China is not a Contracting State (see Art. I). If it had been, the Tribunal would have had to take into account Art. VII, which directs Arbitrators to apply "the proper law under the rule of conflict that the arbitrators deem applicable", taking into account "trade usage". This provision was used by the Tribunal in ICC Case 9419 (9.98 www.unilex.info) to deny application of transnational law/UNIDROIT Principles.

[5]The corresponding provision in the ICC Rules of Arbitration is article 17, which provides that the "Arbitral Tribunal shall apply the rules of law which it determines to be appropriate". The Swedish text is more precise, since it clearly distinguishes between "laws" and "rules of law" - laws being the narrower concept, including only legal systems created by states, and "rules of law" a broader term, which also covers transnational law, *lex mercatoria*, general principal of international trade and the like (paragraph 5 *infra*).

Agreements. The arguments followed by the Arbitrators are convincing: a Settlement Agreement should follow the same law as its main agreement (except if the parties provide otherwise), and a *"depeçage"* (always a contentious solution[6]) is totally unacceptable in a symmetrical agreement for the barter of technology.

The Tribunal then focused on the possibility of establishing a "law" which would be "appropriate" in the given circumstances. For this effort it used Swedish conflict-of-law rules, Sweden being the agreed place of arbitration, and specifically the Rome Convention on the Law Applicable to Contractual Obligations. The basic rule in this Convention is that of "closest connection" (art. 4.1.). The Convention presumes *iuris tantum* that the closest connection coincides with the domicile of the party that has to provide the characteristic performance (art. 4.2.). The arbitrators, however, came to the conclusion that no characteristic performance could be identified in the Agreements, and that consequently the presumption did not apply (as foreseen in art. 4.5. of the Convention).

The Tribunal then looked for other criteria from which to infer the closest connection between the Agreements and a legal system. The only available criterion is that the place of negotiating and signing of the Agreements was Beijing, and that would lead to applying the laws of China. The Tribunal, however, rejected this conclusion, since "the location where the Agreement was negotiated and signed can in the present case not reasonably be assumed to be itself decisive for the law that should govern" the contracts.

The Tribunal also rejected the possibility of applying Swedish substantive law to the agreement, arguing that a preferred choice of *situs* is influenced by a number of considerations (*e.g.* neutrality, local arbitration law) that have no bearing whatsoever on the issue of applicable law.

Summing up, the Tribunal reached the conclusion that there is no "law" (in the sense of art. 24(1) of the SCC Arbitration Rules) which could reasonably be applied to the substance of the agreement - indeed, that the parties deliberately refrained from agreeing on the applicable law in the Agreements.

On the basis of this argument the Tribunal concluded that the issue in dispute should be solved, not on the law of any particular jurisdiction, but on "rules of law that have found their way into international codifications" and enjoy widespread recognition. "The only codification that can be considered to have this status is the UNIDROIT Principles." Consequently, the Tribunal decided that these rules should be the first source of applicable law. To the

[6]See art. 4.1. 1980 Rome Convention on the Law Applicable to Contractual Obligations, which only permits "depeçage" in "exceptional circumstances".

extent that the UNIDROIT Principles do not provide an answer to any question of substantive nature, the Tribunal decided, "in view of the lack of distinctive elements for a choice of any other law ... to apply Swedish substantive law, unless both parties agree otherwise".

3. The UNIDROIT Principles and their application

UNIDROIT is an intergovernmental agency, re-established in 1940 on the basis of a multilateral treaty. Membership is restricted to States, and some 59 are members. In 1994 it published its "UNIDROIT Principles of International Commercial Contracts," composed of a Preamble and 119 articles, with the aim of providing a general regulation of contractual law. The structure and style are similar to that of European civil codes, although the UNIDROIT Principles are unique in that each article is accompanied by comments and by case descriptions, intended to explain the basic rules.[7]

The UNIDROIT Principles are most certainly not an international treaty; neither are they a compilation of international usages. They are a restatement of existing international law, selecting those rules which the working group designated by UNIDROIT found most persuasive or best suited for cross border transactions and acceptable to both civil and common law lawyers. If the UNIDROIT Principles are such a convincing piece of draftsmanship, it is because the aim was not to find the broadest compromise but the most fitting solution.[8]

