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The Fatal Leviathan: A Hayekian Perspective of Lex Mercatoria in Civil Law Countries

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THE FATAL LEVIATHAN: A HAYEKIAN PERSPECTIVE OF *LEX MERCATORIA* IN CIVIL LAW COUNTRIES

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ABSTRACT

Who should create default commercial rules? Should they be created in a constructivist way or should they be created rather through a spontaneous order? Should Kelsen's positivism prevail in commercial law? Drawing on diverse libertarian literature, I will argue that, since courts do not play a dominant role in civil law countries and, more importantly, do not set precedents, default commercial rules should not be created by the legislator, but through the Lex Mercatoria.

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TABLE OF CONTENTS

I.Introduction 425
II.Why Shouldn't Default Commercial Rules Be Created By Legislatures 427
III.How Are Social Orders Created? 435
IV.Who Should Be in Charge of Creating of Creating Default Commercial Rules in Civil Law Countries? 441
V.What is *Lex Mercatoria* and Where Can We Find It? 448
VI.Example: How are Default Commercial Rules Created in Construction Law? 452
VII.Examples Of Default Commercial Rules of the Peruvian Civil Code that Contravene the *Lex Mercatoria* 454
A. Who provides or manufactures the materials for the execution of the works 454
B. Person in charge of approving the variations of the works 456
C. Verification of the works and potential claims of the principal in the future 458
D. Party that must assume the delivery and transportation costs 462
E. Number of installments that must be failed 463
VIII.What Default Rules Should Be Created Through the *Lex Mercatoria* and What Default Rules Should be Created by the State? 465
A. The universal acceptance of certain rules 466
B. The necessity of counting with general institutions of private law in order to allocate risks efficiently 467
IX.Arbitral Awards are the Source Par Excellence of *Lex Mercatoria* in the Peruvian Legal System 470
X.Conclusion 481
XI.Proposals 484

I. INTRODUCTION

Is the common law system better than the civil law system or vice versa? With respect to commercial law, while clearly both legal systems have advantages and disadvantages, the common law is much more efficient. In my view, this is partially explained by the fact that judges are better commercial rule creators than legislators or other lawmakers.[1]

As Professor Schwartz has suggested, there are two reasons why common law courts enjoy a comparative advantage in rule creation. First, these courts apply common law rules in several economic sectors.[2] Second, the courts cannot continue to apply a default commercial rule that merchants would reject because otherwise they would fill the gap with their own rule. Hence, a judicially created default commercial rule can only become part of the common law of contracts only if parties accept it.[3]

Much has been written in the common law about default rules.[4] Various legal academics in the common law tradition have answered every imaginable question related to this topic, including: (1) when should a rule be default; (2) what types of default rules should exist; and (3) who should create default rules?[5] By contrast,

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[1] *See* Alan Schwartz & Robert E. Scott, *The Common Law of Contract and the Default Rule Project,* 102 VA. L. REV. 1523, 1526 (2016) (affirming the notion that "the common law is a better institution than the private law-making bodies for creating contract law defaults that contracting parties will accept.").

[2] *Id.* at 1530.

[3] *Id.* at 1530–31.

[4] *See generally* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, YALE L.J. 87 (1989) (Faculty Scholarship Series); RICHARD POSNER, ECONOMIC ANALYSIS OF LAW (1986); Omri Ben-Shahar, *A Bargaining Power Theory of Default Rules*, COLUM. L. REV. 400, 400–01 (2009); Douglas Baird & Thomas Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, VAND. L. REV. 829, 835–36 (1985).

[5] Professors Schwartz and Scott have explained how are default commercial rules created in the common law. In this sense, Schwartz and Scott have synthesized and affirmed in the abstract of their article that "[t]he common law developed over centuries a small set of default rules that courts have used to fill gaps in otherwise incomplete contracts between commercial parties. These rules can be applied almost independently of context . . . When parties in various sectors of the economy write sales contracts but leave terms blank, courts fill in the blanks with their own rules. As a consequence, a judicial rule that many parties accept must be "transcontextual": parties in varied commercial contexts accept

in civil law countries, the legal writing on default rules are conspicuous in their absence; virtually nothing has been written.[6] Latin American universities teach that default rules must exist because they reduce transaction costs, but nothing else. It is not clear when, how or who should create these rules.

Despite the above considerations, civil law countries have legislated an immense number of default rules on commercial law ("default commercial rules"). Review of the Civil Codes and sectoral laws of these countries indicates that legislators have created thousands of default commercial rules through which they have allocated risks arbitrarily without the information necessary to do so.[7]

This paper will answer the following question: Who should create the majority of default commercial rules in civil law countries?[8] Some scholars believe that filling the gaps is one of the most important duties of legislators.[9] I will question that belief.

Drawing on diverse libertarian literature, I will argue that default commercial rules should not be created by the legislator, but through the *Lex Mercatoria,* because courts do not play a dominant role in civil law countries and, more importantly, do not set precedents.

The Article proceeds as follows: In the first section I will explain why legislators should not be responsible for creating default commercial rules. Then, I will explain how social orders are created. The third section will explain the origin of the *Lex Mercatoria* and the praxeological process by which default commercial rules are created. I will then illustrate how default commercial rules are created in the construction sector. Afterwards,

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the courts' rule by writing contracts that contain just the gap the rule could fill." Schwartz & Scott, *supra* note 1, at 1523.

[6] Upon knowledge, the only important article that is available about default rules in Latin American universities is: Ian Ayres & Robert Gertner, *Cubriendo Vacíos en Contratos Incompletos: Una Teoría Económica sobre Reglas Supletorias* [*Covering Gaps in Incomplete Contracts: An Economic Theory about Supplementary Rules*] 43 THĒMIS L.J. 195 (2003).

[7] *See infra* Section XI.

[8] In answering this question, this article will not seek to demonstrate who should create penalty or sticky default commercial rules.

[9] *See generally* Schwartz & Scott, *supra* note 1, at 1525.

I will share some examples of default commercial rules of the Peruvian Civil Code that contravene the *Lex Mercatoria*.

The seventh section will propose some parameters for determining when a default rule should be created by the State and when through the *Lex Mercatoria*. I will then explain why arbitral awards are the source par excellence of *Lex Mercatoria* in the Peruvian legal system. In the penultimate section I conclude and finally I briefly explain my proposals.

II. WHY SHOULDN'T DEFAULT COMMERCIAL RULES BE CREATED BY LEGISLATURES

Commercial law is the body of law that regulates the conduct of merchants engaged in commerce and trade. By contrast, civil law is the branch of law that regulates the legal relationships between privates. For the purposes of this paper, I will differentiate default civil rules and default commercial rules while acknowledging that it is difficult to draw a sharp boundary between them.[10]

One example of a default civil rule is the fact that a promisor is only liable for damages foreseen or which could have reasonably been foreseen (by both parties) at the time when the agreement was made. Such a civil default rule applies to any kind of contract. This rule can be applied almost independently of context.[11]

By contrast, in the framework of a construction contract, it is a default commercial rule that the contractor must, whenever required

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[10] In fact, our concept of default civil rules is very similar to the concept of transcontextual default rules used by Professors Schwartz and Scott. In this regard, they have argued that "[t]he Anglo-American nineteenth-century contract law contained relatively few default rules and these rules had a particular character: they could be applied almost everywhere. Thus, the rule that an acceptance had to mirror the offer could be applied just by comparing the offer and the acceptance, whatever the content of those communications . . . [b]ecause the law was a set of defaults, a rule could exist through time only if later parties in different contexts than the one that constituted the originating case accepted it. Therefore, enduring common law rules have to be transcontextual; that is, they must be satisfactory to parties over broad sections of the economy. The common law of contract has few default rules because few rules can satisfy the structural requirement that they are (almost) everywhere applicable just because commercial parties (almost) everywhere like them. Schwartz & Scott, *supra* note 1, at 1585–86.

[11] *Id.* at 1523.

by the engineer, submit details of the arrangements and methods which the contractor proposes to adopt for the execution of the works. This default commercial rule applies only to construction contracts.

Since commercial law applies to the professional activity of merchants, default commercial rules inevitably allocate risks. In short, while default civil rules create civil law general institutions, default commercial rules tend to allocate risks in contracts of various economic sectors.[12]

In the Civil Codes existing in countries with a civil law tradition, it is possible to find a large number of default commercial rules. In fact, after a general section on contract law that includes provisions on contract formation, interpretation, remedies, force majeure, hardship, fraud, duress and more, Civil Codes tend to include specific sections for sale contracts, lease contracts, supply contracts, and construction contracts, among others.[13] These sections include

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[12] Professors Schwartz and Scott have differentiated contextual default rules from transcontextual default rules. However, this differentiation is basically the same that we do. Transcontextual default rules are usually civil default rules; while contextual default rules are usually default commercial rules. In this regard, Professors Schwartz and Scott have stated that "[t]he second distinction we make is between 'contextual' rules and standards and 'transcontextual' rules and standards. In this Article, a 'context' is an economic environment populated by agents with the same or similar contracting preferences. A context may be as small as the parties to a particular contract, but commonly is larger. For example, parties that trade wheat use contracts with the same or similar delivery terms and storage requirements. Hence, the wheat trade is a 'context . . . [T]he term requiring notice of defects within a specified time is contextual because parties in different industries likely would choose different periods within which to make claims. An efficient notice term turns on how easy a defect is to discover, the nature of the goods, the seller's ability to repair or replace, and similar factors. Thus, because wheat is perishable while machines are not, the contract term requiring notice of a defect commonly differs between the wheat context and machine contexts." *Id.* at 1527.

[13] It is enough to review the Civil Codes of Latin American countries or the UNIDROIT Principles to notice that this is the way in which these normative texts are usually structured. Schwartz and Scott explain that in the common law there are a few numbers of transcontextual rules such as "the rules of offer and acceptance, conditions, impossibility, expectation damages, foreseeability, and indefiniteness . . . Such doctrines include fraudulent and innocent misrepresentation, fraudulent nondisclosure, unilateral and mutual mistake, and specific performance and other injunctive relief, as well as equitable principles specifically designed to vitiate clear common law rules, including the penalty doctrine, the forfeiture doctrine, and the doctrines specifically inviting the court

hundreds of default commercial rules by which technical risks are allocated to one party or the other.

If the legislators of Civil Codes were asked how they designed the default commercial rules, they would most likely answer that they simulated what the parties of such contracts would have wanted. In other words, the literature guides the drafters in this task primarily with the admonition to create rules that "the majority" of future parties would prefer.

The problem with these assertions is that they are grounded on a false premise. They are based on the idea that legislators are in a privileged position to create default commercial rules. However, why should it be assumed that legislators have sufficient information to determine what the majority wants? In fact, legislators are frequently unaware of merchants' needs. It is worth recalling that the creation of these default rules usually requires highly specialized, technical knowledge. In effect, legislators should not be entitled to create default rules that the majority of merchants would prefer unless they were default civil rules.[14]

Nowadays there is such a diversity of contracts that if legislators want to legislate in order to respond to the merchants' needs in every single economic sector, they would have to create a Civil Code with thousands, perhaps millions of rules. In this regard, Schwartz and Scott have affirmed that:

> Because most contract terms are contextual, it follows that default *rules* that substitute for those terms must be contextual as well. As a consequence, the Restatement and UCC drafters would have had to create a large number of contextual rules for many contracting problems. For example, had the UCC attempted to regulate notice-of-breach issues with *rules*, the drafters would have been required to create a menu of rules governing notice, each of which would have solved the problem of choosing an efficient notice period for a particular context or for similar contexts. It may be apparent, and it is our claim, that drafters could not then and cannot now create efficient defaults such as these. The UCC and the Restatement apply to the entire U.S. economy. There are so many contexts in this economy that the drafters could not access the necessary context information (what is maximizing for parties that transacted in

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to rely on the factual context of the particular dispute in derogation of the common law rules of interpretation." *Id.* 1540–41.

[14] *Id.* at 1554.

> context *X* may not have been maximizing for parties that transacted in context *Y*); nor could the drafters, even if well informed, create the very large number of rules that parties functioning in these contexts would require.[15]

In civil law countries, default commercial rules proliferate rapidly in an almost uncontrolled fashion. Legislators, who lack the necessary technical background, are charged with allocating risks through default commercial rules. These rules lack technical rationality. Cases abound in economic sectors such as construction, energy, mining, finance, and many others.[16] Even in sale and lease contracts, the risk allocations made by the legislator are unsustainable in commercial practice. [17]

Legislators should not have the responsibility of creating default commercial rules. They lack enough information to adopt such decisions; therefore, they do not have the legitimacy to fulfill such an important task. Even in the common law, the drafters implicitly recognized the difficulty of creating efficient default rules, and proposed few rules for the Second Restatement of Contracts and the UCC.[18]

Conferring the power to make default commercial rules upon the legislator is an absurdity. For example, it is taken for granted that lawmakers are in a privileged position to allocate risks in an energy contract, to determine who should be liable under certain breaches in a long-term construction contract, to decide who should assume a risk under a contingency not foreseen in a share purchase agreement, and to distribute risks in a thousand other extremely technical scenarios. In my view, the legislator is frequently in a very poor position to adopt such decisions.

Legislators are not intelligent enough to decide how risks should be allocated in contracts of different economic sectors. It is simply humanly impossible for a single individual (or even group of individuals) to store the information that is derived from the millions of transactions that are executed every day.

As explained by Schwartz and Scott: "[t]he inability of

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[15] *Id.* at 1528 (emphasis in original).
[16] *See infra* Section XI.
[17] *Id.*
[18] Schwartz & Scott, *supra* note 1, at 1526.

drafters to create contextual defaults explains both phenomena . . . The drafters have no fact-finding arm; they cannot hold hearings or call expert witnesses. Nor do drafters have the resources to retain experts or commission studies."[19]

As Hayek points out in *The Use of Knowledge in Society*, knowledge is dispersed among thousands of individuals who cast votes every time they enter into a contract with particular clauses. By means of these votes, they reveal how risks should be allocated in a specific economic sector.[20]

In Hayek's words:

> Concerning our modern economic system, understanding of the principles by which its order forms itself shows us that it rests on the use of knowledge (and of skills in obtaining relevant information) which no one possesses in its entirety, and that it is brought about because individuals are in their actions guided by certain general rules. Certainly, we ought not to succumb to the false belief, or delusion, that we can replace it with a different kind of order which presupposes that all this knowledge can be concentrated in a central brain, or group of brains of any practicable size.[21]

Hence, those who have the information and legitimacy to allocate risks efficiently in contracts are trade operators whose commercial practices are in widespread use. They know better than anyone their own interests and expectations. As we will see in a later section, these generalized practices of merchants constitute *Lex Mercatoria*.

While legislators typically do not have sufficient information to choose the rule that is preferred by merchants, one can imagine a hypothetical situation in which the legislator guessed the correct default commercial rule. In this case, the rules chosen will likely soon become outdated, since the needs of merchants vary much faster than it is possible to imagine. The cost of amending statutes makes matters even worse. When it comes to the distribution of risks of all economic sectors, while commerce progresses at full speed, State imposed rules remain stagnant for

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[19] *Id.* at 1569.

[20] Friedrich A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 520 (1945) [hereinafter *The Use of Knowledge in Society*].

[21] F. A. HAYEK, NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS AND HISTORY OF IDEAS 13 (1978) [hereinafter NEW STUDIES].

years.

For example, the share purchase agreement that two parties can engage in today is not the same as the one that was available 10 years ago. Model contracts and the *Lex Mercatoria* continually change to adapt to the new needs and expectations of merchants, and the law must be sufficiently flexible to adapt and provide immediate and effective responses to these new demands.

The UNIDROIT Principles are the best example of the changing character of commercial law: They were drafted in 1994, modified in 2004 and 2010, and have again recently been modified in 2016. They have continually evolved to respond effectively to the changing needs and expectations of trade operators.

