T.C.
MARMARA ÜNİVERSİTESİ
AVRUPA TOPLULUĞU ENSTİTÜSÜ
AVRUPA BİRLİĞİ HUKUKU ANABİLİM DALI

CHOICE OF LAWS
IN
INTERNATIONAL COMMERCIAL ARBITRATION

Yüksek Lisans Tezi

ONUR GÜNAYDIN

Tez Danışmanı : Doç. Dr. Sibel ÖZEL

İstanbul – 2007

ABSTRACT

Today, international commercial arbitrations take place extensively in different parts of the world. In general, it is proceeded in accordance with rules agreed by the parties or laid down by the arbitral tribunal, other than any reference to any outside system of law. The present system of international commercial arbitration is effective because of being in a circumstance of complex system of laws. These laws include international treaties, beside the national laws of many different countries. Even a simple international commercial arbitration may require reference to four different systems laws. Firstly, law governing recognition and enforcement. Then there is the law which governs the procedures of arbitration. Then as the most significant issue, there is the law or the set of rules which arbitral tribunal has to apply to the merits of that dispute. Finally, there is the law which governs recognition and enforcement of the award of the arbitral tribunal.

We sometimes see that these laws may be the same. The law governing arbitral proceedings can also be the law applicable to the merits of the dispute or not. The applicable law may be a different system of law. For example, an arbitral tribunal sitting in Switzerland, governed by Swiss law as the law of the place of arbitration, may well be required to apply English law as the proper law of the contract.

Practically, the determination of an applicable law in the absence of the parties' choice can cover the dispute with an uncertainty, when it is considered that different arbitrators having different approaches. While the method of applying the law most closely connected to the transaction seems to be the emerging common practice in this regard, parties are better advised to put this matter beyond doubt by stipulating their own choice of law.

For the foregoing reasons, in case of an absence of an applicable law, there cannot be a universal rule. According to some systems of law, an arbitral tribunal should follow the rules of conflict of the seat of arbitration. Presently, there are

contemporary conventions and rules of arbitration for giving a strong tendency to arbitral tribunals in making their choice of law, instead.

If the parties do not wish the arbitral tribunal to be effective, the solution is in their hands. Otherwise the parties may spend time and money while this preliminary point is being resolved, in the case a dispute arises. Consequently, every national contract should include a functional clause that selects the governing substantive law with the purposes to govern both for the performance of the contract, and the merits of the substance in case a dispute arise.

LIST OF ABBREVIATIONS

AAA	American Arbitration Association
ADR	Alternative Dispute Resolution
EC	European Community
ICC	International Chamber of Commerce
ICC Rules	Rules of Arbitration of the International Chamber of Commerce in force as from 1 January 1998.
ICJ	International Court of Justice
LCIA	London Court of International Arbitration
LMAA	London Maritime Arbitrators Assocciation
Model Law	Model Law on international commercial arbitration, adopted by United Nations Commission on International Trade Law.
New York Convention	Convention on the Recognition and Enforcement of Foreign Arbitral Awards.
UNCITRAL	United Nations Commission an International Trade Law.
UNIDROIT Principles	UNIDROIT Principles of International Commercial Contracts Rome (1994)
Washington Convention	Convention on the Investment of Investment Disputes Between States and Nationals of other States.

CHOICE OF LAWS IN INTERNATIONAL COMMERCIAL ARBITRATION

CHAPTER ONE: CHOICE OF LAW ISSUES IN PROCEDURAL MATTERS

INTRODUCTION

> *"Of all mankind's adventures in search of peace and justice, arbitration is among the earliest. Long before law was established, or courts were organized, or judges had formulated principles of law, man had resorted to arbitration for resolving of discord, the adjustment of differences and settlement of disputes."*[1]

Arbitration is the process by which a difference among parties as to their mutual legal rights is referred and determined with binding effect by the application of law by an arbitral tribunal instead of a court. In earlier times arbitration as a dispute-resolving mechanism was viewed by the courts with suspicion because it was regarded as a competitor of judicial trials. Now it is a common process for resolving international commercial disputes.[2]

Arbitration, to use the words of one writer is a "simple proceeding voluntarily chosen by parties who want a dispute determined by an impartial judge of their own mutual selection, whose decision, based on the merits of the case, they agree in advance to accept as final and binding."[3] Arbitration as an institution is not new, having being in use many centuries before the beginning of English common law. One court has called arbitration; "the oldest known method of settlement of disputes between men."[4]

Commercial arbitration has long been used as a substitute for court action in the settlement of disputes between businessmen. International arbitration has been used for the settlement of differences between nations; differing which if not removed, might lead to war. International commercial arbitration has been used with increasing frequency.

