INTERNATIONAL ARBITRATION LAW

BY EMMANUEL GAILLARD

General Principles of Law — More Predictable After All?

THE VALIDITY of choosing general principles of law — also frequently referred to as transnational rules or lex mercatoria — to govern an international contract is widely accepted in international commercial arbitration today.

Emmanuel Gaillard

In the first place, the parties to a contract may prefer not to have their contract governed by a particular national law and, instead, elect to have general principles of law apply. This option is now recognized in most legal systems to be binding on an arbitral tribunal. In the second place, it is increasingly accepted that an arbitral tribunal may choose to apply lex mercatoria when the parties are silent as to the governing law. As a result of the progressively more regular recourse to general principles of law in international contracts, general principles of law are becoming increasingly specialized and coherent in arbitral practice.

Critics of Lex Mercatoria

Lex mercatoria nonetheless remains a highly controversial subject, and still has a number of critics. The critics tend to reject the idea that general principles of law can constitute a genuine legal order in the same way as national laws or public international law. Their position is that general principles of law lack certain attributes of a genuine legal order, such as completeness, structure, an ability to evolve and predictability (see Emmanuel Gaillard, "Transnational Law: A Legal System or a Method of Decision-Making?", 17 ARB'N INT. 59 (2001)). On this last point of predictability, the criticism of lex mercatoria is that only a genuine legal system can offer a degree of certainty that is sufficient for a party to be able assess the likely outcome of any dispute that may arise. General principles of law, lacking this degree of certainty, would thus necessarily be unpredictable. The argument is often summarized by stating that if asked by an "ordinary businessman" what the lex mercatoria answer to a given issue would be, it would be almost impossible to provide a specific answer (see Rt. Hon. Lord Justice Mustill, "The New Lex Mercatoria: The First Twenty-Five Years," 4 ARB'N INT. 86 (1988)).

In practice, the case can be made that general principles of law offer as much predictability and, in some instances, even more predictability, than genuine legal systems. Conversely, the predictability of genuine legal systems, such as a national law, may sometimes prove to be more theoretical than real. A recent arbitral award, to date unpublished, rendered in 2001 by an arbitral tribunal sitting in Brussels, in ICC Case No. 10625/DB provides an interesting example of a situation where the parties' choice of a genuine legal order — Portuguese law — to govern their contract gave rise to a highly unpredictable result.

This arbitration concerned a dispute arising from the purchase of a turbo-generator plant by a Portuguese chemicals manufacturer from a French vendor. The purchase agreement was governed by Portuguese law. Following several failures of the plant, the Portuguese purchaser brought arbitral proceedings against the vendor, claiming damages for various losses resulting from being deprived of the use of the plant for a period of nearly eight months due to the breakdowns.

The respondent's defense turned on the presence in the purchase agreement of a limitation of liability clause. The respondent submitted that its sole duty under the purchase agreement was to repair any defects in the plant appearing during the warranty period, given that the parties had agreed to each bear any consequential losses under a provision of the contract stipulating that "neither party shall be liable for indirect loss or consequential damage unless caused by a deliberate act."

In its award on the merits, the arbitral tribunal found this limitation of liability clause to be null and void under Portuguese law. The arbitral tribunal noted that in most continental European laws of the civil law type, the parties to a contract may freely exclude or limit liability for breach of contract, provided the breach is not intentional or grossly negligent. Portuguese law on civil liability, however, evolved somewhat differently from other continental legal systems, and its Civil Code contains an Article 809 providing, in translation and in pertinent part, as follows:

> Waiver of rights of a creditor
>
> A clause is null and void according to which the creditor in advance waives any of the rights which are granted the creditor in the previous divisions in the case of non-performance or delay of the debtor.

Relying on Portuguese case law and published legal doctrine, the arbitral tribunal deduced from this provision that under Portuguese law, no party to a contract can, in advance, be exempted in any way from liability for breach of contract, regardless of whether that breach is intentional, grossly negligent or lightly negligent. The arbitral tribunal found the invalidity of limitation of liability agreements to be a mandatory rule of Portuguese law, restricting the freedom of contract of the parties in this respect.

A Legal Vacuum?