For instance, the Governing Council of UNIDROIT realized a few years ago that the UNIDROIT Principles of 2010 did not provide an effective response to long-term contracts, so they reacted immediately and began working on a new edition that was approved a few years later. Along these lines, the introduction of the UNIDROIT Principles of 2016 expressly states the following:

> The 2016 edition of the UNIDROIT Principles is not intended as a revision of the previous editions. As amply demonstrated by the extensive body of case law and bibliographic references on the UNILEX database . . . the UNIDROIT Principles continue to be well received generally and have not given rise in practice to any significant difficulties of application. The main objective of the fourth edition of the UNIDROIT Principles *is to take better into account the special needs of long-term contracts.*[22]

Despite being a text that includes general rules and principles, it remains in constant evolution. If this happens with the UNIDROIT Principles, the sectoral rules by which risks are allocated must be flexible and adapt without any major obstacles to the new demands of commerce. Since by their very nature they are dynamic, these rules cannot be permanent.

Thus, if the needs of the merchants change, the rules that respond to these needs must also change. However, when these needs are regulated by State-rules, the possibility of amending the rules to commercial practice is extremely costly.

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[22] *Overview,* UNIDROIT, https://www.unidroit.org/unidroit-principles-2016/unidroit-principles-2016-over (last visited June 27, 2019) (emphasis added).

Amending a Civil Code is a very complicated task, involving a heavy dose of political negotiation. There have been several attempts to modify the Peruvian Civil Code, all of them frustrated. This has a very simple explanation: The attempts to change legislation constitute authentic litigation in which there are many political interests, so it is very difficult to reach a consensus. The rule may be totally outdated and still remain in force because there are political interests involved. In the words of Professor Neely: "Efforts to change existing laws can be characterized as 'disputes,' but they are political disputes rather than the factual disputes that courts are theoretically in business to resolve."[23]

The best example of this problem is the Peruvian Civil Code. It is obvious that we no longer live in 1984, the date in which the Peruvian Civil Code was enacted. Obviously, the rules designed in 1984 do not respond effectively to the myriad of situations that may arise today. The reality is quite different today.

Thus, this Civil Code includes plenty of default commercial rules for accommodation contracts, custodian contracts, bailment contracts, and others. These contracts are rarely executed today, as such, the default rules of the Civil Code that regulate this contract are factually derogated. However, since the Peruvian Civil Code hasn't been amended for more than 35 years, these provisions remain, despite the societal changes that have occurred.

By contrast, the contracts that are executed more frequently today, such as energy contracts, leasing contracts, financing contracts, and more, are not contemplated in the Peruvian Civil Code. Nevertheless, judges and arbitrators have never had problems in resolving disputes that arise from such contracts. They apply the *Lex Mercatoria* for any situation that has not been foreseen by the parties.

The most serious situations, however, occur with the provisions for sale contracts and construction contracts that are regulated in the Peruvian Civil Code. As mentioned previously, these provisions were enacted in 1984, so obviously, with the changes over the past 35 years, the provisions do not satisfy the current needs and expectations of merchants. The problem is, although these rules are divorced from our current commercial

[23] RICHARD NEELY, WHY COURTS DON'T WORK 167 (1983).

reality, judges and arbitrators must apply them to any controversy.

Given the drastically changing commercial reality, it is indeed arbitrary to apply these rules. It is well-known that the construction sector is very dynamic, so the needs of merchants in this economic sector change all the time. Consequently, the default construction rules that governed contracts 35 years ago cannot be the ones that govern today's construction contracts. Unbelievably, this is what actually happens in Peru. Hence, in many occasions the risk allocations of the default commercial rules do not respond to what the parties want, but instead respond to what the parties don't want.

When the legislators of the Peruvian Civil Code designed the sale contract rules, the legislative intent pertained to real-estate contracts. 35 years later, however, judges and arbitrators have to apply these default commercial rules to share purchase agreements. This method is completely irrational. The worst part is, some of these outdated rules are mandatory, so the parties are not entitled to contract around them.

Construction projects have changed drastically over the last 35 years. In the field of *Lex Mercatoria,* it is often said that *Lex Constructionis* (*i.e.*, *Lex Mercatoria* applied to construction) is in constant evolution. FIDIC (Fédération Internationale Des Ingénieurs-Conseils or in English, International Federation of Consulting Engineers) model contracts, for example, are continually modified. It is illogical, therefore, to create state rules that allocate risks in the construction sector. Inevitably, the new needs of trade will demand new default rules, and the provisions of the Civil Code will be serious obstacles to commercial traffic.

The needs of merchants change much faster than it is possible to imagine. Obviously, it does not make sense that default commercial rules should be modified in a closed room by legislators. It is inexcusable that the commercial rules by which risks are allocated remain the same 35 years later.

Designing a State rule by which risks are allocated to one side or the other is to create a keyless padlock that will remain closed for years. By contrast, the advantage of *Lex Mercatoria* over any State rule is that it can easily be adapted to the new expectations of merchants. It is flexible by nature. The legislator has to let the *Lex Mercatoria* do its job.

III. HOW ARE SOCIAL ORDERS CREATED?

Praxeology is not exactly a science, but rather a methodology that studies the logical structure of human action.[24] In this regard, it focuses its analysis on individuals and assumes as a premise that human beings exhibit perfect rationality.[25]

Although the term "praxeology" was first used by the German philosopher Clemens Timpler, it is often associated with intellectuals of the Austrian school of economics, such as Mises and Hayek.[26] Both authors explain that the actions of individuals interested only in their own welfare, even though they are not deliberately trying to do so, ends up creating social orders.

The structures formed by traditional human practices are neither natural in the sense of being genetically determined, nor artificial in the sense of being the product of intelligent design. They are the result of a process of winnowing or sifting, directed by the differential advantages gained by groups from practices adopted for some unknown and perhaps purely accidental reasons.[27]

Mises and Hayek argue that social orders are accidentally self-generated. They do not appear as a result of a natural need, nor as an arbitrary product of society. Social order is not a deliberate plan of designers with poor information.[28] The Austrian school of economics claims that the spontaneous appearance of order arises from an

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[24] In that sense, Mises states that "the field of our science is human action, not the psychological events which result in an action. It is precisely this which distinguishes the general theory of human action, praxeology, from psychology. The theme of psychology is the internal events that result or can result in a definite action. The theme of praxeology is action as such." LUDWIG V. MISES, A TREATISE ON ECONOMICS: HUMAN ACTION 11–12 (The Scholars ed., 1998).

[25] *See* NEW STUDIES, *supra* note 21, at 5.

[26] MISES, *supra* note 24, at 20. In this regard, Mises states that "[o]ut of the political economy of the classical school emerges the general theory of human action, *praxeology*. The economic or catallactic problems are embedded in a more general science, and can no longer be severed from this connection. No treatment of economic problems proper can avoid starting from acts of choice; economics becomes a part, although the hitherto best elaborated part, of a more universal science, praxeology." *Id*. at 3.

[27] *See* 2 FRIEDRICH A. HAYEK, LAW, LEGISLATION AND LIBERTY: THE MIRAGE OF SOCIAL JUSTICE 155 (1998) (mentioning the essay "The Three Sources of Human Values") [hereinafter LAW, LEGISLATION AND LIBERTY].

[28] MISES, *supra* note 24, at 36.

apparent chaos, a notion which may at first seem counterintuitive.

With respect to praxeology, Hayek has stated that:

> It must suffice for the moment to show that this constructivist interpretation of social formations is by no means merely harmless philosophical speculation, but an assertion of fact from which conclusions are derived concerning both the explanation of social processes and the opportunities for political action. The factually erroneous assertion, from which the constructivists derive such far-reaching consequences and demands, appears to me to be that the complex order of our modern society is exclusively due to the circumstance that men have been guided in their actions by foresight – an insight into the connections between case and effect – or at least that it could have arisen through design. What I want to show is that men are in their conduct *never* guided *exclusively* by their understanding of the causal connections between particular known means and certain desired ends, but always also by rules of conduct of which they are rarely aware, which they certainly have not consciously invented, and that to discern the function and significance of this is a difficult and only partially achieved task of scientific effort.[29]

Like Adam Smith's invisible hand, the Austrian school of economics argues that social order is not created deliberately, but, on the contrary, accidentally. In this regard, Menger proposed that the origin, formulation and the ultimate process of all social institutions including law are essentially the same as the "spontaneous order" Adam Smith described for markets.[30]

Markets guided by Smith's invisible hand coordinate interactions, and so does customary law. These systems develop because, through a process of trial and error, it is found that the actions they are intended to coordinate are performed more effectively under one institutional arrangement or process than under another. The more effective institutions and practices replace the less effective.[31]

Consequently, social orders are not created in a planned way,

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[29] NEW STUDIES, *supra* note 21, at 6–7 (emphasis in original).

[30] *See generally* ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF WEALTH OF NATIONS (1937) (discussing the improvement in productive powers of labour of nations).

[31] Bruce L. Benson, *The Spontaneous Evolution of Commercial Law*, 55 S. ECON. J. 644, 644 (1989).

but rather through spontaneous order.[32] As explained by Hayek:

> By "order" we shall throughout describe a state of affairs in which a multiplicity of elements of various kinds are so related to each other that we may learn from our acquaintance with some spatial or temporal part of the whole to form correct expectations concerning the rest, or at least expectations which have a good chance of proving correct.[33]

The example par excellence of a social order created spontaneously is language. No central body created language.[34] The thousands of languages and dialects that exist in the world were created through a spontaneous process. In Hayek's words:

> We need merely to consider language, which today nobody still believes to have been 'invented' by a rational being, in order to see that reason and civilization develop in constant mutual interaction. But what we know no longer question with regard to language (though even that is comparatively recent) is by no means generally accepted with regard to morals, law, the skills of handicrafts, or social institutions. We are still too easily led to assume that these phenomena, which are clearly the results of human action, must also have been consciously designed by a human

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[32] 3 LAW, LEGISLATION AND LIBERTY, *supra* note 27, at 158. In that sense, Hayek has stated that "what on an earlier occasion I have called the twin concepts of evolution and spontaneous order enables us to account for the persistence of these complex structures, not by a simple conception of one-directional laws of cause and effect, but by a complex interaction of patterns which Professor Donald Campbell described as 'downward causation.'" *Id.*

[33] 1 LAW, LEGISLATION AND LIBERTY, *supra* note 27, at 36 (emphasis omitted).

[34] In this regard, Menger has stated that "it might be pointed out that other social institutions, language, law, morals, but especially numerous institutions of economy, have come into being without any express agreement, without legislative compulsion, even without any consideration of public interest, merely through the impulse of individual interests and as a result of the activation of these interests. The organization of the traffic in goods in markets which recur periodically and are held in definite localities, the organization of society by separation of professions and the division of labor, trade customs, etc., are nothing but institutions which most eminently serve the interests of the common good and whose origin seems at first glance to be based necessarily on agreement or state power. They are, however, not the result of agreement, contract, law, or special consideration of the public interest by individuals, but the result of efforts serving individual interests." 3 CARL MENGER, INVESTIGATIONS INTO THE METHOD OF THE SOCIAL SCIENCES 157 (Louis Schneider, ed., 1985) (emphasis omitted).

> mind, in circumstances created for the purposes which they serve – that is, that they are what Max Weber called *wert-rationale* products. In short, we are misled into thinking that morals, law, skills and social institutions can only be justified in so far as they correspond to some preconceived design.[35]

There are many other phenomena that have developed over time spontaneously.[36] In this regard, Hayek suggests that:

> Morals, religion and law, language and writing, money and the market, were thought of as having been deliberately constructed by somebody, or at least as owing whatever perfection they possessed to such design. This intentionalist or pragmatic account of history found its fullest expression in the conception of the formation of society by a social contract, first in Hobbes and then in Rousseau, who in many respects was a direct follower of Descartes . . . .
>
> Yet the basic assumption underlying the belief that man has achieved mastery of his surroundings mainly through his capacity for logical deduction from explicit premises is factually false, and any attempt to confine his actions to what could thus be justified would deprive him of many of the most effective means to success that have been available to him. It is simply not true that our actions owe their effectiveness solely or chiefly to knowledge which we can state in words and which can therefore constitute the explicit premises of a syllogism. Many of the institutions of society which are indispensable conditions for the successful pursuit of

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[35] NEW STUDIES, *supra* note 21, at 4 (emphasis in original).

[36] White explains that "[t]he concept of spontaneous order was not original with Menger, but he is unquestionably one of its major developers and expositors. The 'tradition of spontaneous order' in social thought, as Norman Barry has shown, is both long and rich. Yet if one name from each of the last three centuries could be chosen to exemplify the tradition, the names would be: Adam Smith, Carl Menger, and Friedrich A. Hayek. Before Smith there were noteworthy contributions to non-intentionalist social theory by Bernard Mandeville, David Hume, and Adam Ferguson. Smith is well known today for his simile likening spontaneous social ordering forces to an 'invisible hand,' of course, and for his explanation of how the division of labor is promoted by market forces stemming from the pursuit of self-interest. Between Smith and Menger valuable applications or extensions of the spontaneous order concept were made by the French economists Frederic Bastiat and Gustave de Molinari, by the British free banking advocates Thomas Hodgskin and Samuel Bailey, and by the sociologist Herbert Spencer." Lawrence B. White, *Introduction to the New York University Press Edition*, *in* INVESTIGATIONS INTO THE METHOD OF SOCIAL SCIENCES vii, xvi (Louis Schneider ed., 1985).

> our conscious aims are in fact the result of customs, habits or practices which have been neither invented nor are observed with any such purpose in view. We live in a society in which we can successfully orientate ourselves, and in which our actions have a good chance of achieving their aims, not only because our fellows are governed by known aims or known connections between means and ends, but because they are also confined by rules whose purpose or origin we often do not know and of whose very existence we are often not aware.[37]

This is typical of the evolution of life: the rules of transit, the market economy, the price system, money and even the existence of queues to enter a certain place.[38] "The brain is an organ enabling us to absorb, but not to design culture."[39] The evolution of millions of brains participating in the world is useful for absorbing cultural tradition, but distinct from a brain's biological evolution.[40]

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[37] 1 LAW, LEGISLATION AND LIBERTY, *supra* note 27, at 10–11.

[38] "The structures formed by traditional human practices are not artificial in the sense of being the product of intelligent design, but the result of a process of winnowing or sifting, directed by the differential advantages gained by groups from practices adopted by the differential advantages gained by groups from practices adopted by some unknown and perhaps purely accidental reasons." 3 LAW, LEGISLATION AND LIBERTY, *supra* note 27, at 155.

[39] *Id.* at 157 (emphasis omitted). But, it would be absurd to assume that we could ever ascertain all these particular facts. If at a given moment someone could know the sum total of all the particular facts, which are dispersed among the millions or billions of people living at the time, he may be in a position to bring about a more efficient order of human productive efforts than that achieved by the market. Science can help us to a better theoretical understanding of the interconnections. But, science cannot significantly help us to ascertain all the widely dispersed, rapidly fluctuating particular circumstances of time and place which determine the order of a great complex society. *Id.* at 173–74 (emphasis in original).

[40] *Id.* at 157. In this regard, Hayek has stated that "*Man did not adopt new rules of conduct because he was intelligent. He became intelligent by submitting to new rules of conduct.* The most important insight which so many rationalists still resist and are even inclined to brand as a superstition, namely that man has not only never invented his most beneficial institutions, from language to morals and law, and even today does not yet understand why he should preserve them when they satisfy neither his instincts nor his reason, still needs to be emphasized. The basic tools of civilization—language, morals, law and money—are all the result of spontaneous growth and not of design . . . Although the Left is still inclined to brand all such efforts as apologetics, it may still be one of the most important tasks of our intelligence to discover the significance of rules we

None of the examples mentioned above Rules of conduct were not created in a constructivist way. They were created spontaneously and could not have been created by an individual mind because these rules formed the basis for reason.[41] Hence, Hayek points out that "the reason for this is that the 'data from which the economic calculus starts are never for the whole society "given" to a single mind which could work out the implications, and can never be so given."[42] For instance, one of the most emblematic phrases of Hayek is "*We have never designed our economic system. We were not intelligent enough for that.*"[43]

In White's words:

> To exemplify the concept of a spontaneously evolved social institution Menger restates his own theory of the origin of money (pp. 152-155). This marvelous theory shows that the use of certain goods as money is not originally invented by the state or adopted by a conscious social agreement, but is arrived at through a natural convergence of self-seeking actions in a market setting. The same approach can be extended to explain the origins of advanced monetary institutions such as coinage, banknotes, checks, and clearinghouses. Menger identifies several other major institutions as undesigned or, "organic" in origin: language, law, morals, trade customs, professionalism, cities, and tribes (or primitive "states").[44]

Therefore, in order to explain the economic aspects of large social systems, I have to account for the course of a flowing stream, constantly adapting itself as a whole to changes in circumstances of which each participant can know only a small fraction, and for a hypothetical state of equilibrium determined by a set of ascertainable data.[45]

Thus, the peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make use never exist in

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never deliberately made, and the obedience to which builds more complex orders that we can understand." *Id.* at 163 (emphasis in original).