Most disputes arise from disagreements over facts, rather than law; and most disputes which are legal disputes arise from the interpretation of agreements whose

---

[1] F. Kellor, American Arbitration: Its History, Functions and Achievements (New York: Harper and Brothers, 1948) p.3
[2] Zekos, I.Georgios, "Dispute Resolution Journal; May 1999, 54, 2, ABI/INFORM Global, p8.
[3] Referred by, Elkouri, Frank, "How Arbitration Works?" [2003], BNA Books, p.3 at footnote 7 "*Chappel, Arbitrate ... and Avoid Stomach Ulcers, 2 Arb. Mag. Nos, 11-12 at 6,7 (1944)*".
[4] Mc Amis v. Panhandle Pipe Line Co., 23 LA 570, 574 (1954).

validity is not in question. Nonetheless, the choice of the law applicable to determine the merits of a dispute is not a matter, because it determines the rules which are applicable to, for example the interpretation of an agreement, the permissible means of performance, and the consequences of breach. The law applicable to the merits (the applicable law) is as we have seen, quite distinct from the *lex arbitri*. The governing principle is that the parties are free to choose the applicable law. In some circumstances the choice of the tribunal dictates the applicable law.[5]

International commercial arbitrations take place daily in different parts of the world. Usually they proceed in accordance with rules agreed by the parties or laid down by the arbitral tribunal, without obvious reference to any outside system of law. The present system of international commercial arbitration only works effectively because it is held in place by a complex system of laws. These laws include international treaties, as well as the national laws of many different countries. Even a comparatively simple international commercial arbitration may require reference to as many as four different systems or rules of law. First, there is the law which governs recognition and enforcement of the agreement to arbitrate. Then there is the law which governs (or regulates) the actual arbitration proceedings themselves. Then (and in most cases, most importantly) there is the law or the set of rules which arbitral tribunal has to apply to the substantive matters in dispute before it. Finally, there is the law which governs recognition and enforcement of the award of the arbitral tribunal.

These laws may be the same. The law which governs the arbitral proceedings may also be the law applicable to the substantive matters in issue. But this is not necessarily so. The applicable law may be a different system of law. For example, an arbitral tribunal sitting in England, governed by English law as the law of the place of arbitration, may well be required to apply French law as the proper law of the contract.[6] Moreover, the proper law of the contract may not necessarily be a given national system of law. It may be international law; or a blend of national law and international law; or even an assemblage of rules of law, known as international trade

[5] Collier, John; Lowe Vaughan, "The Settlement of Disputes in International Law", (2000), Cambridge University Pres. p.239.
[6] for instance, *Compagnie d'Armement Maritime S.A. v. Compagnie Tunisienne de Navigation S.A.,* [1971]

law, transnational law, law merchant (*lex mercatoria*) or by some other convenient title. Finally, the system of law which governs recognition and enforcement of the award of the arbitral tribunal will almost certainly be different from that which governs arbitral proceedings themselves.[7]

1.2.1 Definition of International Commercial Arbitration

Terms in common use tend to elude definition. There is nonetheless a certain (and perhaps inevitable) ambiguity in the use of the terms "international" and "commercial." One persons definition differs from another's. Nevertheless, an attempt at definition must be made.[8]

The distinction is important in practice. Amongst states which have a developed law of arbitration it is generally recognized that more freedom may be allowed in an international arbitration than is commonly allowed in a domestic arbitration. The reason is evident. Domestic arbitrations usually take place between the citizens or residents of the same state, as an alternative to proceedings before the courts of law of that state.

1.2.2. Character of Internationality

The determination whether an arbitration is international or national (domestic) is often significant because most countries have different legal regimes to govern each type of arbitration. *The word "international" is used to distinguish domestic arbitrations from those that in some way transcend national boundaries.* International arbitrations usually contain a foreign element and most countries treat such arbitrations much more liberally than they do arbitrations with purely domestic elements. The liberal treatment of international arbitrations includes greater respect for the expressed intensions of the arbitrating parties and far less judicial intrusion in the arbitration process than is the case in domestic arbitrations. There are two main methods used in determining whether an arbitration is international: the identity of the parties and the nature of the dispute.[9]

---

[7] This is because an international award will generally fall to be recognized an enforced in a state other than that in which it is made.