The purpose of the UNIDROIT Principles is clearly established in its Preamble: parties may agree to apply them in their international contracts, and in such case they become mandatory (*ex lege contractus*). Courts and arbitrators "may" apply them, when the agreement of the parties is "that their contracts be governed by general principles of law, the lex mercatoria or the like", when "it proves impossible to establish the relevant rule of applicable law", or when it is necessary "to interpret or supplement international uniform law".[9]

It is impossible to qualify the UNIDROIT Principles—a private codification of civil law, approved by an intergovernmental institution—within the traditional sources of law. The UNIDROIT Principles are neither treaty, nor

[7]See M.J. Bonell: "An International Restatement of Contract Law" 2ed (1997). A complete bibliography on the Principles can be found under www.cisg.law.pace.edu.

[8]M. Fontaine: "The UNIDROIT Principles: An Expression of Current Contract Practice?" in note (2), 95.

[9]Interestingly the Principles do not list as a purpose the use which is most frequent in case law: to supplement and interpret municipal law; see M.A. Pendón in "Comentarios a los Principios UNIDROIT para los Contratos del Comercio Internacional" (1998), 46.

compilation of usages,[10] nor standard terms of contract.[11] They are in fact a source of transnational law, an example—possibly the most widely accepted—of the growing trend to codify *lex mercatoria*.[12]

There cannot be any doubt that in general the valuation of the UNIDROIT Principles has been very positive, although some of the specific rules have not escaped criticism.[13] One thing, however, is undisputed: that arbitrators are applying the UNIDROIT Principles with increasing frequency in order to reason their awards. There are 68 decisions (some from Courts but mostly from arbitrators) which refer to or apply the UNIDROIT Principles,[14] either to supplement or construe municipal law, or to solve the dispute. In order to examine this application, two different scenarios have to be distinguished: that the parties have concluded an agreement as regards substantive law (be it UNIDROIT Principles, *lex mercatoria*, or a municipal law) (4.) or that such agreement does not exist (5.).

4. Agreement among the parties on governing law

The clearest situation arises when parties have agreed to the application of the UNIDROIT Principles as substantive law of their contract. In such case the Principles are to be applied like any other municipal law which might have been chosen by the parties. Given that the UNIDROIT Principles only cover general rules on contracts, parties frequently provide for a national law to supplement them.[15]

[10]Although some of its rules may reflect existing trade usage—see note (22) *infra*. ICC award number 10022 (10.2000 www.unilex.info) acknowledges that the Principles are a codification of international trade usages, but not of mandatory but rather of persuasive nature.

[11]*Contra*, CW Canaris: "Die Stellung der "UNIDROIT Principles" und der "Principles of European Contract Law" im System der Rechtsquellen", in Basedow (ed): "Europäische Vertragsrechts- vereinheitlichung und deutsches Recht", (2000), 21; the Principles lack the element of unilateral drafting and one sidedness in the allocation of rights and obligations which is an essential element of standard terms; the application to the Principles of state laws designed for the protection of the weaker party in a standard contract terms situation (like the German AGB Gesetz), which is defended by Canaris, *op. et loc. cit.*, is not appropriate.

[12]Berger: "The creeping Codification of the *lex mercatoria*" (1999). See also www.tldb.de for an online list of *lex mercatoria* principles. For a criticism of the "list approach" to *lex mercatoria*, and a defence that *lex mercatoria* is a method E. Gaillard in note (1), 59.

[13]E.g. H. Raeschke-Kessler: "The UNIDROIT Principles in Contemporary Contract Practice" in note (2), 99 (*"have won considerable praise"*); Fouchard/Gaillard/Goldmann: "International Commercial Arbitration" (1999) 817 (*"vital contribution to development of transnational rules"*). Criticism seems centered on the rules on hardship (art. 6.2.1.) and *force majeur* (art. 7.1.7.) - see M. Fontain in note (2), 97.

[14]The decisions can be found in www.unilex.info; the ICC International Court of Arbitration Bulletin published in two numbers 37 ICC awards which apply the Principles: (1999), 10, 2 and (1999) 12, 2.