[41] *Id.* at 157.

[42] *The Use of Knowledge in Society*, *supra* note 20, at 519.

[43] 3 LAW, LEGISLATION AND LIBERTY, *supra* note 27, at 164 (emphasis in original).

[44] White, *supra* note 36, at xvii.

[45] 3 LAW, LEGISLATION AND LIBERTY, *supra* note 27, at 159.

concentrated or integrated form, but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess.[46]

This 'world 3', as Sir Karl Popper has called it, though at all times kept in existence by millions of separate brains participating in it, is the outcome of a process of evolution distinct from the biological evolution of the brain, the elaborate structure of which became useful when there was a cultural tradition to absorb. Or, to put it differently, mind can exist only as part of another independently existing distinct structure or order, though that order persists and can develop only because millions of minds constantly absorb and modify parts of it.[47]

As Hayek explains: "The conception of an already fully developed mind designing the institutions which made life in society possible is contrary to all we know about the evolution of man."[48]

As rightly stated by Professor Ferrero, there appears to be a solution to the problem, "that the elite of mankind acquire a consciousness of the limitation of the human mind, at once simple and profound enough, humble and sublime enough, so that Western civilization will resign itself to its inevitable disadvantages."[49]

In summary, we can conclude that social orders are created through a spontaneous order. As Ferguson points out, many human institutions "are the result of human action, but not the execution of any human design."[50]

IV. WHO SHOULD BE IN CHARGE OF CREATING OF CREATING DEFAULT COMMERCIAL RULES IN CIVIL LAW COUNTRIES?

If we believe that commercial law is generated externally to society; that is, if there is someone who gives order to society as the result of superior intelligence, authority or force, it is logical to assume that commercial law should be created monopolistically.

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[46] *Id.* at 519.

[47] *Id*. at 157.

[48] 1 LAW, LEGISLATION AND LIBERTY, *supra* note 27, at 17.

[49] GUGLIELMO FERRERO, THE PRINCIPLES OF POWER: THE GREAT POLITICAL CRISIS OF HISTORY 318 (1942).

[50] ADAM FERGUSON, AN ESSAY ON THE HISTORY OF CIVIL SOCIETY 122 (5th ed. 1767). In the same sense, Hayek has stated that "a large part of social formations, although the result of human action, is not of human design." *See* NEW STUDIES, *supra* note 21, at 5.

On the other hand, if we think that commercial law is not designed, but rather is developed praxeologically, we will inevitably conclude that commercial law should be created spontaneously.[51]

In my view, the formation of commercial law is not far from the formation of language, traffic rules, the market economy, the price system, money, and so on.[52] By contrast, *mutatis mutandi*, they are formed following the same process.

As one commentator noted:

> Commerce and commercial law have developed conterminously, without the aid of and often despite the interferences of the coercive power of nation-states because there is a mechanism in place. Commercial law itself is analogous to the price system in that it facilitates interaction and makes exchange more efficient . . . Commercial law develops directly from the market exchange process as business practice and custom evolves.[53]

As a popular French song said: how wise nature is, that makes rivers pass just below the bridges. The funny thing is that it's just the other way around. We have to stop thinking of the law as a bridge that some nameless engineer has built. Instead, we must

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[51] Enrique Ghersi, *El carácter competitivo de las fuentes del derecho*, 7 REVISTA DE ECONOMÍA Y DERECHO [J. ECON. & L.] 45, 50 (2010).

[52] In this regard, Menger states that "[i]f the theory of the 'organic origin' of law is to be more than an empty phrase, if the above problem is really to be solved, if we are actually to become clearly aware of the 'organic origin' of law as opposed to its social-pragmatic genesis, then, on the contrary, it is necessary for us to examine its nature. It is necessary to examine the course of the process by which law appears without positive legislation, that process which one can always call 'organic . . . ' MENGER, *supra* note 34, at 223–24 (Appendix VIII). "The special contents that law assumes in a concrete case, before legislation begins to shape them, depend on the particular conditions of the population from whose mind law originated. Directed in its original form toward assuring the most important and most general individual interests of the people of the nation, it broadens and deepens gradually with increasing intercourse and the growing insight of individuals into their interests. It is affirmed by custom and is shaken and finally altered by the change of those conditions to which it owes its origin. Certain conditions resulting from general human nature and thus appearing everywhere produce similar institutions of law everywhere by their nature, while tribal differences and variety of external conditions and mental spheres result in differences in law." *Id.* at 228–29.

[53] Benson, *supra* note 31, at 645.

think of the law as the river, which flows with all the impetus and irregularity of nature.

In the words of Leoni:

> People who ignore this fact ought to take seriously a couplet once sung in a cabaret in Montmartre:
>
> *Voyez comme la nature a en un bon sens bien profunds Á faire passer les fleuves justement sous les ponts.*
>
> (See how nature had the extreme good sense To make the rivers flow exactly under the bridges).[54]

Nevertheless, we have always lived under the paradigm that default commercial rules must be created in a constructivist way, so we have always believed that legislative production must be centralized and hierarchical.[55] Hence, Kelsen—the foremost precursor of constructivism with respect to the formation of commercial rules—coined the term "positive law," that is to say, "laid law."[56]

In words of Professor De Jesús:

> The most serious criticism comes from the supporters of traditional state positivism and conflicts of law. For these scholars . . . it is simply unacceptable to admit that a rule of law can have a private origin . . . a vast number of sectors of the economy [if not all] . . . have been witnessing an extraordinary proliferation of non-state rules of law contained in new practices, codes of conduct, new contracts, model contracts, doctrinal codifications and arbitral jurisprudence.[57]

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[54] BRUNO LEONI, FREEDOM AND THE LAW 50–51 (1961) (emphasis in original).

[55] In this regard, Hayek has stated that "it seemed to me necessary to introduce the term "constructivism" as a specific name for a manner of thinking that in the past has often, but misleadingly, been described as 'rationalism'. The basic conception of this constructivism can perhaps be expressed in the simplest manner by the innocent sounding formula that, since man has himself created the institutions of society and civilization, he must also be able to alter them at will so as to satisfy his desires or wishes. It is almost 50 years since I first heard and was greatly impressed by this formula." NEW STUDIES, *supra* note 21, at 49.

[56] HANS KELSEN, PURE THEORY OF LAW 15 (1967).

[57] Alfredo De Jesús O., *The Prodigious Story of the Lex Petrolea and the Rhinoceros Philosophical Aspects of the Transnational Legal Order of the*

There is absolutely no reason why commercial default rules should be designed by lawmakers in a closed room, while *Lex Mercatoria* has effective answers for all types of contingencies not foreseen in a given contract through non-State legal rules.[58] The idea that the State is necessary to create default commercial rules is a paradigm. Keep in mind that rules are social institutions that existed before the State had the competence to create them. Rothbard, for example, has stated that "the entire law merchant was developed, not by the State or in State courts, but by private merchant courts. It was only much later that government took over mercantile law from its development in merchants' courts."[59]

Thus, the idea that commercial default rules must be the product of the will of the legislator is a constructivist fallacy that collides head-on with the spontaneous process that characterizes its formation. Commercial law is neither artificial nor rationally designed.

In this regard, Hayek has stated that:

> To modern man, on the other hand, the belief that all law governing human action is the product of legislation appears so obvious that the contention that law is older than law-making has almost the character of a paradox. *Yet there can be no doubt that law existed for ages before it occurred to man that he could make or alter it* . . . In the form in which it is now widely held, however, namely that all law is, can be, and ought to be, the product of the free invention of a legislator, it is factually false, an erroneous product of that constructivist rationalism which we described earlier.
>
> *We shall later see that the whole conception of legal positivism which derives all law from the will of a legislator is a product of the intentionalist*

Petroleum Society, 1 TRANSNAT'L PETROLEUM L. INST. 1, 12 (2012).

[58] *See* HAROLD J. BERMAN, LAW AND REVOLUTION: THE FORMATION OF WESTERN LEGAL TRADITION 274 (1983); *see also* BRUCE L. BENSON, THE ENTERPRISE OF THE LAW: JUSTICE WITHOUT THE STATE 12 (1990) ("Law can be imposed from above by some coercive authority, such as a king, a legislature, or a supreme court, or law can develop 'from the ground' as customs and practice evolve. Law imposed from the top—authoritarian law—typically requires the support of a powerful minority; law developed from the bottom up—customary law—requires widespread acceptance.").

[59] MURRAY N. ROTHBARD, FOR A NEW LIBERTY: THE LIBERTARIAN MANIFESTO 283 (2nd ed. 2006).

> *fallacy characteristic of constructivism, a relapse into those design theories of human institutions which stand in irreconcilable conflict with all we know about the evolution of law and most other human institutions*.[60]

The debate between Kelsen and Hayek, when applied to the creation of commercial default rules, mirrors the inherent conflict between constructivism and spontaneous order. While Kelsen would argue that default commercial rules must be designed by the legislator, Hayek, by contrast, would argue that default commercial rules are formed progressively and spontaneously as a consequence of human action.

In that regard, Hayek attempted to show why legal positivism, with its belief that every legal rule must be derivable from a conscious act of legislation, and that all conceptions of justice are the product of particular interests, is conceptually and historically mistaken.[61] Thus, Hayek criticizes Kelsen stating that "[l]aw is thus for Kelsen a deliberate construction, serving known particular interests."[62]

In this regard, Hayek explains that:

> The logic of the positivist argument would be compelling only if its assertion that all law derives from the will of a legislator did not merely mean, as it does in the system of Kelsen, that its validity is derived from some act of deliberate will, but that its content is so derived. This, however, is factually often not the case. *A legislator, in trying to maintain a going spontaneous order, cannot pick and choose any rules he likes to confer validity upon them, if he wants to achieve his aim. His power is not unlimited because it rests on the fact that some of the rules which he makes enforceable are regarded as right by the citizens*, and the acceptance by him of these rules necessarily limits his powers of making other rules enforceable.[63]

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[60] 1 LAW, LEGISLATION AND LIBERTY, *supra* note 27, at 73 (emphasis added).

[61] *Id.* at 173–74.

[62] NEW STUDIES, *supra* note 21, at 18.

[63] 2 LAW, LEGISLATION AND LIBERTY, *supra* note 27, at 61 (emphasis added).

Thus, when the parties execute contracts and allocate risks recurrently in a certain way, they are casting votes. It is this constant vote of merchants repeated over time that determines the progressive formation of *Lex Mercatoria*. Through the execution of contracts, they are allocating risks to one side or the other. From an economic point of view, contracts are ultimately nothing more than the distribution of risks.

In Benson's words:

> The commercial sector is completely capable of establishing and enforcing its own laws.
>
> A second purpose is to illustrate that modern commercial law is, in fact, largely made by the merchant community despite governmental efforts to take over provision of such law. Commerce is an evolving process of interaction and reciprocity which is simultaneously facilitated by and leads to an evolving system of commercial law . . .
>
> In the case of customary commercial law, traditions and practice evolve to produce the observed spontaneous order.[64]

Since all merchants execute contracts and, consequently, cast votes, the decision as to how the risks of a given contract should be allocated is absolutely democratic. Through their actions, merchants create *Lex Mercatoria*. The latter, therefore, is not created in the same way in which a law is created. As Bullard states, "the lex mercatoria was and is created every day by merchants."[65] Fuller states that *Lex Mercatoria* "consists of reciprocal expectations that arise out of human interaction."[66] Therefore, it could best be defined as a language of interaction.

As Benson explains, commercial law is formed through a process of natural selection. When problems arise, the practices that are most efficient in facilitating the exchange displace those that are

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[64] Benson, *supra* note 31, at 644.

[65] Alfredo Bullard González, *Comprando justicia: ¿genera el mercado de arbitraje reglas jurídicas predecibles?* [*Buying Justice: Does the arbitration market generate predictable legal rules?*], 53 THĒMIS 71, 86 (2007) (trans. by Fabio Núñez del Prado Ch.).

[66] THE PRINCIPLES OF SOCIAL ORDER: SELECTED ESSAYS OF LON L. FULLER 673 (Kenneth L. Winston ed., 1981).

inefficient.[67] Hume explains that rules should be discovered through a method of trial and error, which is the most appropriate way of resolving conflicts.[68] As Hayek argues:

> The development of such rules will evidently involve a continuous interaction between the rules of law and expectations: while new rules will be laid down to protect existing expectations, every new rule will also tend to create new expectations. As some of the prevailing expectations will always conflict with each other, the judge will constantly have to decide which is to be treated as legitimate and in doing so will provide the basis for new expectations. This will in some measure always be an experimental process, since the judge (and the same applies to the law-maker) will never be able to foresee all the consequences of the rule he lays down, and will often fail in his endeavor to reduce the sources of conflicts of expectations. Any new rule intended to settle one conflict may well prove to give rise to new conflicts at another point, because the establishment of a new rule always acts on an order of actions that the law alone does not wholly determine. Yet it is only by their effects on that order of actions, effects which will be discovered only by trial and error, that the adequacy of the rules can be judged.[69]

Default commercial rules shouldn't be produced in a monopolistic and constructivist way, but rather spontaneously. These rules should be flexible and should evolve over time to adapt to the new needs and expectations of merchants.[70] As Rothbard states, *Lex Mercatoria* "[was] not decided arbitrarily by any king or legislature; they grew up over centuries by applying rational—and very often libertarian—to the cases before them."[71]

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[67] BRUCE BENSON, THE ENTERPRISE OF LAW: JUSTICE WITHOUT STATE 32 (1990).

[68] DAVID HUME, A TREATISE ON HUMAN NATURE 315 (David F. Norton & Mary J. Norton eds., 2011).

[69] 1 LAW, LEGISLATION AND LIBERTY, *supra* note 27, at 102.

[70] James Buchanan asked, "if government is dismantled how do rights re-emerge and come to command respect? How do 'laws' emerge that carry with them general respect for their 'legitimacy'"? He contended that collective action would be necessary to devise a social contract or constitution to define rights and to establish the institutions to enforce those rights. But collective action can be achieved through individual agreements, with useful rules spreading to other members of a group. *See generally* James M. Buchanan, *Before Public Choice*, *in* ANARCHY, STATE AND PUBLIC CHOICE 77, 77 (Edward Stringham ed., 2005).

[71] ROTHBARD, *supra* note 59, at 283.

In conclusion, default commercial rules should not be an invention of the legislature, but rather the result of a praxeological process. The constructivist and hierarchical structure of the design of commercial rules has harmed the development of commercial law and has frustrated the expectations of merchants.

V. WHAT IS *LEX MERCATORIA* AND WHERE CAN WE FIND IT?

There is no consensus regarding the definition of *Lex Mercatoria.*[72] However, there have been several attempts to define *Lex Mercatoria.*[73]

Berthold Goldman has defined *Lex Mercatoria* as "a set of general principles and customary rules spontaneously referred to or elaborated in the framework of international trade, without reference to a particular national system of law."[74] Julian Lew defines it as a "non-national or transnational commercial law [which] governs those aspects of international trade not regulated by some national law, and are applied by arbitrators."[75] Peter North defines *Lex Mercatoria* as "a set of legal rules not tied to the law of any country."[76] Bernardo Cremades and Steven Plehn describe the *Lex Mercatoria* as "a single autonomous body of law created by the international business community."[77] Ole Lando has defined *Lex Mercatoria* as customs and usages of international trade, to the rules of law which are common to all or most of the States engaged in international trade or to those States which are connected to the

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[72] Michael Mustill, *The New Lex Mercatoria: The First Twenty-Five Years, in* LIBER AMICORUM FOR THE RT. HON. LORD WILBERFORCE 149–51 (Ian Brownlie & Maarten Bos eds., 1987).