[8] A.Redfern and M.Hunter, p,14

[9] Chukwumerije, Okezie, "Choice of Law in International Commercial Arbitration", Quorum Books, Westport, Connecticut, London, 1994, p.4.

Identity of the Parties:

The first method focuses on the identity of the arbitrating parties: their nationality and habitual place of residence, if they are individuals; or their place of incorporation or the seat of their management and control, if they are corporate entities. This approach is exemplified by the European Convention on International Commercial Arbitration, which applies to "arbitration agreements concluded for the purpose of settling disputes arising from international trade between physical and legal persons having, when concluding the agreement, their habitual place of residence or their seat in different Contracting States."[10]

Defining international arbitration is very limiting in that it excludes some situations where the dispute being arbitrated has a foreign element. For example parties resident in the same country may have a dispute abut a subject matter located in a foreign country. Focusing on the identity of the parties in case like this obscures the fact that the nature of the subject matter in dispute imports an international element into the dispute, an element that may be crucial in resolution of the dispute. This method also categorizes as domestic cases involving a foreign party who has a representative place of business in the country of the other party. For example, a transnational corporation based in the United States may have a representative office in Sydney through which it deals with its Australian customers. To characterize an arbitration between such a corporation and one of its Toronto customers as domestic fails to recognize the fact that the dealings between the parties are, as a practical matter, of an international nature.[11]

Nature of the Dispute

The second criterion examines the nature of the dispute between the parties and categorizes the arbitration as international if the dispute implicates international commercial interests. The International Chamber of Commerce (ICC) was the first to adopt this criterion. Article 1.1 of the ICC Rules defines the function of the Court of Arbitration of the ICC as the provision of a forum for the "settlement of arbitration of business disputes of an international character." The international nature of

[10] European Convention Article 1 (1) a.
[11] Chukwumerije, et seq. p. 4

arbitration does not mean that the parties must necessarily be of different nationalities. By virtue of its object the contract can nevertheless extend beyond national borders, when for example a contract is concluded between two nationals of the same State for performance in another country, or when its concluded between a State, and a subsidiary of a foreign company doing business in that State.[12]

In practice, most international commercial arbitrations are likely to satisfy both criteria- that is to say, that of the different nationality of the parties and that of the international nature of the transaction. In the Model Law on International Commercial Arbitration it was recognized that, if a new legal regime is to be created to apply to international commercial arbitration, a definition of the term "international" is required.[13] The definition in the model law provides four alternative tests for determining when an arbitration is international:

a) the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their place of business in different;
   or
b) one f the following places is situated outside the State in which the parties have their place of business:
   (i) the place of arbitration if determined in, or pursuant to, the arbitration agreement;
   (ii) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected; or
c) the parties have expressly agreed that the subject matter of the arbitration agreement relater more than one country.[14]

The definition adopts both the identity of the parties and the nature of dispute tests, in addition to two other ones: the "situs" test (the situation of the arbitration proceedings outside the place of business of one of the parties) and the "opt-in test" (the parties

[12] The International Solution to International Business Disputes - ICC Arbitration (ICC Publication No.301, 1977) at 19.
[13] The Secretary-General of UNCITRAL stated that in considering the word "international" it would seem "necessary, though difficult, to define that term since the model law is designed to provide a special legal regime for those arbitrations where more than purely domestic interests are involved" Fourteenth Session of UNCITRAL, June 19-26, 1981, Report of the Secretary-General, UN Doc. A/CN.9/207.
[14] The Model Law on International Commercial Arbitration, Art. 1(3).

expressly agree that the subject matter of the arbitration agreement relates to more than one country). This definition effectively expands the test of internationally, although the opt-in provision may create some difficulties.