[15]UNIDROIT recommends the following model clause: *"This contract shall be governed by the UNIDROIT Principle 1994, supplemented when necessary by the laws of jurisdiction X"*.

The agreement may be included *ab initio* in the contract, but it is also frequent that the original contract remains silent, and that at the outset of the arbitration the parties agree to abide by the Principles.[16]

But the Principles may be agreed upon not only as the law applicable to the merits of the case (with or without a municipal law to fill in possible gaps), but also as the law which will be used to interpret and complement the choice of law made by the parties.[17]

The situation is more difficult, when the agreement among the parties does not refer explicitly to the UNIDROIT Principles, but rather states that the merits of the case shall be solved (or the agreed municipal law interpreted) by applying "principles of international commercial law," "*lex mercatoria*," "principles of equity" or similar formulas.[18] Does this authorize the arbitrators to apply directly the UNIDROIT Principles? There are two well-known cases in which the arbitrators were confronted with this question. In one case the parties had agreed that the substance of the dispute should be solved applying "general principles of equity," and in the other "rules of natural justice." In both circumstances the arbitrators decided to use the UNIDROIT Principles[19] —a reasonable conclusion, foreseen in the very preamble of the Principles.

Finally, there is the case when the parties have agreed on a specific municipal law. In such case, there cannot be any doubt that the choice of law must be respected where it is provided for by the parties. Can the Principles in these circumstances be used as an ancillary source of law, in order to interpret or supplement national law? Practitioners have always voiced the fear that national legal provisions may prove too rigid or ill suited to solve disputes among

[16]M.J. Bonell: "The UNIDROIT Principles and Transnational Law," Uniform Law Review (2000) 199-218, also at www.unidroit.org, 3 with case law; P. Mayer: "The Role of the UNIDROIT Principles in ICC Arbitration Practice," in note (2), 114, suggests that in these cases the application of the Principles is suggested by the Tribunal; H. Raeschke-Kessler in note (2), 99, cautions users not to agree UNIDROIT Principles as single governing law, since they are still incomplete.

[17]Even without agreement among the parties, arbitrators often use the Principles in order to confirm the reasonableness of a solution which they have reached applying the municipal law agreed upon by the parties.

[18]There is no doubt that such an agreement between the parties is valid and binding; art. 28 of the Uncitral Model Law provides that arbitrators must apply the "rules of law" (including transnational rules of law) chosen by the parties; see extensively Fouchard/Gaillard/Goldman in note (13), 802.

[19]ICC Case 9797 (28.7.2000 www.unilex.info); for a commentary of this "Arthur Andersen case" see J.M. Bonell: "A 'Global' Arbitration decided on the Basis of the UNIDROIT Principles", (2001), 17, Arbitration International, 249; ICC Case 7110, (4.98 www.unilex.info); see Y. Derains: "The Role of the UNIDROIT Principles in International Commercial Arbitration" in note (2), 17.

merchants - especially if they come from different jurisdictions. The role of softening the impact of national laws, and to construe these rules in a way which furthers trade, has traditionally been entrusted to trade usages. Most legal systems and arbitration rules provide that arbitrators must "take into account" trade usages[20]—that does not imply, however, that, when trade usages and provisions of the law chosen by the parties clash, the former prevail over the latter. Trade usage may at best be used to interpret or to fill gaps in the municipal law chosen by the parties.

But do the UNIDROIT Principles constitute trade usages?

It is not possible to equate the UNIDROIT Principles as a whole with trade usages.[21] The principal aim of the draftsmen was not to recollect existing trade usage, but rather to restate international law, choosing the option that, in the working group's opinion, was best suited for international trade. Consequently, all rules contained in the Principles do not *per se* meet the traditional test required for usages to be accepted as source of law (*"repetitio"* and *"opinio iuris"*); parties will have to prove and the Arbitrators accept in each case and for each rule contained in the Principles, that it reflects an accepted international trade usage.[22]

5. Inexistence of agreement regarding applicable law

If the parties have not agreed in their contract (or *ex post* in the course of the arbitration) to any substantive applicable law, or a submission to *lex mercatoria*, trade usage or principles of law, the burden of solving this fundamental issue must be shouldered by the arbitrators—in a interim award, like in our case, or in the final award on the merits.