[73] *See* Vanessa L.D. Wilkinson, *The New Lex Mercatoria: Reality or Academic Fantasy*, 12 J. INT'L ARB. 103, 104 (1995).

[74] Berthold Goldman, *The Applicable Law: General Principles of Law – The Lex Mercatoria*, *in* CONTEMPORARY PROBLEMS IN INTERNATIONAL ARBITRATION 113, 116 (Julian DM Lew ed., 1987).

[75] Julian DM Lew, *Determination of Arbitrator's Jurisdiction and the Public Policy Limitations on that Jurisdiction*, *in* CONTEMPORARY PROBLEMS IN INTERNATIONAL ARBITRATION, *supra* note 74, at 231.

[76] PETER NORTH, PRIVATE INTERNATIONAL LAW PROBLEMS IN COMMON LAW JURISDICTIONS 109 (1993).

[77] Bernardo M. Cremades & Steven L. Plehn, *The New Lex Mercatoria and the Harmonization of the Laws of International Commercial Transactions*, 2 B.U. INT'L L.J. 317, 324 (1984).

dispute.[78] Finally, Vanessa Wilkinson states that *Lex Mercatoria* "incorporates the common customs and usages of the business community of each State, and, where there are gaps, supplements it with equity and creativity of the arbitrator."[79]

In my view, *Lex Mercatoria* is a normative activity permanently enriched by the activity of merchants, including contractual practices (e.g., standardized clauses, standard contracts, and general contracting conditions), model laws and arbitration jurisprudence--with aspirations to standardize commercial law. In this regard, the essential characteristic of *Lex Mercatoria* is its need to satisfy the expectations of merchants.

Professor De Jesús has pointed out, for example, that *Lex Petrolea—Lex Mercatoria* applied to the oil sector—is enriched by the following sources:

> Besides the creation of the ever evolving series of *best oilfield practices* at the origin of much of the transnational rules of the petroleum society, one could mention the rules arising from (i) the new contracts and clauses that have emerged from the evolution of transnational petroleum contracts; (ii) the standardization and institutionalization of some of those contracts and clauses by the practice and the works of professional associations; (iii) the publication of doctrinal codifications of rules potentially applicable to oil and gas contracts; and (iv) the works and reflections of both contract and investment treaty arbitral tribunals.[80]

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[78] Ole Lando, *The Law Applicable to the Merits of the Dispute*, 2 ARB. INT'L 104, 107 (2014).

[79] Wilkinson, *supra* note 73, at 104.

[80] De Jesús O., *supra* note 57, at 23. In this regard, Professor De Jesús has stated that "[t]he first principle is that these transnational rules are to be found or extracted from all the sources of law (state or non-state sources of law). These rules may be created by the petroleum society itself or incorporated from other legal orders. In this regard, they can either be created by industry practices, standards and usages or they can be incorporated from international conventions or doctrinal codifications (i.e. the Unidroit or Lando principles or the works of the Gandolfi and von Bar commissions). Members of the petroleum society, including arbitrators, may also incorporate general principles of law as transnational rules to the *Lex Petrolea*. Regarding the incorporation of general principles of the transnational legal orders, Professor Kahn affirms, for example, that when an arbitrator applies and incorporates a principle of law, he transforms it in a certain way, detaching it from its source which might as well be a national or an international legal order and transnationalizes it. The only requirement for their incorporation in the *Lex Petrolea* is that they meet the test of serving and

On the other hand, one of the most important sources of *Lex Mercatoria* is arbitral jurisprudence. The paradigm of confidentiality in arbitration has been relativized. Extracts of thousands of arbitral awards are published in multiple databases. To the extent that arbitrators decide quite frequently how the risks of a given contract should be allocated in complex and unprecedented situations, the awards constitute a privileged source of *Lex Mercatoria*, even more so when considering that arbitrators are specialists in commercial law and technical matters.

In this regard, Professor De Jesús has stated that:

> Unsurprisingly, an important example of this increasing interest on the *Lex Mercatoria* and transnational law can be found in the area of "international arbitration" – more appropriately referred to as "transnational arbitration." . . . . King & Spalding's Doak Bishop believes that arbitral awards involving petroleum issues have developed the beginnings of a *Lex Petrolea* that serves to instruct and regulate the international petroleum industry. In our opinion, the debate on transnational legal orders is no longer focused on whether or not they exist, but on their plurality and their content and methodology.[81]

Some specialists claim that *Lex Mercatoria* is formed by universal principles that can be applied to multiple diverse situations.[82] In my view, however, *Lex Mercatoria* is formed through the transactions that merchants execute every day. Through the latter, merchants decide to allocate risks in one way or the other, and *Lex Mercatoria* is formed organically.[83]

Lex Mercatoria, hence, cannot be defined as a pyramid with clearly established hierarchies, but as a network formed by a conglomeration of rules that are scattered in many places that come from different sources. Thus, if the old paradigm was represented

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satisfying the needs and interests of the transnational petroleum society. In short, transnational rules and transnational legal orders such as the *Lex Petrolea* are constantly enriched from all sources of law." *Id.* at 46 (emphasis in original).

[81] De Jesús O., *supra* note 57, at 20–21.

[82] This was argued by many French scholars in the Beaune Meeting titled "The New World Order of Economic Relations in the Light of Arbitral Jurisprudence" organized by the ICC International Court of Arbitration which took place on September 27, 2014.

[83] *See* De Jesús O., *supra* note 57, at 28–29.

by a pyramid (a pyramid of norms), the new paradigm is represented by a *network*, in which the pluralities of legal orders interact.[84]

The essential characteristics of *Lex Mercatoria* are the following:

A. Its meticulousness

Within the framework of a contractual relationship, innumerable complex controversies may arise that cannot necessarily be solved through the application of positive law. Sometimes the issues of these disputes are so complex that even the parties are unable to foresee their occurrence. Unlike state law, *Lex Mercatoria* usually has an answer for all these situations. As discussed above, to the extent that model contracts are the result of thousands of transactions, they are extremely detailed.

Lex Mercatoria reaches a level of meticulousness that Civil Code rules could never attain. Inevitably the latter satisfies better the needs and expectations of merchants.

B. Its universality

There is an invisible hand that makes the risk distributions of every single contract universal. In fact, if the clauses of an energy contract in Kenya are compared with those of a similar contract in the United States, the same contractual creature will be found.

Regardless of the country, the distribution of contractual risks tends to be virtually the same. In that sense, Professor De Jesús has stated that "[f]or some authors, *at least 80% of the contents of most transnational petroleum contracts include the same clauses*."[85]

C. Its sectorialization

Because *Lex Mercatoria* is sectorialized, there is no general framework. Instead, there is a specific *Lex Mercatoria* unique to each economic sector. Thus, there is a *Lex Constructionis,* for international construction law; a *Lex Petrolea,* laws for the international oil and gas sectors; a *Lex Informatica*, a body of transnational rules for the informatic sector; a *Lex Sportiva* for the

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[84] *See id.*

[85] De Jesús O., *supra* note 57, at 23 (emphasis added).

transnational sports sector, and so on. In short, *Lex Mercatoria* varies from industry to industry.

D. Its legitimacy

Having a system in which default commercial rules are created by virtue of *Lex Mercatoria* generates several positive externalities. Non-state legal rules are typically seen as legitimate by members of society. This is to be expected, considering that such rules were created by merchants. None of the latter could argue, therefore, that a rule is arbitrary.

E. Its effectiveness

Finally, *Lex Mercatoria* "is effective because it provides courts [and arbitrators] with repeated opportunities to apply their rules across contexts. And those opportunities exist because parties [only] accept the rules that can be applied in that way."[86]

VI. EXAMPLE: HOW ARE DEFAULT COMMERCIAL RULES CREATED IN CONSTRUCTION LAW?

One of the most illustrative examples mentioned by Professor De Jesús is the FIDIC contracts. Such contract models have become the standard model of construction contracts most used internationally.

The first edition of these contracts was published in 1957.[87] Since then, revisions and new versions of these contract models have been published.[88] It is worth noting that, in 1999, a whole new generation of FIDIC contracts was born that reflected the new demands arising from the growing internationalization of the engineering and construction sectors.[89]

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[86] Schwartz & Scott, *supra* note 1, at 1551.

[87] THE RAINBOW SUITE: THE 1999 FIDIC SUITE 1 http://fidic.org/sites/default/files/FIDIC-rainbow-suite-2012.pdf.

[88] *See generally id.*

[89] *Id.* at 1.

As a prestigious FIDIC specialist have noted:

> The FIDIC Books have been conceived for all types of infrastructure projects and include a multiplicity of services provided by contractors (designs, consulting, construction, operation, etc.). For practical purposes, FIDIC identifies its model contracts by colors (orange, red, yellow, silver, gold, green, white, among others). All contracts have the same structure: general conditions and specific conditions that allow the parties to include modifications and additions to these general conditions.[90]

In this regard, Salguero has stated that:

> Multiple advantages are derived from the utilization of the FIDIC books. Among others, we can mention the clear allocation of risks; the regulation of tests upon completion; the ways of solving nimbly controversies of a purely technical nature, and the causes for price revision and extension of deadlines. The consequence of this is that the negotiation of a construction contract is limited to the regulation of particular conditions in accordance with the specific nature of the latter, which implies greater agility in the development of construction projects.[91]

It could be argued that the FIDIC contracts are not examples of *Lex Mercatoria* because they provide model contracts that the parties can adopt. If they have already entered into a FIDIC contract and a contingency not foreseen in the contract arises, the reasoning goes, the same contract cannot be applied as *Lex Mercatoria*. This, however, is a partial analysis, for several reasons.

First of all, FIDIC contracts have reached such an incredible level of meticulousness that it is very unlikely that a contingency not foreseen by the parties in the contract arises. FIDIC has been developing over time since 1957, so it regulates virtually all situations that may arise. Still, even if an unprecedented situation arises, it would be absurd to believe that a contingency that has not been regulated in FIDIC will find an answer in a Civil Code.

In addition, it is worth mentioning that FIDIC contracts are

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[90] Jorge Salguero García, Los Contratos FIDIC [The FIDIC Contracts], *Escuela de Organización Industrial* [*School of Industrial Organization*] (Apr. 2, 2012), http://www.eoi.es/blogs/embacon/2012/04/02/los-contratos-fidic/ (trans. by Fabio Núñez del Prado Ch.).

[91] *Id.* (trans. by Fabio Núñez del Prado Ch.).

applied as *Lex Mercatoria* precisely in those cases in which the parties celebrated a construction contract that was not based on the FIDIC models. Thus, if a situation that is not foreseen in the contract arises, it would be much more efficient to apply the FIDIC clauses as *Lex Mercatoria* instead of arbitrary rules contained in a Civil Code. Such rules are divorced from reality and, in many cases, have not been amended for decades.

FIDIC contracts are *Lex Constructionis* par excellence. The FIDIC model contracts are nothing more than the result of a constant vote that the merchants have casted for construction contracts. FIDIC is the result of human action; of a spontaneous order that has determined that the model contracts are the most desirable way to distribute risks in construction contracts.

The fact that there are different types of FIDIC contracts identified by colors (orange, red, yellow, silver, gold, green, white, among others) reveals that merchants have diverse needs that must be satisfied differently. FIDIC, therefore, is an excellent example of how the *Lex Mercatoria* develops gradually over time.

VII. EXAMPLES OF DEFAULT COMMERCIAL RULES OF THE PERUVIAN CIVIL CODE THAT CONTRAVENE THE *LEX MERCATORIA*

In the following section I will share some examples of articles from the 2015 version of the Peruvian Civil Code (1984) that contravene the *Lex Mercatoria.* The Peruvian Code was originally drafted and published in Spanish. To my knowledge, there are no known scholarly and freely available English translations of the text. Therefore, as a native Spanish speaker, translations of all sections noted below are my own. Additionally, all italicized words within the Code are solely my emphasis and are not contained within the text of the Code unless otherwise noted. I will start with some examples from the construction field:

A. Who provides or manufactures the materials for the execution of the works

Obligation of the contractor
Article 1774º.- The contractor is obliged:

> . . .
>
> 2.- To give immediate notice to the *employer* of the defects of the floor *or of the poor quality of the materials provided by it*, if they are discovered before or in the course of the work and may jeopardize their regular execution.

Under the Peruvian Civil Code, the employer is in charge of providing the materials for the execution of the work. Certainly, this was the commercial practice for a long time, but it has not been like that for many years. At present, it is the contractor who has the obligation to provide or manufacture the materials for the execution of the works.

Thus, in the Conditions of Contract for Construction of the FIDIC Red Book (1999) ("FIDIC Red Book") there are many rules that suggest that in international construction practice it is the contractor who provides and manufactures the materials. Similarly, as with the Peruvian Code, any italicized words within the text is solely my emphasis and is not contained within the text of the Code unless otherwise noted:

> **1.1.5 Works and Goods**
>
> . . .
>
> **1.1.5.2** *"**Goods**" means* Contractor's Equipment, *Materials*, Plant and Temporary Works, or any of them as appropriate.
>
> **1.1.5.3** "***Materials**" means* things of all kinds (other than Plant) intended to form or forming part of the Permanent Works, including the supply-only materials (if any) *to be supplied by the Contractor under the Contract*.
>
> **4.1. Contractor's General Obligations**
>
> . . .
>
> *The Contractor shall provide the Plant* and Contractor's Documents specified in the Contract, and all Contractor's Personnel, *Goods*, consumables and other things and services, whether of a temporary or permanent nature, required in and for this design, execution, completion and remedying of defects.

7.1. Manner of Execution

The Contractor shall carry out the manufacture the Plant, the production *and manufacture of Materials*, and all other execution of the Works:

(a) in the manner (if any) specified in the Contract.

(b) in a proper workmanlike and careful manner, in accordance with recognized good practice, and

(c) with properly equipped facilities and non-hazardous Materials, except as otherwise specified in the Contract.

7.2. Samples

The Contractor shall submit the following samples of Materials, and relevant information to the Engineer for consent prior to using the Materials in or for the Works:

(a) manufacturer's standard samples of Materials and samples specified in the Contract, all at the Contractor's cost, and

(b) additional samples instructed by the Engineer as a Variation.

Each sample shall be labelled as to origin and intended use in the Works.

It is evident that Article 1774º of the Peruvian Civil Code creates a lot of confusion and is divorced from international commercial practice. This is understandable, considering that article 1774º was written more than thirty-five years ago.

B. Person in charge of approving the variations of the works

Prohibition to introduce variations
Article 1775º.- The contractor cannot introduce variations in the agreed characteristics of the work without the written approval of the principal.

Under the Peruvian Civil Code, the employer is in charge of approving the variations. This rule, nevertheless, is completely outdated. In 1984, when the rules of the Peruvian Civil Code were drafted, it was understood that the only participants of work contracts were the employer and the contractor. Today, however, construction contracts cannot be understood without the participation of the "Engineer."

In accordance to rule 1.1.2.4 of the FIDIC Red Book, "Engineer" has the following meaning:

> "**Engineer**" means the person appointed by the Employer to act as the Engineer for the purposes of the Contract and name in the Appendix to Tender, or other person appointed from time to time by the Employer and notified to the Contractor under Sub-Clause 3.4 [*Replacement of the Engineer*].