The opt-in clause gives the parties the opportunity to internationalize an arbitration with exclusively domestic elements merely by stating that "the subject matter of arbitration agreement relates to more than one country." This provision is objectionable in that nationals of the State seeking to benefit from the liberal treatment of international commercial arbitration may find tenuous grounds for proclaiming that their agreement relates to more than one country, and thereby internationalize their arbitration proceedings. There is evidence that the drafters of the model law were aware of this possibility:
"It was understood that the States will prepared to allow the "opting-in" only if an element of internationality is present. Such elements should have been that not all of the following places are situated in the same State: place of offer of contract containing the arbitration clause or of separate arbitration agreement; place of performance of contract or of location of subject matter; place of registration or incorporation or nationality of each party; place of arbitration."[15]

In summary, the identity of the parties and the nature of the dispute are the two main methods of determining when an arbitration is international, although the model law introduces additional methods. It is crucial to remember that the answer to the question whether an arbitration is domestic or international is always to be found in the provisions of the relevant national law.

1.2.3. Character of Commerciality

The term commercial is used in the civil law countries, which distinguish between contracts which are commercial and those which are not. A commercial contract is, in broad terms, the kind of contract made by merchants or traders in the ordinary course of their business.

[15] I.Szasz, "Introduction to the Model Law of UNCITRAL on International Commercial Arbitration" (Deventer, The Netherlands: Kluwer Law and Taxation Publshers, 1984) at 43.

The fact that in some countries arbitration is only permissible in respect of commercial contracts, whilst in others there is no such limitation, was given international recognition many years ago. The Geneva Protocol of 1923 obliged each contracting state to recognize the validity of an arbitration agreement concerning disputes which might arise from a contract "relating to commercial matters or any other matter capable of settlement by arbitration." This phrase indicates the recognition of distinction between commercial and other matters; further emphasis is added by the stipulation in the protocol that each contracting state may limit its obligations "*to contracts which are considered as commercial under its national law.*"[16] This is so-called commercial reservation, which appears again in the New York Convention Article.[17]

There is universal accepted definition of the term commercial, has now become the part of the language. It serves, for instance, to distinguish international commercial arbitrations from international arbitrations between states concerned with boundary disputes and other political issues. It also serves to distinguish them from arbitrations (which are usually but not necessarily domestic) concerned with such matters as property tenure, employment and family law. Indeed, it may be said that, if the term had not existed it would have been necessary to invent it, much as it has been necessary to establish in a national commercial court which deals only with disputes arising out of trading and other commercial relationships.[18]

In a particular case it may be of great importance to know whether the legal relationship out of which the arbitration arose was or was not a commercial relationship. The question will arise, for example if it becomes necessary to seek recognition or enforcement of a foreign arbitral award in a state which has adhered to the New York Convention, but which has entered the commercial reservation. It will then be necessary to look closely at the law of the state concerned to see what definition it adopts of the term "commercial". Internationally, the approach is to interpret the term "commercial" as widely as possible. Although problems have occasionally arisen because courts of particular countries have adopted a narrow

[16] Geneva Protocol of 1923, Art. 1.
[17] New York Convention, Art. 1.3.
[18] A.Redfern and M.Hunter, p,21

definition of commercial, the general approach of courts of many nations is to define commercial so as to embrace all types of trade or business transactions. The Model Law does not define the word but states:[19]

The term 'commercial' should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation and or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business co-operation; carriage of goods or passengers by air, sea, rail or road.[20]

Finally, especially in practice, it may be necessary to decide whether or not a particular agreement is commercial (for instance, for the purposes of enforcement under the New York Convention) reference must be made to the relevant national law.

1.2.4. Virtues and Drawbacks of International Commercial Arbitration

Arbitration is intended to provide a quicker, less expensive, and more private alternative to litigation. But this alternative dispute- resolution mechanism that allows for decision making other than by law involves commitment and credibility. So, international commercial arbitration has gained in popularity and use with the business community beginning to realize its advantages.

Instead of going through the prolonged and potentially expensive civil court system, contracting parties can opt for arbitration which is fast, is not rigid as court rulings (it allows parties to structure the proceedings and choose a convenient approach), and is usually not expensive. Most important, the privacy is not violated; in case of judicial settlement, this is lost with the courts being public for a. This aspect is important

[19] The definition appears as a footnote to Art. 1(1), which states that the Model Law applies to "International Commercial Arbitration."
[20] See, http://en.wikipedia.org/wiki/Commercial last visited on May 17th, 2006.

when sensitive issues are involved, and the participants want to keep the information secure, as when trade secrets are involved or when party's business or personnel reputation is at stake.[21]