The traditional methods followed by arbitrators for choosing the relevant municipal law is either to apply some choice of law rule which they deem reasonable, or to follow the *voie directe*, directly selecting the most appropriate legal system. The first is the more traditional approach, followed by the UNCITRAL Model Law (art. 28.2.) and the second the solution preferred by

[20]European Convention on International Commercial Arbitration, Article VII, 1; UNCITRAL Model Law art. 28.4.; art. 17.2. ICC Arbitration Rules; art. 33.3. UNCITRAL Arbitration Rules; the SCC Arbitration Rules lack any reference to trade usages.

[21]Fouchard/Gaillard/Goldman in note (13), 846.

[22]In ICC Cases 8873 (7.97.www.unilex.info) and 9029 (3.98.www.unilex.info), one party tried to invoke the provisions of the UNIDROIT Principles on hardship arguing that they were trade usages. In both cases this was refused by the Tribunal, which held that the Principles at the time and on this issue did not correspond to current practices in international trade. In ICC Case 8502 (11.96 www.unilex.info), however, the Tribunal accepted that the UNIDROIT Principles constitute trade usages. See also Farnsworth: "The Role of the UNIDROIT Principles in International Commercial Arbitration" in note (2), 26.

most contemporary arbitration rules, including those of the SCC.[23] In practice, however, the net result of both systems is very similar: the arbitrators will select one (or more) municipal laws to solve the substance of the dispute, on the basis that the dispute and that legal system have the closest connection.

Absent of any choice of law agreed by the parties, do arbitrators have the duty to select a municipal law, or can they decide to apply "general principles of international law", "UNIDROIT Principles", "*lex mercatoria*" or the like, without reverting to any specific "national law?".[24]

This question has been and still is one of the most contentious issues of international arbitration. It gave rise to the famous Norsolor case,[25] in which the arbitrators, in absence of an agreed applicable national law, based their award on *lex mercatoria*. Their decision was first overturned by the Vienna Court of Appeal, but then confirmed by the Austrian Supreme Court.[26]

The Norsolor Case was decided when the applicable arbitration rules (in that case art. 13.3. of the 1975 ICC Rules) still ordered arbitrators to designate the proper law by applying a rule of conflict. The situation in the meantime, however, has changed in order to clarify the powers of arbitrators and to avoid a repetition of cases like Norsolor. The change has been formalized by the acceptance, in most modern arbitration laws and regulations, of a French terminology: "rules of law" (*règles de droit*) as opposed to law (*loi*). The terminology was first used in 1981 in art. 1496 of the *Nouveau Code de procédure civile*, which stated that the parties were free to select the *règles de droit* applicable to their dispute, and *règles de droit* was unanimously construed as a reference to transnational rules and *lex mercatoria*.[27] The terminology was then accepted by various national laws[28] and arbitration rules, including the SCC Rules (art. 24) - but giving arbitrators different degrees of freedom as regards the liberty to use exclusively transnational law or *lex mercatoria* as the governing law.

The UNCITRAL Model Law, for example, only authorizes the application of rules of law when this is the agreement of the parties. If the choice has to

[23]Art. 24 SCC Rules: "... In the absence of such an agreement, the Arbitral Tribunal shall apply the law or rules of law which it considers to be most appropriate". See also art. 17.1. ICC Rules, art. 22.3. LCIA Rules.

[24]Assuming that the Arbitrators do not have powers to act as *amiable compositeur* or *ex aequo et bono*, in which case they are authorized by the parties not to base their decision on any municipal of law - see art. 24.3. SCC Rules.

[25]ICC Arbitration 3131; for an excellent summary see Craig/Park/Paulsson: "International Chamber of Commerce Arbitration", 3ed, (2000), 334.

[26]Supreme Court Austria, November 18, 1982 in (1983), Recht der Internationalen Wirtschaft, 29.

[27]Fouchard/Gaillard/Goldman in note (13), 802.