The relevance of the "Engineer" is so great, that in the current construction contracts that the FIDIC Red Book dedicates an entire section to regulate its rights, obligations, authority, as well as different aspects with respect its competences:

> 3. THE ENGINEER
>
> 3.1. Engineer's Duties and Authority
>
> 3.2. Delegation by the Engineer
>
> 3.3. Instructions of the Engineer
>
> 3.4. Replacement of the Engineer
>
> 3.5. Determinations

According to the FIDIC Red Book it is the Engineer who is in charge of approving the variations, either by an instruction or by a request for the Contractor to submit a proposal. Rule 13.1 of the FIDIC Red Book states the following:

> **13.1 Right to Vary**
>
> *Variations may be initiated by the Engineer* at any time prior to issuing the Taking-Over Certificate for the Works, either by an instruction or by a request for the Contractor to submit a proposal.
>
> The Contractor shall execute and be bound by each Variation unless the Contractor promptly gives notice to the Engineer stating (with supporting particulars) that the Contractor cannot readily obtain the Goods required for the Variation. Upon receiving this notice, the Engineer shall cancel, confirm or vary the instruction.
>
> . . .

Since this is the practice of international construction, it is easy to see how serious is the confusion created by having the

employer approving the variations.

To make matters worse, the Peruvian lawmaker has established an unreasonable additional requirement: The approval of the variations must be in writing. This rule is really harmful and costly considering that in the practice of international construction, the speed with which the contractor must execute the works often requires that the variations be approved orally.

C. Verification of the works and potential claims of the principal in the future

Verification of the work
Article 1778º.- The principal, before receiving the work, has the right to its verification. *If the principal neglects to proceed to it without just cause or does not communicate its result within a short time, the work is considered accepted.*

Responsibility of the contractor for destruction, vices or ruin
Article 1784º.- If in the course of the five years from its acceptance, the work is destroyed, totally or partially, or it presents evident danger of ruin or serious defects due to defect of the construction, *the contractor is responsible before the employer or his heirs*, provided that he notifies the contractor in writing within six months after the discovery.

Assumption of absence of contractor liability
Article 1785º.- The contractor bears no responsibility in the cases referred to in Article 1784, if it proves that the work was executed according to the rules of the art and in strict accordance with the instructions of the professionals who prepared the studies, plans and other necessary documents for the completion of the work, when they are provided by the principal.

All the above-mentioned rules—articles 1778º, 1784º, and 1785º of the Peruvian Civil Code—are outdated. The rules establish assumptions that are simply impossible in construction contracts of today.

With respect to article 1778º, the rule establishes the assumption that the employer neglects to proceed with the verification of the work without just cause or does not communicate its result. This is simply impossible. In the practice of modern construction contracts there is always a phase in which the employer take-over the works. Rule 10.1 of the FIDIC Red Book states:

> **10.1 Taking Over of the Works and Sections**
>
> Except as stated in Sub-Clause 9.4 [*Failure to Pass Tests on Completion*], the Works shall be taken over by the Employer when: (i) the Works have been completed in accordance with the Contract, including the matters described in Sub-Clause 8.2 [*Time for Completion*] and except as allowed in sub-paragraph (a) below, and (ii) a Taking-Over Certificate for the Works has been issued, or is deemed to have been issued in accordance with this Sub-Clause . . . .

At present, it is inconceivable that a construction contract in which this take-over phase is omitted. The works are always take-over by the employer. What is more, after the works are take-over, the employer always issues a certificate that demonstrates that the contractor has performed all its obligations. This suggests that it is absurd to have a rule in the Peruvian Civil Code that regulates the tacit acceptance of the works.

With respect to article 1784, this rule establishes the assumption that the contractor has to respond to the employer if, after five years from its acceptance, the work is destroyed, totally or partially, or it presents evident danger of ruin or serious defects due to defect of the construction. This assumption also contravenes the practice of international construction because, after the "Performance Certificate" is issued by the employer, the contractor is released from any responsibility.

In this regard, rule 11.9 of the FIDIC Red Book states the following:

> **11.9 Performance Certificate**
>
> Performance of the Contractor's obligations shall not be considered to have been completed until the Engineer has issued the Performance Certificate to the Contractor, stating the date on which the Contractor completed his obligations under the Contract.
>
> The Engineer shall issue the Performance Certificate within 28 days after the latest of the expiry dates of the Defects Notification Periods, or as soon thereafter as the Contractor has supplied all the Contractor's Documents and completed and tested all the Works, including remedying and defects. A copy of the Performance Certificate shall be issued to the Employer.
>
> Only the Performance Certificate shall be deemed to constitute acceptance of the Works.

In addition, it is absurd to create a rule that states that the contractor assumes the risk if the work is destroyed, totally or partially, or it presents evident danger of ruin or serious construction defects, because in modern construction contracts there is always a "Defects Notification Period" and a period in which the contractor is obliged to complete outstanding works and remedy defects.

As such, rules 1.1.3.7 and 11.1 of the FIDIC Red Book states the following:

> **1.1.3.7** "**Defects Notification Period**" means the period for notifying defects in the Works or a Section (as the case may be) under Sub-Clause 11.1 [*Completion of Outstanding Work and Remedying Defects*], as stated in the Appendix to Tender (with any extension under Sub-Clause 11.3 [*Extension of Defects Notification Period*], calculated from the date on which the Works or Section is completed as certified under Sub-Clause 10.1 [*Taking Over of the Works and Sections*].

> **11.1 Completion of Outstanding Work and Remedying Defects**
>
> In order that the Works and Contractor's Documents, and each Section, shall be in the condition required by the Contractor (fair and wear and tear expected) by the expiry date of the relevant Defects Notification Period or as soon as practicable thereafter, the Contractor shall:
>
> (a) complete any work which is outstanding on the date stated in a Taking-Over-Certificate, within such reasonable time as is instructed by the

> Engineer, . . . and
>
> (b) execute all work required to remedy defects or damage, as may be notified by (or on behalf of) the Employer on or before the expiry date of the Defects Notification Period for the Works or Section (as the case may be).

It is contrary to the *Lex Constructionis* to allocate to the contractor the risk of what could happen to the work after its completion. The employer has plenty of time to warn during the "Defects Notification Period" of any defects or damages that the work presents, and to request the contractor to remedy them in the shortest possible time.

This period of remedy –that is within the term of the contract– is so relevant here that the FIDIC Red Book includes an entire section of defects liability:

> 11. DEFECTS LIABILITY
>
> 11.1 Completion of Outstanding Work and Remedying Defects
>
> 11.2 Cost of Remedying Defects
>
> 11.3 Extension of Defects Notification Period
>
> 11.4 Failure to Remedy Defects
>
> 11.5 Removal of Defective Work
>
> 11.6 Further Tests
>
> 11.7 Right of Access
>
> 11.8 Contractor to Search
>
> 11.9 Performance Certificate
>
> 11.10 Unfulfilled Obligations
>
> 11.11 Clearance of Site

Consequently, article 1785º is also contrary to international commercial practice because the contractor has no need to prove that the work was executed according to the rules of the art and in strict accordance with the instructions provided. It is enough to prove that the employer issued the "Performance Certificate."

It is also possible to name several examples with respect purchase-sale contracts.

D. Party that must assume the delivery and transportation costs

Delivery and transportation costs
Article 1530º.- The delivery costs are borne by the seller and the transportation costs to a different place of fulfillment are borne by the buyer.

Article 1530º of the Peruvian Civil Code establishes which party assumes the delivery and transportation costs for all kind of purchase-sale contracts.

This rule is contrary to the practice of international trade because the decision of which party should assume the delivery and transportation costs should never be established in a general way. The rules regarding which party assume the costs should vary depending on the sale contract that is executed. There are so many types of sale contracts in the economy that the lawmakers cannot access the necessary context information (what is maximizing for parties that transacted in context X may not have been maximizing for parties that transacted in context Y).[92]

When merchants execute contracts for the sale of goods at present, they use International Commercial Terms ("Incoterms") to determine which party must assume these costs. Since there are many types of contracts for the sale of goods, it is inconceivable for merchants to have a rule that establishes who assumes the costs in a general way.

The Incoterms are a series of pre-defined commercial terms published by the International Chamber of Commerce (ICC) that are intended primarily to communicate the costs and risks associated with the international transportation and delivery of goods.

The Incoterms are accepted by governments, legal authorities, and practitioners worldwide for international trade, which implies that they are part of the *Lex Mercatoria*. They seek to reduce or remove uncertainties with respect costs and risks.
Incoterms 2010 defines 11 rules with the purpose of allocating costs to buyer/seller: (i) EXW – Ex Works (named place of delivery); (ii) FCA – Free Carrier (named place of delivery); (iii) CPT – Carriage

[92] Schwartz & Scott, *supra* note 1, at 1528.

Paid To (named place of destination); (iv) CIP – Carriage and Insurance Paid to (named place of destination); (v) DAT – Delivered At Terminal (named terminal at port or place of destination); (vi) DAP – Delivered At Place (named place of destination); (vii) DDP – Delivered Duty Paid (named place of destination); (viii) FAS – Free Alongside Ship (named port of shipment); (x) FOB – Free on Board (named port of shipment); CFR – Cost and Freight (named port of destination); (xi) CIF – Cost, Insurance & Freight (named port of destination).

After analyzing the practice of international trade through the Incoterms, it is hard not to see the absurdity of having a legislator that determines in a closed room—for all types of sales contracts—which party is going assume the costs of delivery and transport. In my view, article 1530º of the Peruvian Civil Code is, as Hayek suggests, an example of fatal arrogance.

E. Number of installments that must be failed

> **Failure to pay installments**
> **Article 1561º.-** When the price must be paid in several installments, if the buyer fails to pay three of them, successive or not, the seller can request the termination of the contract or demand from the debtor the immediate payment of the balance, giving due the installments that were pending.

It is clear that there are many types of sale contracts and, therefore, it is also evident that there are sale contracts whose price is divided into different number of installments. Thus, there are sale contracts whose price must be paid in three installments and others that must be paid in 300. Despite this, the Peruvian lawmaker has arrogantly determined that if the buyer fails to pay three installments, this amounts to a fundamental breach and, consequently, the seller is entitled to declare the avoidance of the contract. If it is not relevant whether the contract price is divided into five or 500 installments, the legislator's decision to divide it into three is entirely arbitrary to enable the seller to terminate the sale contract.

I believe that article 1561º of the Peruvian Civil Code is an

arbitrary rule that lacks rationality. The legislator is smart enough to determine in a general way how many installments must be missed before the seller can declare the avoidance of the contract, because nobody is that smart. Sincerely, I do not think anyone is.

What is more, I believe that no one should establish the number of installments that the buyer must fail in order to enable the seller to declare the avoidance of the contract. Drafters would be required to create a menu of rules governing the termination of the sale contract, each of which would depend on the number of installments that the parties agreed.[93]

In my view, the seller should be entitled to terminate an installment contract when the failure of the buyer constitutes a fundamental breach of the contract, which occurs if this breach results in such detriment to the seller as substantially to deprive him of what he is entitled to expect under the contract. This not only depends on the number of installments that the contract has, but on many other variables.

I believe that the most appropriate formula in a Civil Code is to create a general rule that establishes that the contract can be terminated if the failure to perform any obligation constitutes a fundamental breach of the contract. It must be the arbitral tribunal who must determine, by virtue of many variables—not only the total number of installments—if the failure amounts to a fundamental breach of contract.

For example, although it is inserted in the context of a specific sector, the United Nations Convention on Contracts for the International Sale of Goods (CISG) has opted for this path by legislating these rules with a general scope:

> Article 25
>
> *A breach of contract committed by one of the parties is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract*, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result (emphasis added).

[93] Schwartz & Scott, *supra* note 1, at 1528.

> Article 64
>
> (1) The seller may declare the contract avoided:
>
> (a) if the failure by the buyer to perform any of his obligations under the contract or this Convention *amounts to a fundamental breach of contract* . . . (emphasis added).
>
> Article 73
>
> (1) In the case of a contract for delivery of goods by instalments, if the failure of one party to perform any of his obligations in respect of any instalment constitutes a fundamental breach of contract with respect to that instalment, the other party may declare the contract avoided with respect to that instalment.
>
> (2) *If one party's failure to perform any of his obligations in respect of any instalment gives the other party good grounds to conclude that a fundamental breach of contract will occur with respect to future instalments,* he may declare the contract avoided for the future, provided that he does so within a reasonable time (emphasis added).
>
> . . .

VIII. WHAT DEFAULT RULES SHOULD BE CREATED THROUGH THE *LEX MERCATORIA* AND WHAT DEFAULT RULES SHOULD BE CREATED BY THE STATE?

In some cases, it makes sense for the State to create default rules, but only in a minority of cases. This is the case for rules that recognize the obligatory nature of contracts, the techniques of contractual interpretation, the grounds for nullity, the effects of contractual resolution, force majeure, hardship, and etcetera.[94]

However, if there are some default rules that should be created by the State and others through the *Lex Mercatoria*, where is the dividing line? As mentioned above, default civil rules and default commercial rules must be differentiated. Broadly speaking default civil rules are general while default commercial rules are

[94] For instance, Schwartz and Scott, have affirmed that "[t]he default rule project could have responded to this constraint by only proposing transcontextual default rules. There are, however, just a few transcontextual default rules, and most of them had already emerged through the common law process. Here, the drafters wisely followed the common law; most of the transcontextual UCC and Restatement default rules were adopted from prior judicial creations." *Id.*

sectoral. When default rules are sectoral, they seek to distribute risks. Those default rules should not be included in a Civil Code because it is a field that belongs, in the absence of the agreement of the parties, to the *Lex Mercatoria*. The State, therefore, must not create default rules that belong to sectors such as construction, energy, hydrocarbons, merchandise, and sports.

On the contrary, when it comes to general default rules, the State must legislate them in a Civil Code for two reasons: (i) the universal acceptance of certain rules; and (ii) the necessity of counting with general institutions of private law in order to allocate risks efficiently.

A. The universal acceptance of certain rules

There are some rules that are so universal that it makes sense that they are legislated in a Civil Code. What is more, some of them find their source in principles. Thus, the obligatory nature of contracts finds its source in the principle *pacta sunt servanda*, the force majeure in the principle *rebus sic stantibus*, the exception of breach in the principle *exceptio non adimpleti contractus*, the prohibition of own acts in the principle *venire factum proprium non-valet*, among many others.

In a study on the *Lex Mercatoria* prepared by the International Chamber of Commerce entitled "Developing Neutral Legal Standards for International Contracts: A-national rules as the Applicable Law in International Commercial Contracts" it was stated that there were a number of principles that have a vocation for universality, since they are present in all legal systems:

- Parties are bound to respect the terms of the contract (*pacta sunt servanda*), unless there is a significant change of circumstances (*rebus sic stantibus*);
- Parties must perform the contract in good faith. Parties may be liable for not respecting good faith during negotiations (*culpa in contrahendo*);
- A contract obtained by bribes is void, or at least unenforceable;
- A party can refuse to perform its obligations if the other has committed a substantial breach (*inadiplenti non est adimplendum*);
- Damages for breach of contract are limited to the foreseeable consequences of the breach and include actual loss and loss of profit;

- A party which has suffered a breach of contract must take reasonable steps to mitigate the damage.[95]

On the other hand, a list of 130 general principles of the *Lex Mercatoria*, is published on 'TransLex,' (www.trans-lex.org) the online platform on transnational commercial law, operated by the Center for Transnational Law Cologne Law School.[96]

It is true that several of the rules that are based on these principles are mandatory, however, there are several that are not. It is perfectly possible, for example, that the parties' contract around the hardship clause or the force majeure clause. They can also agree that certain type of damages will not be paid and that parties have no obligation to mitigate damages. To the extent that many default rules find sustenance in principles, it makes absolute sense that it is the State that creates them.

B. The necessity of counting with general institutions of private law in order to allocate risks efficiently

With the purpose of providing legal certainty and reducing transactional costs, the general institutions of private law that the parties should use to allocate the risks of their contracts should be the same for everyone.

One party cannot have a notion of contract and another a different one; nor can divergences exist with respect to the definition of concepts such as obligation, term, condition, nullity, resolution, contractual interpretation, etcetera. If so, everything would be chaotic. Almost no transactions could be executed and it would be extremely costly for the courts to resolve disputes.