The respondent argued that the limitation of liability clause should nonetheless apply and submitted that, by allowing the limitation of liability clause to stand, the arbitral tribunal would be endorsing a better and more modern view of Portuguese law supported by a number of authors, which would bring Portuguese law into line with the law of other civil law countries. Noting that "the contract is not in a legal vacuum, it is inserted into Portuguese private law," the arbitral tribunal found that it "cannot decide the case on some sort of abstract contract interpretation," and rejected this approach, reasoning as follows:

> While the Arbitral Tribunal would not consider itself necessarily bound to follow the case law even of the highest court and a majority view of legal doctrine in each and every case, and it also holds considerable sympathy for the view that it is difficult to understand why it should be against public policy for a party to a contract to exclude in advance by agreement its liability for light negligence as is possible throughout the European continent, the Arbitral Tribunal does not believe that it

Continued on page 4

Emmanuel Gaillard *is head of the international arbitration group of Shearman & Sterling and managing partner of the firm's Paris office. He is also a professor of law at the University of Paris XII.* **Jenny Edelstein,** *an associate at the firm's Paris office, assisted in the preparation of this article.*
DISCLOSURE: *Shearman & Sterling represented one of the parties in the arbitral proceedings described in this article. However, the views expressed herein represent those of the author exclusively*

INTERNATIONAL ARBITRATION LAW

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Continued from page 3

would be right for it to initiate such an important and fundamental step in the development of Portuguese law which would have repercussions in innumerable contracts and liability insurance policies. It must apply Portuguese law as it now stands and leave it to the Portuguese legislature or possibly state courts to change it.

For this reason, the arbitral tribunal concluded that under Portuguese law, "the exclusion of liability pursuant to clause 19.1.10 and 22.3 of the Contract, is null and void, no matter how customary or normal it may otherwise be in international business," while acknowledging that the application of Portuguese law in this case had "far-reaching consequences." Indeed, the result under Portuguese law — the invalidity of the limitation of liability clause — had major financial implications in terms of the compensation due by the respondent. This result was also very unpredictable. It is highly unlikely that either party was aware of the invalidity of such a clause under Portuguese law, or else it quite simply would not have been included in the parties' agreement.

In fact, the arbitral tribunal points out in its award that the language of the contract was obviously not at all geared to Portuguese law, but appeared designed to work in the environment of English law or some other law of the Anglo-American type. The arbitral tribunal notes that much of the agreement was drafted at a time when the applicable law was expected to be the law of Sweden. In all likelihood, the decision that Portuguese law would govern the contract was taken at the last minute, as a concession on one side in exchange for some other benefit, but with no particular knowledge on either side of the particular idiosyncrasies of Portuguese law (which of course, although commonplace, is not necessarily advisable). From the viewpoint of one "ordinary businessman" in particular, the respondent in this arbitration, the result of this choice of law was entirely unforeseeable and rather undesirable. The author of this comment expresses no opinion regarding the merits of the contents of Portuguese law on this issue or any other, but merely notes that on the issue of limitation of liability clauses it is an atypical law.

General Principles

Had the arbitral tribunal applied general principles of law to this case — either following the parties' choice or on its own initiative in the event the parties had not selected a governing law — the result would certainly have been entirely different. Using the transnational rules method, on the basis of a comparative law analysis, the arbitrators would have to identify and apply the principles of law most widely recognized by the various legal systems of the world. As most legal systems recognize limitation of liability clauses, there would be no grounds for declining to enforce that provision in the purchase agreement at hand. Thus, the contract would apply as originally intended by the parties, which is necessarily the most predictable result, and the one with which an "ordinary businessman" would be the most comfortable.

Conclusion

A striking feature of arbitral case law is the remarkable consistency of the decisions reached by arbitral tribunals in spite of the diversity of the reasoning employed (see Fouchard Gaillard Goldman on International Commercial Arbitration 812 (1999)). In terms of predictability, it is by no means clear that arbitrators applying general principles of law are less predictable than arbitrators ruling on the basis of a national law, or even a national court applying a law other than its own law. With the development of lex mercatoria through arbitral case law, a coherent and predictable body of rules has emerged that are tailored to the needs of international commercial activity. In a poll of "ordinary businessmen," it would be interesting to see how many, after having read the case discussed above, would elect in a similar situation to have general principles of law apply to their contract.

New York Law Journal

"General Principles of Law – More Predictable After All?", *New York Law Journal*, December 6, 2001