[28]Article 1054 Netherlands Code of Civil Procedure, article 187 Swiss Private International Law Statute; art. 28 UNCITRAL Model Law.

be made by the arbitrators, they are instructed to apply the law (*i.e.* the municipal law, not transnational law) determined by the conflict of law rules which the Tribunal considers applicable.[29]

The SCC Rules[30] give a different, more flexible solution. Art. 24 authorizes the use of "law or rules of law" both if there is agreement by the parties, or in the absence of such agreement. In this last situation, the Rules authorize the Tribunal to apply the "law or rules of law which it considers most appropriate." The same solution has been adopted by the 1998 ICC Rules and 1998 LCIA Rules.[31]

6. Valuation

In the present case, the parties had elected to have their arbitration governed by the SCC Rules, which give arbitrators the freedom to choose either a law which has a close connection with the case, a neutral law like the law of the seat of arbitration,[32] or to apply transnational law, either in its traditional non-codified version, or in any of its codified systems, like the UNIDROIT Principles.[33]

This is an important conclusion: from a strictly legal perspective, the decision taken by the Arbitrators is unimpeachable. Their decision to submit the substance of the case to a codification of transnational law, like the UNIDROIT Principles, and to subsidiarily apply a neutral law like the law of the seat, is a valid decision, fully covered by the wording of article 24 SCC Rules. No Court in any jurisdiction should be entitled to challenge the arbitrators' decision, or to deny enforcement of the award for this reason.[34]

Notwithstanding its legality, there is no denying that a number of authors have cautioned against arbitrators' decisions to base their findings exclusively on *lex mercatoria*, or UNIDROIT Principles, when the parties have not foreseen this possibility. The fear is that in many countries an award based

[29]The same rule is contained in Paragraph 1051 of the German ZPO, and in art. 834 Italian Code of Civil Procedure.

[30]Which are directly applicable, given that there is no Swedish law rule on this matter.

[31]Article 24.1. SCC Rules is particularly well drafted, since it explicitly refers twice to "laws" and "rules of law", thus clarifying beyond any doubt the exact meaning of both concepts. Art. 17.1. ICC Rules simply refers to "rules of law", art. 22.3. LCIA Rules follows the SCC drafting.

[32]Traditionally, English law has held that the decision to resort to arbitration in England is a strong indication that English law is to be preferred. In contemporary international arbitration the tendency is to give less importance to the choice of the seat of arbitration. But in absence of other relevant criteria, arbitrators may resort to this point of connection, as they did in ICC Case 2735, in (1977), 104, JDI, 947, with observations by Y. Derains.

[33]Other possible codifications are the Principles of European Contract Law (*"Lando Principles"*) or the almost 80 principles collected by Berger under www.tldb.de.

[34]The choice of law made by arbitrators can in general not be re-examined by Courts: see art. 34 UNCITRAL Model Law, and art. V, 1958 New York Convention; see also Fouchard/Gaillard/Goldman in note (13), 879.

exclusively on transnational law may be more prone to challenge and more difficult to enforce - that some jurisdiction may not accept the conclusion that the submission to the SCC Rules implicitly results in a broad authorization to the arbitrators to use the "rules of law" they see as most appropriate.[35]

In our case, the fact that the arbitrators have not chosen "transnational law," or "*lex mercatoria*" as a method to find applicable rules, but rather the codified UNIDROIT Principles, opens a further line of attack: that any specific article of the Principles applied by the arbitrators is not in accordance with general principles of law or usage over which there is an international consensus.[36] Besides, by choosing the UNIDROIT Principles rather than *lex mercatoria* or transnational law, the arbitrators have of course selected a list of rules, which by no means is exhaustive, instead of a source of law which provides a methodology to determine an unlimited number of applicable rules.

When confronted with the same factual situation as SCC Case 117/1999, arbitration case law seems to be split. There does not seem to be any precedent emanating from the Arbitration Institute of the Stockholm Chamber of Commerce, but there are a number of awards rendered in other arbitral institutions. Some of them have accepted a solution similar to the one adopted in our case,[37] but a majority seem to have given preference to municipal law.[38]

[35]Craig/Park/Paulsson in note (25), 337 caution that "arbitrators run the risk of doing mischief". P. Mayer in note (2), 112 argues that "there is reason to pause before encouraging arbitrators to declare the UNIDROIT Principles applicable on the sole ground that the parties have not included a choice of law clause in their contract".