In fact, many of these rules simply define the institutions. Therefore, they provide parties with the tools through which they can decide how to allocate the risks of their contracts. In this regard, the State must provide the ingredients and the parties must be free to decide how they want to mix them.

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[95] INT'L CHAMBER OF COMMERCE: POLICY & BUS. PRACTICES, DEVELOPING NEUTRAL LEGAL STANDARDS FOR INTERNATIONAL CONTRACTS 10 http://store.iccwbo.org/content/uploaded/pdf/Developing%20neutral%20legal%20standards%20for%20Intl%20contracts.pdf.

[96] *Id*.

The State, however, cannot infringe on party autonomy and decide instead of the parties how the risks of the contract should be allocated. In short, the State should give the ingredients to the parties, but not prepare the cake for them. The parties should prepare the cake using the ingredients provided by the State. If the parties forget to regulate a certain issue in their contract, the answer must be found in the *Lex Mercatoria*.

The best example of how a Civil Code should be designed are the UNIDROIT Principles.[97] If a thorough review of this text is carried out, it can be noticed that it basically contemplates general institutions. The experts of UNIDROIT would never design rules that determine how risks should be allocated, for example, in a sale contract, in a lease contract or in a construction contract. They know perfectly well that they do not have any legitimacy to determine how the risks in economic sectors should be allocated.

In my view, the UNIDROIT Principles are not part of the *Lex Mercatoria*. This is the case because they contemplate, in essence, rules that could be perfectly included in a Civil Code. The *Lex Mercatoria* has a dynamic and evolving character, and the UNIDROIT Principles do not. The fact that the UNIDROIT Principles are codified in a normative text is the most reliable proof that it does not has a praxeological nature. And, as I have explained, its praxeological nature is one of the essential distinctive features of the *Lex Mercatoria*.

In this regard, Professor De Jesús has stated that:

> In addition to the emergence of new contracts and their progressive standardization by the work of private professional organizations, a new source of transnational law has emerged in the past few decades that could potentially influence the transnational law of petroleum contracts: institutional codifications of contractual principles such as the UNIDROIT Principles of International Commercial Contracts and the Lando

[97] International Institute for the Unification of Private Law (UNIDROIT), is an intergovernmental organization based in Rome, Italy. Its objective is to study the needs and methods to modernize, harmonize and coordinate private law and commercial law, in particular among the States, as well as to formulate the instruments of uniform law, principles, and norms to achieve said objectives. Its main function is to harmonize private law among States. *History and Overview,* UNIDROIT, https://www.unidroit.org/about-unidroit/overview (last visited June 27, 2019).

> Principles of European Contract Law. Both doctrinal codifications state that they may be used to govern transnational contracts when this has been agreed by the parties, when the parties have agreed their contract to be governed by general principles of law, the Lex Mercatoria or the like and also when the parties have not chosen any rules to govern their contracts. *There has been a lot of debate regarding the nature of these codifications, as to whether they can be considered as a part of the Lex Mercatoria or as a new expression of the Lex Mercatoria. Although we believe that these codifications are extremely useful (and we recognize their role as an exceptional source of transnational rules) we don't systematically recognize them as being part of the Lex Mercatoria, the Lex Petrolea or any other transnational legal order. Only the rules of these codifications that really satisfy the needs and interests of a particular transnational industry will be considered as part of its transnational legal order*. The process of incorporation of the rules of these codifications, or at least some of them, into the Lex Mercatoria, the Lex Petrolea or any other legal order depends exclusively on the choice of their members. A choice that can be ascertained by industry practices, by agreement of the parties to transnational contracts or, alternatively, by the application of these rules by arbitral tribunals.[98]

The *Lex Mercatoria* is composed by praxeological default rules that are formed spontaneously in every single economic sector. Thus, *Lex Mercatoria* is a product of repetition; not of a decision. When a group of experts meets to decide what should be the general rules applicable to contracts, we are clearly facing a constructivist process. The *Lex Mercatoria* is by definition an enemy of constructivism, which means that the UNIDROIT Principles are simply a model law.

Arguing that the UNIDROIT Principles are part of the *Lex Mercatoria* because in its preamble it is established that "[t]hey may be applied when the parties have agreed that their contract be governed by general principles of law, the *lex mercatoria* or the like"[99] is a very unpersuasive argument. The essence of things lies in their nature, not in the preamble of a normative text.

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[98] De Jesús O., *supra* note 57, at 24–25 (emphasis added).

[99] UNIDROIT, pmbl., https://www.unidroit.org/english/principles/contracts/principles2010/integralversionprinciples2010-e.pdf.

IX. ARBITRAL AWARDS ARE THE SOURCE PAR EXCELLENCE OF *LEX MERCATORIA* IN THE PERUVIAN LEGAL SYSTEM

The sources par excellence of *Lex Mercatoria* in international commercial relations are the following: (i) the new contracts and clauses that have emerged from the evolution of transnational contracts, (ii) the standardization and institutionalization of some of those contracts and clauses by the practice and the works of professional associations; (iii) the publication of doctrinal codifications of rules potentially applicable to contracts and (iv) the arbitral awards.[100]

Although *Lex Mercatoria* has different sources, I believe that the most important one in the Peruvian legal system are arbitral awards. The reason is very simple: Arbitral awards are the only source that has answers to contingencies not foreseen in the contracts executed by the parties.

When the parties are not sophisticated merchants, it makes sense for arbitrators to use modern contract clauses or new standardized contracts as *Lex Mercatoria* to resolve disputes. Nevertheless, when the parties are sophisticated merchants, the sources mentioned above are irrelevant because the contracts entered into by the parties are usually very advanced and in most of the cases already include all the contingencies foreseen in modern clauses or in new standardized contracts.

By contrast, arbitral awards decide on situations that parties usually have not anticipated in their contracts. As these decisions have a very clear economic rationality, they have substantial legitimacy and are usually followed by other arbitral tribunals in future disputes. Faced with the reiteration of awards in a certain direction, the parties begin to anticipate this risk in their contracts and specialists begin to include them in standardized contracts. As a result, *Lex Mercatoria* spontaneously develops.

In this regard, I believe that arbitral awards are the key source driving the evolution of the *Lex Mercatoria*. This is the only source in which answers to unforeseen contingencies can be found when the parties are sophisticated merchants. New contractual trends and standardized contracts are sources that have usually been

[100] De Jesús O., *supra* note 57, at 23.

taken into account by the parties when concluding the contract.

It might be possible to argue that the same function could be fulfilled by courts because judges also have the possibility to rule on contingencies not foreseen in the contract. In the following sections, I will demonstrate that, while that might be true with respect to common law judges, civil law judges create commercial in a very limited way. In addition, I will demonstrate that, unlike civil law judges, arbitrators continually create commercial law through their arbitral awards.

a) Courts do not create commercial law through their judgments

Some scholars have argued that a court system (public or private) provides two types of service: The first is dispute resolution, i.e., determining whether a rule has been violated, the second is rule formulation, i.e., creating rules of law as a by-product of the dispute settlement process. In this regard, it is argued that when a court resolves a dispute, its resolution, especially if embodied in a written opinion, provides information regarding the likely outcome of similar disputes in the future.[101]

According to this line of thought, courts fulfill two functions: A jurisdictional function and a legislative function. Courts fulfill a jurisdictional function when they resolve disputes, but they also perform a legislative function when they create law through their judgments.

Along these lines, Posner and Landes have argued that:

> A court system (public or private) produces two types of service. One is dispute resolution—determining whether a rule has been violated. The other is rule formation—creating rules of law as a by-product of the dispute-settlement process. When a court resolves a dispute, its resolution, especially if embodied in a written opinion, provides information regarding the likely outcome of similar disputes in the future. This is the system of precedent, which is so important in the Anglo-American legal

[101] Richard A. Posner & William M. Landes, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235, 236 (1979).

system.[102]

Posner and Landes argue that the creation of law is a public good because, when judges resolve disputes, this service is consumed by the society as a whole. Thus, they affirm that predictability and the creation of law are public goods because they create a climate of institutional trust that promotes investment, expedites dispute resolution, and reduces transaction costs. These benefits do not have rivalry in their consumption.

In the Peruvian legal system (and in civil law countries in general), however, the only body that has the obligation to create law and predictability is the Supreme Court. It is true that courts, for example, can not deviate from the precedents created by the Supreme Court; however, creating law is not one of their functions. And in the hypothetical scenario in which it was one of their functions, the externalities they would create would be much more negative than positive, because by continually rendering contradictory judgments, they would create legal uncertainty in the legal system.

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[102] *Id*. Similarly, Silberman has stated that "[s]ome critics, however, have raised a more fundamental challenge to ADR. They have argued that ADR subverts one of the basic purposes of adjudication—the public resolution of disputes and the public articulation of legal norms. For these critics, the resolution of disputes in a public forum, resulting in the making of law, is not just an incidental feature of adjudication, but one of its principal purposes. On this view, delegating the dispute resolution process to a privatize organization always comes at a cost, no matter how efficient or accurate the result." LINDA SILBERMAN ET AL., CIVIL PROCEDURE, THEORY AND PRACTICE 1190 (5th ed. 2017) (emphasis omitted). Finally, Cuniberti has stated that "[a]nother public function of adjudication is to make the law accessible to the public. Public access to adjudication enables the public to learn about the law and about procedures. Public trials and published judgments teach the public that there are rules, and that such rules are enforced. This knowledge increases the awareness of the public of their rights, and thus results more often in the vindication of those rights. The actual reach of the legal system is extended. Moreover, as the state is able to clearly show that it uses its power in accordance with procedures and rules, it reinforces the legitimacy of such power." Gilles Cuniberti, *Beyond Contract – The Case for Default Arbitration in International Commercial Disputes*, 40 FORDHAM INT'L L.J. 417, 463 (2008).

As explained by Correa:

> Civil and commercial justice is now financed by general revenues, in terms of the cost of running the courts, in circumstances that not only do not constitute a public good, but also that the externalities that could eventually be generated are, in fact, very limited.[103]

The Peruvian legal system is far removed from the common law systems in which courts create commercial law continually. This being so, it is nonsense to argue that by resolving commercial disputes civil law judges provide a public good in the legal system. In fact, it sounds like a joke in poor taste to use this argument when Peruvian courts contradict each other every day. The lack of predictability is the daily bread of the Peruvian legal system.

b) Arbitrators continually create commercial law through their arbitral awards

Unlike judges, arbitrators create commercial law through their arbitral awards all the time. Many specialists even suggest that arbitrators create precedents, and as we will see, their arguments are very strong.

In this regard, Professor Weidemaier has stated that:

> Do arbitrators create precedent? The claim that they do not recurs throughout the arbitration literature. Yet this claim conflicts with a small but growing body of evidence that, in some arbitration systems, arbitrators frequently cite to other arbitrators, claim to rely on past awards, and promote adjudicatory consistency as an important system goal. Thus, although not every system of arbitration generates precedent, some clearly do.[104]

At least in the Peruvian legal system, arbitrators are more

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[103] Jorge Correa S. et al., *Poder Judicial y Mercado: ¿Quién Debe Pagar por la Justicia?* [*Judicial Power and Market: Who Should Pay for Justice*] 2 INFORMES DE INVESTIGACIÓN [RES. REP.] 29, 35 (1999) (trans. by Fabio Núñez del Prado Ch.).

[104] W. Mark C. Weidemaier, *Toward a Theory of Precedent in Arbitration*, 51 WM. & MARY L. Rev. 1895, 1899 (2010).

likely to create commercial law than are judges. For a common law lawyer, it might be difficult to believe that arbitrators create more commercial law than do judges through their arbitral awards. While arbitrators do not create commercial law in the same way as common law judges, they have proven to be the producers par excellence of *Lex Mercatoria*.

In effect, when a contingency has not been foreseen in the contract, the arbitrators decide which of the parties should assume this risk. Since the arbitrators are experts in the economic sector in which the controversy unfolds, their decision is not only automatically respected by the parties, but is also repeated by other arbitrators in future disputes. Then, the parties begin to incorporate this contingency in their contract to have a clear agreement and, in this way, the *Lex Mercatoria* is formed spontaneously.

What is more, to the extent that regardless of the country, the distribution of contractual risks tends to be virtually the same, domestic arbitral awards are not the only ones that arbitrators can apply as *Lex Mercatoria* for the resolution of commercial disputes; they can apply international arbitral awards as well.

In the oil sector, for example, the *Lex Petrolea* has developed over time and can be found in various arbitral awards: the Abu Dhabi award of 1951, the Qatar award of 1953, the Aramco award of 1953, the Saphire award against Iran of 1963 and the three awards against Libya, the BP award of 1973, the Texaco award of 1977 and the Liamco award of 1977.[105] It is precisely these arbitral awards that have created the transnational oil rules.

In this regard, Professor De Jesús has stated that:

> It follows that arbitral jurisprudence is another crucial source of rules for the transnational petroleum industry. Formerly, the paradigm maintained that international arbitration was confidential but the reality embodied in new trends points towards transparency (particularly in investment treaty cases) and the impact of the communication technologies in this hyper-connected world demonstrates that arbitral awards, even awards that are supposed to remain confidential, are easily accessible in the petroleum society. These arbitral awards or relevant extracts are also published in law reviews of some of the foremost arbitral institutions like the ICC International Arbitration Court Bulletin, the ICSID Review – Foreign

[105] De Jesús O., *supra* note 57, at 25.

> Investment Law Journal, as well as the Journal de droit international (Clunet). In general, most arbitral awards can be construed as a source of inspiration for the transnational petroleum industry, but without any doubt the arbitral awards rendered in the field of petroleum resources constitute a privileged source of the Lex Petrolea. In recent years, a number of papers have been published concerning arbitral jurisprudence related to the petroleum industry, some analyzing the different phases of its evolution, others identifying and categorizing the issues decided in these awards.[106]

Additionally, arbitrators create much more commercial law than judges, particularly because the latter have almost no opportunity to decide on commercial disputes. In Peru, nearly all commercial disputes are resolved through arbitration. In the words of Bullard:

> Today in Peru it is difficult to imagine conflicts of important commercial contracts that are solved in the judiciary. Virtually everything is resolved through arbitration.[107]

Finally, arbitrators have much more legitimacy when creating commercial law than judges, because unlike them, they are specialized in the economic sectors in which commercial disputes are usually inserted. Thus, to the extent that the parties are entitled to choose their arbitrators, the latter are always experts in matters of conflict. Indeed, if a party has an energy dispute, it will designate an energy expert as an arbitrator. If a party has a construction dispute, it will designate a construction expert as an arbitrator. Many parties even appoint engineers as their arbitrators in construction disputes or economists for their energy disputes. These people are in the best position to identify the applicable uses and customs or, in any case, to determine which of the two parties should assume a certain risk. The arbitrators understand the economic sector of the dispute very well, so their decisions not only have legitimacy before the parties, but before society as a whole.

Arbitrators, consequently, continually create *Lex Mercatoria* through their arbitral awards. The *Lex Petrolea*, for example, has been created largely through arbitral awards. The same happens with

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[106] *Id.* at 25–26.

[107] Bullard González, *supra* note 65, at 86 (trans. by Fabio Núñez del Prado Ch.).

the *Lex Constructionis*. It is the decisions of the arbitrators that determine whether the risks of a certain economic sector are allocated to one side of the table or the other. Not in vain is it often said that international arbitrators are the natural judges of the *Lex Mercatoria*.[108]

Along these lines, Professor De Jesús has argued that:

> It follows that arbitral jurisprudence is another crucial source of rules for the transnational petroleum industry. Formerly, the paradigm maintained that international arbitration was confidential but the reality embodied in new trends points towards transparency (particularly in investment treaty cases) and the impact of the communication technologies in this hyper-connected world demonstrates that arbitral awards, even awards that are supposed to remain confidential, are easily accessible in the petroleum society. These arbitral awards or relevant extracts are also published in law reviews of some of the foremost arbitral institutions like the ICC International Arbitration Court Bulletin, the ICSID Review – Foreign Investment Law Journal, as well as the Journal de droit international (Clunet).[109]

Unlike arbitrators, courts are not well placed to create *Lex Mercatoria* because they do not have the ability to identify which is the applicable transnational rule, and because they lack the technical or specialized knowledge to do so. Among other reasons, this explains why in Peru there is an absolute distrust in the courts.

It is also argued by many scholars that arbitration is not a predictable system. At least in Peru, arbitrators are much more predictable than judges. As Bullard explains below, predictability in arbitration is not created from the top by a higher centralized body, but from below, by means of the decisions of arbitrants in the market.[110] To the extent that arbitrators are paid by the parties, they have all the incentives to create predictable rules. Doing so ensures

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[108] Alfredo De Jesús O., *La Autonomía del Arbitraje Comercial Internacional a la Hora de la Constitucionalización del Arbitraje en América Latina* [*The Autonomy of International Commercial Arbitration at the Time of Constitutionalization of Arbitration in Latin America*] 3 LIMA ARB. 151, 167 (2008).

[109] De Jesús O., *supra* note 57, at 26.

[110] Bullard González, *supra* note 65, at 79 (trans. by Fabio Núñez del Prado Ch.).

them work in the future.[111] This explains why arbitrators tend to create uniform rules spontaneously.[112]

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[111] In that sense, Cuniberti has stated that "ADR critics further argue that, even if access to arbitral awards was easy, it would not bring much, as arbitrators have neither the willingness, nor the ability to develop precedents. First, arbitrators would have no incentives to develop rules, as they would not be paid to perform this function, but solely to resolve disputes. Second, they would not have the appropriate training anyway. Finally, and in any case, even if they would and could, arbitration is too decentralized to offer the possibility to develop a consistent and precise body of rules. The two first arguments are contradicted by the reality of modern international commercial arbitration. It is true that the vast majority of international arbitration regimes do not require that arbitrators have legal training. It is also true that the service that the parties seek is the settlement of their private dispute. However, in practice, most international arbitrators are distinguished jurists. They are either experienced legal practitioners, or law professors. Their legal expertise and prestige is often very high. If one accepts that judges are not superheroes for the sole reason that they went through the appointing process of their country of origin, there is no reason to consider that arbitrators could not have the training and the skills to develop the law if they wanted to. However, would they be willing to do so? Again, the practice of international commercial arbitration is that they most often are, so much so that they are commonly urged not to forget that their main task is not to develop the law and to write legal dissertations, but to settle the dispute appropriately. At first sight, this may seem surprising. Arbitrators do not seem to need to engage into a difficult activity without being paid for it, and parties certainly do not have any reason to pay for an activity which will essentially benefit others, that is future litigants. How can this seemingly inefficient conduct be explained, then? Quite simply, by the need for arbitrators to show their skills. They do not necessarily wish to market themselves aggressively so as to be appointed in future arbitrations, but they certainly have a professional reputation that they wish to maintain, or to enhance. Additionally, it should be underlined that many international arbitrators, especially in the civil law world, are law professors. They thus have an inclination towards legal analysis, and may wish to use the arbitration as just another forum." Cuniberti, *supra* note 102, at 456–57.

[112] As we have pointed out, in the system we propose, the risk of contradictory awards is eliminated. And if it were true that this risk continues to exist, a competitive system is spontaneously created in which the best awards are those that prevail. The bad ones are automatically discarded from the system. In this regard, Cuniberti has stated that "[i]n the last decade, the practice of international arbitration has offered evidence that arbitral tribunals can develop precedents. In several specialized fields, arbitral tribunals cite, examine and follow decisions made by prior tribunals. Some of the common features of these specialized arbitrations explain why this has been possible. First, most of the awards made by these tribunals are public. They are typically available on line shortly after being made, and are also published in legal journals. Second, the

To again quote Bullard:

> Would the arbitrators still have incentives to generate good rules for others that will not pay them? The answer is affirmative. To deny it is to lose perspective that, as usually happens in the market, arbitration is a repeated game, in which the possibility of selling my services tomorrow depends on how I lent my services yesterday. The arbitrators, like any other person who sells something, want to continue selling their services in the future. Therefore, being recognized as the generator of a public asset ensures them work in the future.[113]

Moreover, if arbitral awards and judgments are analyzed, it would be very easy to realize that arbitrators cite other awards more frequently than courts cite other judgments. When parties prepare writs, most of the parties' arguments are supported by arbitral awards in previous cases. Parties do not cite arbitral awards without reason; they cite them because arbitral tribunals pay significant attention to what other arbitrators have decided in previous cases.

As Professor Kaufmann-Kohler has stated: It may be debatable whether arbitrators have a legal obligation to follow precedents—probably not—but it seems well settled that they have a moral obligation to follow precedents so as to foster a normative environment that is predictable.

Some might claim that arbitral awards cannot be one of *Lex*

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awards provide a detailed analysis of legal issues. In one particular field, foreign investment law, they commonly reach a hundred pages. Third, the vast majority of the arbitrators sitting in the tribunals are experienced legal academics or practitioners, and sometimes indeed very distinguished jurists. On these three accounts, these arbitral tribunals are not significantly less equipped than courts to make the law and develop precedents. Of course, if these tribunals had been unwilling and unable to develop precedents, they would not have done so. Yet they have." *Id.* 458–59.

[113] "[T]he same does not happen with ordinary judges. The number of cases, the volume of work and the level of income of a judge is not related to a repeated game or to the amount of work. The parties are subject to certain judges by a centralized and planned shift system that assigns work only because it is your turn. What incentive does a judge have in creating good and predictable rules? In principle none. The game will continue to be equally repetitive regardless of whether it solves well or solves badly, and what is worse, will continue to charge the same." Bullard González, *supra* note 65, at 79–80 (trans. by Fabio Núñez del Prado Ch.).

Mercatoria's sources par excellence in the Peruvian legal system because, due to the principle of confidentiality, awards are not accessible to the public. While I disagree with this principle (for reasons I will explained later), it has been diminishing in significance in the Peruvian legal system.

For example, the website of the arbitral institution of the State Procurement Supervisory Body ("OSCE")—one of the many existing Peruvian arbitral institutions—stores more than 1800 arbitral awards in its bank of awards despite the fact that the institution was created in 2011.[114]

Additionally, with respect labor matters, under article 60 of the Regulations of the Collective Labor Relations Act, it has been established that the Labor Directorate must centralize arbitral awards and must publish them on the website of the Ministry of Labor. Again, arbitral awards are accessible to the public.

On the other hand, the International Court of Arbitration of the International Chamber of Commerce ("ICC Court")—which administers several arbitrations in Peru—does not establish an obligation of confidentiality in its arbitral rules. Moreover, every certain period of years the ICC publishes a book called *Collection of ICC Arbitral Awards* that contains extracts of arbitral awards that were rendered in the framework of an ICC arbitration. This measure adopted by the ICC since 1974 has been, to a large extent, the accelerator that has allowed the development of *Lex Mercatoria* worldwide in many economic sectors.[115]

Although the publication of these books has had a very significant relevance for the development of commercial law, this year the ICC has adopted one of the most revolutionary measures in the history of arbitration, and which, against all odds, reinforces my proposal.

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[114] It is possible to access the OSCE here: http://prodapp1.osce.gob.pe/sda-pub/documentos/public/busquedaArbitraje.xhtml (last visited Aug. 26, 2019).

[115] There are seven books that contain extracts of arbitral awards from the last 45 years: Collection of ICC Arbitral Awards 1974–1985, Collection of ICC Arbitral Awards 1986–1990, Collection of ICC Arbitral Awards 1991–1995, Collection of ICC Arbitral Awards 1996–2000, Collection of ICC Arbitral Awards 2001–2007, Collection of ICC Arbitral Awards 2008–2011, Collection of ICC Arbitral Awards 2012–2015, and the last one is forthcoming.

Indeed, on January 1, 2019, the ICC Court issued a Note to Parties and Arbitral Tribunals on the Conduct of the Arbitration under the ICC Rules of Arbitration changing the paradigm of confidentiality:

> D - Publication of Awards
>
> 40. Publicising and disseminating information about arbitration has been one of ICC's commitments since its creation and an instrumental factor in facilitating the development of trade worldwide.
>
> 41. Parties and arbitrators in ICC arbitrations accept that ICC awards made as from 1 January 2019 may be published according to the following provisions.
>
> 42. The Secretariat will inform the parties and arbitrators, at the time of notification of any final award made as from 1 January 2019, that such final award, as well as any other award and dissenting or concurring opinion made in the case, may be published in its entirety no less than two years after the date of said notification. The parties may agree to a longer or shorter time period for publication.
>
> 43. At any time before publication, any party may object to publication or require that any award be in all or part anonymized or pseudonymized, in which case the award will not be published or will be anonymized or pseudonymized.
>
> 44. In case of a confidentiality agreement covering certain aspects of the arbitration or of the award, publication will be subject to the parties' specific consent.
>
> 45. The Secretariat may anonymize or pseudonymize personal data included in the award as necessary pursuant to the applicable data protection regulations.
>
> 46. The Secretariat may always, in its discretion, exempt awards from publication. [116]

The ICC Court is altering the rule that prevailed with respect the confidentiality. Instead of being an opt-out, confidentiality will be opt-in, which implies that the rule would be the publication of the arbitral award. This measure will certainly make ICC arbitral

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[116] INT'L COURT OF ARBITRATION, NOTE TO PARTIES AND ARBITRAL TRIBUNALS ON THE CONDUCT OF THE ARBITRATION UNDER THE ICC RULES OF ARBITRATION (Jan. 1, 2019), https://iccwbo.org/content/uploads/sites/3/2017/03/icc-note-to-parties-and-arbitral-tribunals-on-the-conduct-of-arbitration.pdf.

jurisprudence more accessible and should be a boon to arbitration counsel.

In my view, this change of paradigm will not only promote transparency in arbitration, but will have an immense impact on the evolution of *Lex Mercatoria*. This is even recognized by the ICC itself, which begins its note affirming that "[p]ublicizing and disseminating information about arbitration has been one of ICC's commitments since its creation and *an instrumental factor in facilitating the development of trade worldwide*."[117]

It would be for best if this initiative will be imitated by other arbitral institutions sooner rather than later. This is the type of measures that must be adopted by the Peruvian arbitral institutions in order to make arbitral awards more accessible, and thus promote the evolution of the *Lex Mercatoria.*

X. CONCLUSION

In my view, if a contingency arises that is not foreseen in the text of the contract, and it is not clear which of the parties must assume the risk, then the answer must be found in the *Lex Mercatoria*. It is the only source that can provide an effective solution to the situation and, to the extent that it is based on commercial practices, it has much more legitimacy for international trade operators.

If disputes were resolved according to the rules of a Civil Code or another State-rule, there is a risk that the solutions provided by the legislator will be absolutely arbitrary and will not find sustenance in trade practices. When this happens and the parties do not understand the rationality of the rule and the reason for a certain decision, the legal system loses legitimacy.

It could be argued that it is indispensable that the State has the responsibility to create default rules because, otherwise, there would be an absolute legal uncertainty in which the arbitrators would not have a clear notion of what default rule they should apply when they have to resolve a dispute. This argument is unfounded.

The best proof of this is that some contracts such as energy contracts or financing contracts are not regulated in the Civil Code. Therefore, there are no default commercial rules to apply, and even

[117] *Id.* para. 40 (emphasis added).

so arbitrators have never had any problems resolving the controversies that arise out from them.

Curiously, the absence of default commercial rules in certain types of contracts in the Peruvian Civil Code is very efficient because parties have strong incentives to regulate all the imaginable contractual terms. They want to be sure that all risks are appropriately allocated in the contract. During the negotiations, they invest a lot of time thinking about all the contingencies that could arise in the future.[118] This may seem inefficient at the beginning, but once the commercial practices are standardized, *Lex Mercatoria* is formed, and the result is extremely efficient for three reasons:

(i) Merchants start using very detailed model contracts that are basically the result of developed commercial practices. This allows parties to save significant negotiation costs. In any case, if for any reason the model contract includes a specific provision that parties do not like, they just need to opt out of it;

(ii) Trade practice starts to spread out between countries. Merchants, judges, and arbitrators know them very well. This saves important litigation costs. Since everyone knows which party, under a particular situation, should assume a particular risk, merchants are disincentivized of initiating disputes they know they are going to lose;

(iii) In a specific case in which the parties forget to use a model contract and, therefore, their contract is full of gaps, *Lex Mercatoria* provides effective responses to all the contingencies not foreseen in the contract. This gap-filling mechanism also saves significant costs.

The absence of default rules and the correlative application of the *Lex Mercatoria* to these controversies generates another important positive externality.

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[118] It is very usual, therefore, that the contract has already determined which of the parties will assume the risk of a certain contingency. In fact, if one revises the model clauses of commercial contracts such as stock purchase agreements, energy contracts, or financing contracts, it is easy to realize that parties are extremely thorough when they negotiate such clauses. And to the extent that new unforeseen situations always arises in reality, the model clauses are constantly optimized.

To the extent that one of the main sources of the *Lex Mercatoria* is the standard contractual clauses, the fact that the parties allocate the risks in one way or the other allows *Lex Mercatoria* to develop.[119]

Thus, these new contracts allow the *Lex Mercatoria* to adapt more effectively to the needs and expectations of merchants. Thus, when the State does not allocate the risks of the contracts, default rules are created spontaneously.

In the words of Trakman: "The only law which could effectively enhance the activities of merchants under these conditions would be suppletive law, *i.e.*, law which recognized the capacity of merchants to regulate their own affairs through their customs, their usages, and their practices."[120]

In this scenario, the resolution of disputes also plays an essential role for the development of the *Lex Mercatoria* because the awards and judgments serve to make the rules more precise and even create new rules that meet the expectations of merchants. As pointed out by Benson:

> Dispute resolution can be a very important source of changes in laws, because a judge will often have to make more precise the rules on which there are differences of opinion and even provide new rules, because those of generalized use do not adjust to the new situation. The new rule becomes part of the order if the relevant group accepts it, and not because it is coercively imposed by some authority that backs the court. In this way, good rules that facilitate interaction tend to remain by selection over time, while bad judgments are ignored.[121]

In the same sense, Professor Epstein has stated that:

> It remains to discover the terms of given contracts, usually gathered from language itself, and the circumstances of its formation and performance. Even with these aids, many contractual gaps will remain, and the [private

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[119] In my view, the arbitrary default commercial rules that are found in the Civil Code or in other special state-law constitute the worst obstacles for commercial law to adapt to the new needs and expectations of merchants.

[120] Leon E. Trakman, *The Evolution of the Law Merchant: Our Commercial Heritage - Part I: Ancient and Medieval Law Merchant*, 12 J. MAR. L. & COM. 1, 5 (1980).

[121] BENSON, *supra* note 67, at 24.

> or public] courts will be obliged, especially with partially executed contracts, to fashion the terms which the parties have not fashioned themselves. To fill the gaps, the courts have looked often to the custom or industry practice. The judicial practice makes good sense, and for our purposes introduces an element of dynamism into the system.[122]

For all the above reasons, I conclude that legislative creation of default commercial rules, in the first place, diminishes the incentives of the parties to regulate exhaustively their contracts; and, if this were not enough, limits and stagnates the development of the *Lex Mercatoria*.

XI. PROPOSALS

I believe that there are three measures that must be adopted immediately in the Peruvian legal system to accelerate the evolution of *Lex Mercatoria* and thus ensure that the resolution of commercial disputes always find sustenance in commercial law: (i) Repeal several articles of the Peruvian Civil Code; (ii) Eliminate the principle of confidentiality in arbitration; and (iii) Recognize arbitration as the default jurisdiction for commercial disputes.

A. First Proposal: Repeal Several Articles of the Civil Peruvian Code

If the legislative creation of default commercial rules diminishes the incentives of the parties to regulate exhaustively their contracts, and limits and stagnates the development of the *Lex Mercatoria*, all the default commercial rules of the Peruvian Civil Code must be repealed. As suggested earlier, the legislator has to let the *Lex Mercatoria* do its job.