[36]P. Mayer in note (2), 112, for example doubts whether the rules on hardship of the Principles (art. 6.2.1.) meet these criteria.

[37]ICC award 7375 (5.6.96 www.unilex.info), rendered in a situation where the parties had not agreed a substantive law, decided to apply General Principles, including UNIDROIT Principles, but only "as far as they can be considered to reflect generally accepted principles and rules"; in ICC award 9875 (01.99 www.unilex.info), also rendered in absence of choice of law provision, the tribunal decided to apply "*lex mercatoria*", including the UNIDROIT Principles. In both cases, the arbitrators decided to apply the UNIDROIT Principles not on their own, but in the context of a general application of *lex mercatoria* the decision is thus different from that adopted by arbitrators in SCC Case 117/1999. Www.unilex.info mentions various other awards from the ICC and the Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation, in which arbitrators decided to directly apply the UNIDROIT Principles. The full text of the awards is not available, and consequently the allegation cannot be verified.

[38]In many instances the issue of applying UNIDROIT Principles or *lex mercatoria* will not even arise, because parties do not bring it up. In those cases were the issue is addressed, a number of Tribunals have rejected the application of *lex mercatoria* or UNIDROIT Principles. In ICC Case 4650 (1987, XII Yearbook of Commercial Arbitration, 112) the Tribunal declined to accept *lex mercatoria*, in absence of agreement among the parties. In ICC Case 5835 (6.96 www.unilex.info) the arbitrators decided to apply domestic law, interpreted in accordance with the UNIDROIT Principles (and not to apply these Principles to the exclusion of domestic law); in ICC Case 9419 (9.98 www.unilex.info) the award denies the possibility of applying *lex mercatoria* / UNIDROIT

In our case, the Arbitral Tribunal was confronted with an especially difficult situation: the parties had not agreed any choice of law provision, not because of oversight, but rather because they probably could not reach an agreement.

The Arbitral Tribunal was also split: one Chinese co-arbitrator, a Swedish co-arbitrator and a Swedish chairman. The Tribunal was left with the options of applying Chinese, Luxembourg or Swedish law. The first two would have been a violation of the implied negative choice agreed upon by the parties. The option of Swedish law would have given an advantage to the Swedish co-arbitrator, and so was also not neutral. Given the drafting of art. 28 SCC Rules, the attractiveness of choosing a "rule of law" was evident. In this situation, the Tribunal opted for the certainty of the list, and rejected the more traditional solution of a general submission to "*lex mercatoria*" or "transnational law." This decision is based on an *a priori*: that all the provisions contained in the UNIDROIT Principles are *hic et nunc* rules of law; that is, they are accepted principles of transnational law—an opinion which is not shared by all commentators nor by other international arbitration awards.

The decision that, in the absence of a choice-of-law agreement among the parties, arbitrators may directly apply UNIDROIT Principles, although still contentious today, may in the future become an undisputed rule of law. The creation of transnational law has an element of self fulfilling prophecy: *lex mercatoria* and trade usages obtain the status of source of law through *repetitio* and *opinio iuris,* through the repetition in the application of a certain rule, and through the widely held conviction that the rule is binding. The arbitrators in our case are convinced that the UNIDROIT Principles *in toto* meet these criteria, are real "rules of law," embodiment of the *lex mercatoria*. If others follow this way of reasoning, their conviction may turn the Principles into binding rules of transnational law.

Yves Fortier has asked the question whether "creeping codification becomes a trend—or whether it means anything in practice."[39] This SCC case may become a trendsetter—a step towards a general acceptance that *lex mercatoria* in the 21st century means the "new, new *lex mercatoria*" embodied in flexible, private codifications like the UNIDROIT Principles.

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Principles as the law applicable to the substance, invoking art. VII of the Geneva Convention, which requires the arbitrator to apply a certain law (and not a rule of law).

[39]Y. Fortier: "The New, New *Lex Mercatoria*, or Back to the Future" (2001), 17 Arbitration International, 127.