To the extent that the Peruvian Civil Code contains several types of contracts, I will focus only on the provisions of the sale contract (which applies to hundreds of contracts today) and the provisions of the work contract (which apply to construction contracts).

Therefore, below, in Figure 1, I propose to repeal the

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[122] Richard A. Epstein, *The Static Conception of the Common Law*, 9 J. LEGAL STUD. 253, 266 (1980).

following default sale rules and default construction rules of the Peruvian Civil Code that have no sustenance in commercial practice:

Figure 1

ARTICLE	TITLE	MAND./DEFAULT	DECISION
SALE CONTRACT			
Article 1529º	Definition	Informative	
Article 1530º	Delivery and transport costs	Default	Repeal
Article 1531º	Conditions of the contract	Mandatory (paternalism)	
Article 1532º	Goods that are susceptible of purchase-sale	Mandatory (externalities)	
Article 1533º	Partial loss of the good	Default	Repeal
Article 1534º	Purchase-sale of future good	Default	Repeal
Article 1535º	Risk of quantity and quality of the future good	Default	Repeal
Article 1536º	Purchase-sale of uncertain hope	Default	Repeal
Article 1537º	Commitment to sell alien good	Default	Repeal
Article 1538º	Conversion of the commitment of sale of good of others in purchase - sale	Mandatory (paternalism)	
Article 1539º	Rescission of the commitment of	Default	Repeal

	sale of good alien		
Article 1540º	Purchase-sell of partial alien good	Default	Repeal
Article 1541º	Effects of the rescission	Default	Repeal
Article 1542º	Acquisition of goods in premises open to the public	Default	Repeal
Article 1543º	Nullity by price fixed unilaterally	Mandatory (paternalism)	
Article 1544º	Determination of the price by a third party	Informative	
Article 1545º	Determination of the price in the stock or in the market	Informative	
Article 1546º	Automatic price adjustment	Informative	
Article 1547º	Fixing the price in case of silence of the parties	Default	Repeal
Article 1548º	Price determined by net weight	Default	Repeal
Article 1549º	Perfecting transfer	Default	Repeal
Article 1550º	Condition of the good at the time of delivery	Default	Repeal

Article 1551º	Delivery of documents and titles of the good sold	Default	Repeal
Article 1552º	Opportunity of the delivery of the good	Default	Repeal
Article 1553º	Place of delivery of the property	Default	Repeal
Article 1554º	Delivery of fruits of the good	Default	Repeal
Article 1555º	Delay in delivery of fruits	Default	Repeal
Article 1556º	Termination for lack of delivery	Default	Repeal
Article 1557º	Extension of deadlines due to delay in delivery of the asset	Default	Repeal
Article 1558º	Time, form and place of payment of the price	Default	Repeal
Article 1559º	Termination for non-payment of the balance	Default	Repeal
Article 1560º	Termination for lack of guarantee for the balance	Default	Repeal
Article 1561º	Failure to pay installments	Default	Repeal

Article 1562º	Inadmissibility of the termination action	Default	Repeal
Article 1563º	Effects of the termination due to non-payment	Default	Repeal
Article 1564º	Termination of the sale of the not delivered movable property	Default	Repeal
Article 1565º	Opportunity of the obligation to receive the good	Default	Repeal
Article 1566º	Sale of inscribed personal property	Informative	
Article 1567º	Transference of the risk	Default	Repeal
Article 1568º	Transfer of risk before delivery	Default	Repeal
Article 1569º	Transfer of risk in the purchase and sale by weight, number or measure	Default	Repeal
Article 1570º	Transfer of risk by issuing the good to a different place Of the delivery	Default	Repeal
Article 1571º	Purchase to satisfaction	Default	Repeal

Article 1572º	Purchase-sale on proof	Default	Repeal
Article 1573º	Purchase on sample	Default	Repeal
Article 1574º	Purchase by extension or capacity	Default	Repeal
Article 1575º	Rescission of the sale on measure	Default	Repeal
Article 1576º	Deadline for payment of excess or refund	Default	Repeal
Article 1577º	Purchase-sale ad corpus	Default	Repeal
Article 1578º	Purchase-sale of homogeneous goods	Default	Repeal
Article 1579º	Expiration of the rescission action	Mandatory (paternalism)	
Article 1580º	Purchase-sale of documents	Default	Repeal
Article 1581º	Opportunity and place of payment	Default	Repeal
Article 1582º	Agreements that cannot integrate the purchase-sale	Mandatory (externalities)	
Article 1583º	Purchase-sale with property reservation	Default	Repeal

Article 1584º	Oponibility of the property reservation agreement	Default	Repeal
Article 1585º	Reserve property on lease - sale	Default	Repeal
Article 1586º	Definition of Re-sale	Informative	
Article 1587º	Nullity of stipulations in the resale agreement	Mandatory (paternalism)	
Article 1588º	Deadline to exercise the right of termination	Default	Repeal
Article 1589º	Re-sale in undivided goods	Default	Repeal
Article 1590º	Re-sale in separate sale	Default	Repeal
Article 1591º	Oponibility of the re-sale	Informative	
Article 1592º	Definition of the right of retraction	Mandatory (externalities)	
Article 1593º	Retraction of payment in kind	Default	Repeal
Article 1594º	Admissibility of the right to retract	Mandatory (paternalism)	
Article 1595º	Irrenunciability and intrasmissibility	Mandatory (paternalism)	

Article 1596º	Deadline to exercise the right of retraction	Mandatory (paternalism)	
Article 1597º	Special deadline to exercise the right of retraction	Mandatory (paternalism)	
Article 1598º	Guarantee in retraction	Mandatory (paternalism)	
Article 1599º	Holders of the right of retract	Already repealed	
Article 1600º	Order of priority of the retractants	Mandatory (externalities)	
Article 1601º	Retract in successive alienation	Mandatory (externalities)	
WORK CONTRACT			
Article 1771º	Definition of work contract	Informative	
Article 1772º	Work sub-contract	Mandatory (paternalism)	
Article 1773º	Obligation of the principal	Default	Repeal
Article 1774º	Obligation of the contractor	Default	Repeal
Article 1775º	Prohibition to introduce variations	Default	Repeal

Article 1776º	Work by elevation adjustment	Default	Repeal
Article 1777º	Inspection of the work	Default	Repeal
Article 1778º	Verification of the work	Default	Repeal
Article 1779º	Tacit acceptance of the work	Default	Repeal
Article 1780º	Work to the satisfaction of the client	Default	Repeal
Article 1781º	Work by piece or measure	Default	Repeal
Article 1782º	Responsibility for diversity and vices of the work	Default	Repeal
Article 1783º	Actions of the principal for defects of the work	Default	Repeal
Article 1784º	Contractor's responsibility for destruction, defects or ruin	Default	Repeal
Article 1785º	Assumption of absence of contractor liability	Default	Repeal
Article 1786º	Faculty of the employer	Default	Repeal
Article 1787º	Obligation to pay after the	Default	Repeal

	death of the contractor		
Article 1788º	Loss of the work without fault of the parties	Default	Repeal
Article 1789º	Substantial deterioration of the work	Default	Repeal

These are just some of the default commercial rules that must be repealed. There are, however, hundreds of other default commercial rules of other types of contracts that must be repealed. In addition, there are many mandatory rules that are absolutely paternalistic that must also be repealed, however, that is not part of the subject of this paper.

B. Second Proposal: Eliminate the Principle of Confidentiality in Arbitration

If we know that arbitral awards are the source par excellence of the *Lex Mercatoria* in the Peruvian Legal System, it is urgent to adopt measures that ensure that arbitral awards are increasingly publicized in the Peruvian legal system.

Given that arbitrators also perform a legislative function (through the creation of commercial law) that is consumed by the society as a whole and, consequently, also fulfill a public function, the principle of confidentiality in arbitration must be eliminated. This would enable the availability of arbitral awards and, consequently, would facilitate the evolution of *Lex Mercatoria* in the Peruvian legal system.

In this regard, Cuniberti has stated that:

> Traditionally, confidentially has been presented as one of the principal advantages of arbitration . . . As far as the publication of awards is concerned, recent developments in certain specialized fields of arbitration have shown that confidentiality has now become the exception rather than the norm. It is not in the very nature of arbitration to be confidential.

> In the proposed model, none of the actors of the arbitral process would have a duty to observe confidentiality . . . As the proposed model would potentially decrease the number of international commercial cases decided by courts, it would be important to make available the decisions of the arbitrators. In principle, thus, awards could be made public.[123]

If commercial justice were a purely private good, it would be absurd to propose that arbitral awards be accessible to the public. However, to the extent that arbitrators create commercial law through their arbitral awards that are publicly consumed, it is undeniable that commercial justice also exhibits some characteristics of a public good. Consequently, it is perfectly reasonable to insist on the mandatory publication of arbitral awards. This is an indispensable measure that must be taken to eliminate any obstacle to the development of Lex Mercatoria.

Thus, in the system I propose, insofar as commercial justice is predominantly a private good, arbitration proceedings would remain confidential. Nevertheless, to the extent that arbitrators act as operators of commerce and, therefore, create commercial law through their arbitral awards, the publication of arbitral awards in a database will be mandatory, so the society will be able to enjoy this public good. The rule, then, should be the publicity of the decisions. As Cuniberti suggests, "[m]y sense is that it does not, and that what really matters is the availability of decisions."[124]

In this model, the parties to the arbitration will be free to cross out those sections of the arbitral award containing extremely sensitive information. However, in no case will they be able to cross out those parts in which the arbitrators are ruling with respect to commercial law.

Other interesting proposals have been offered. Professor Weidemaier, for example, argues that the publication of arbitral awards is not strictly necessary; he affirms that the accessibility to such awards is sufficient. In that sense, Weidemaier has suggested that:

> Of course, no system of precedent is likely to arise unless arbitrators become aware of relevant past awards, either through their own research

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[123] Cuniberti, *supra* note 102, at 465.
[124] *Id.*

> or, more commonly, because the litigants cite past awards as authority. This explains the arbitration literature's emphasis on the importance of award publication. The practice of publishing awards—often in searchable form— significantly reduces the cost to litigants of such research, making it feasible even in relatively low-stakes disputes.
>
> …
>
> Repeat player litigants and law firms likewise accumulate knowledge of prior disputes and may invoke past awards that favor their current positions.[125]

Under Weidemaier's proposal, arbitration consumers—arbitrants—may consider previous awards, even in the absence of publication. Each of the arbitrators will have the obligation to publish their arbitral awards in this platform, which must be available to everyone. The arbitrators may redact the names of parties in the award and any other sensitive information. However, the publication of the reasoning of the arbitral award must be mandatory. In my view, this would enhance the development of commercial law.

This measure will also generate a positive externality, because transparency with respect how disputes are resolved constitutes an authentic guarantee of democracy. Citizens will be able to monitor and supervise the workings of arbitrators.

In arbitration, parties bestow jurisdiction to the arbitrators,

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[125] Weidemaier, *supra* note 104, at 1920–21. Professor Weidemaier has also stated that "the focus on award publication may be misguided. One benefit of publication is that published awards are accessible to third parties with limited (or no) familiarity with the system. For example, because awards issued pursuant to the American Arbitration Association's (AAA) employment rules are available in searchable form on LexisNexis, a lawyer who has not previously arbitrated a case before a AAA arbitrator, but who has access to LexisNexis, can quickly search for relevant past awards, including those issued by prospective arbitrators. Without publication, such relative outsiders are unlikely to locate relevant awards. For reasons that should be fairly obvious, this does not mean that arbitral precedent depends on award publication. What matters is that system participants have access to past awards and assign value to them as precedent. Even when awards are not published, for example, arbitrators are often repeat players and may be well aware of how they and other arbitrators have resolved similar disputes. This suggests that arbitral precedent may evolve more readily in systems in which relatively few arbitrators capture a large share of the arbitration business." *Id.* at 1921.

granting them the power to resolve disputes with res judicata effects. And I believe that any delegated power must have some system of control. As Reisman points out, with controls it remains a delegated and restricted power. Without controls it becomes absolute. Hence the linkage between controls, limited power, and liberty.[126]

C. Third Proposal: Recognize Arbitration as the Default Jurisdiction for Commercial Disputes

In common law, many authors have argued that, as a general rule, default rules should be based on majority preference.[127] In this regard, Professors Ayres and Gertner have stated that:

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[126] *Id.* at 1898.

[127] In this regard, Ayres and Gertner has stated that "[t]he legal rules of contracts and corporations can be divided into two distinct classes. The larger class consists of 'default' rules that parties can contract around by prior agreement, while the smaller, but important, class consists of 'immutable' rules that parties cannot change by contractual agreement. Default rules fill the gaps in incomplete contracts; they govern unless the parties' contract around them. Immutable rules cannot be contracted around; they govern even if the parties attempt to contract around them." Ayres & Gertner, *supra* note 4, at 87. In this sense, Posner has argued that "the default rules should "economize on transaction costs by supplying standard contract terms that the parties would otherwise have to adopt by express agreement." POSNER, *supra* note 4, at 372. Additionally, Ben-Shahar has stated that "[t]here is a troubling paradox surrounding one of the most basic tenets of contract law that gaps in contracts should be filled with terms that mimic the will of the parties-terms that most parties would have jointly chosen. On the one hand, this conception of gap filling makes basic sense: It minimizes the need of the parties to contract around the default rule, and it spells out performance provisions that maximize the parties' joint well-being. But on the other hand, the mimic-the-parties'-will principle assumes that the parties' joint will exists. It assumes that there is a single term such that, if only the parties spent the time and attention dealing with the gap, they would have jointly supported the drafting of this term. Yet the existence of a gap in a contract is often an indication that a consensus could not be reached-that a single jointly preferable term does not exist. The claim from which the analysis in this paper begins is that there are situations in which more than one term satisfies the standard conception of the joint will of the parties to a contract. Absent a more powerful prescription, then, the will-mimicking principle would be indeterminate and too amorphous to fill the gap." Ben-Shahar, *supra* note 4, at 400–01. Finally, Baird and Jackson have stated that "the default rules governing the debtor-creditor relationship "should provide all the parties with the type of contract that they would have agreed to if

> [A]s transaction costs increase, so does the parties' willingness to accept a default that is not exactly what they would have contracted for. Scholars who attribute contractual incompleteness to transaction costs *are naturally drawn toward choosing defaults that the majority of contracting parties would have wanted* because these majoritarian defaults seem to minimize the costs of contracting.[128]

It would appear that the state should choose a default rule reflecting the majority preference. This being the criterion for determining the proper default rule, it is essential to ask ourselves which dispute settlement mechanism is most desired by the Peruvian business community for commercial matters. Only by knowing for certain the preferred dispute mechanism can we determine the optimal default jurisdiction.

In Peru, arbitration has become the preferred dispute mechanism for commercial disputes. Almost all commercial disputes are resolved through arbitration. It should not come as a surprise that Peru is one of the countries with the most arbitrations per capita in the world. The natural order of things has been reversed. In commercial matters, at least, arbitration is the rule, and courts, the exception.

It is curious, to say the least, that arbitration is often considered as an alternative mechanism of dispute resolution. At least in Peru, arbitration has become, undeniably, the natural mechanism for resolving commercial disputes. It is the rule, and, by definition, the rule cannot be an alternative.

The rationality behind the economic theory of default rules is precisely to respond to market demand. Then, if it is crystal clear that arbitration is the preferred dispute mechanism, it should be recognized as the default jurisdiction. This suggests that recognizing arbitration as the default jurisdiction would be the confirmation of a phenomenon that has been stealthily strengthening for decades. Factually, arbitration already works as the default rule. Arbitration has already become the natural mode of commercial dispute resolution.

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they had had the time and money to bargain over all aspects of their deal." Baird & Jackson, *supra* note 4, at 835–36.

[128] Ayres & Gertner, *supra* note 4, at 93 (emphasis added).

Recognizing arbitration as the default jurisdiction will definitely promote the evolution of *Lex Mercatoria* because many types of disputes that were previously resolved in the courts will now be resolved through arbitration. Consequently, there will be more arbitral awards and that will facilitate the evolution of *Lex Mercatoria* in many areas where its development was stagnant.

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