- Advantages of Arbitration Over Litigation

There are many ways of achieving a settlement of a commercial dispute. The simplest and usually the quickest is negotiation between the parties or their advisers. The parties themselves are in the best position to know the strengths and the weaknesses of their cases. If they need advice on points of difficulty or controversy, they can always seek it from lawyers, accountants, engineers or other experts as required. However, negotiation requires a certain detachment and objectivity as well as a willingness to compromise. Sometimes these qualities are hard to find. It is worth keeping in mind that a settlement by negotiation is always possible, even after other methods of resolving the dispute have been set in motion.[22]

If direct negotiations between the parties or their advisers fail, the intervention of a disinterested third party may be helpful. Sometimes this is done formally, by a conciliator or mediator. However, a claimant with a genuine claim should be careful not to be strung along, whether by negotiations or otherwise. Most international trade disputes are resolved by arbitration, if the parties themselves are unable to reach an agreement. To understand why this should be so, it is appropriate to consider other available methods. Not all practitioners or parties would agree that international arbitration is simpler, cheaper and quicker than litigation. The reasons that parties regularly choose arbitration over litigation for international contracts lie elsewhere.[23]

A comprehensive comparison of international arbitration and litigation would require *inter alia* a description of litigation and arbitration options on a nation-by-nation basis, and would require a multi-volume treatise. Arbitration offers the parties to choose their own judge, in a way which is not usually possible in court proceedings. One or more arbitrators may be chosen for their special skill and expertise in commercial

[21] Chakravarthy, M. Praveen, "philosophy of commercial arbitration"
[22] A.Redfern and M.Hunter, p. 22.
[23] See Friedland, Paul D., "*Arbitration clauses for International Contracts"* – "*Choosing between Arbitration and Litigation"*, New York: Juris Publishing, Inc., 2001), p.1.

law, civil engineering or some other relevant discipline. An experienced arbitral tribunal of this kind should be able to understand quickly the salient issues of fact or law in dispute and so save the parties both time and money, as well as offering them the prospect of sensible award.[24]

Moreover, there is continuity in an arbitration, since the arbitral tribunal is appointed to deal with one particular case. The arbitrators follow this case from the beginning to the end unlike a judge. The continuity of its role enables an arbitral tribunal to get to know the parties, their advisers and the case as it develops through the pleadings. This may be particularly useful if an opportunity for a negotiated settlement should arise, since the arbitral tribunal should be well placed to assist the parties in reaching the settlement, if assistance is required.[25]

Arbitration is also, in principle, more flexible and adaptable and as a result quicker and more efficient than litigation. A trial before a national court must be conducted in accordance with the rules of that court. These rules are usually detailed and will have been established for a long period. They must be capable of dealing with many different kinds of cases. They may well be unsuitable for the trial of commercial disputes.[26] In arbitral proceedings, it should be possible to tailor the rules to fit the particular case which is being arbitrated: for example, the parties may agree to limit the extend of the disclosure of the documents; to submit evidence in writing; to impose the limits on the length of the speeches; or generally to adopt other measures to save time and money. Too often however, this chance is missed. Arbitration then becomes a mere replica of proceedings in court.[27]

International arbitration is also preferable to litigation in terms of speed and cost which depends in part upon the assumed efficiency of the arbitrators, parties and

---

[24] There are multi-volume treatises that address and collect national arbitration laws. See, e.g., www.internationaladr.org/e.htm (last visisted in Feb 21st, 2006)

[25] Redfern, For this paragraph, it is said in the end note 87 at p. 23 that: "*An arbitral tribunal nevertheless exercise great caution in entering into any settlement discussions with the parties; and in certainly should not attempt to foist a settlement upon the parties. The task of the arbitral tribunal is to decide the dispute, not to act as mediators or conciliators."*

[26] Ibid., in endnote 88 at p.23, "*[I]n the civil law countries, there is usually a separate code of commercial law and often separate commercial courts. It is also worth nothing that in England, for example, a special Commercial Court has developed from the ordinary civil courts and now has been established to deal solely with commercial cases* [which is also the same in Turkey]".

[27] See Redfern, *"Litigation"* at pp.23, 24.

counsel and in larger part upon the national court system to which arbitration is compared. International arbitration is, for example, plainly speedier than litigation in court systems which are so overcrowded that litigants obtain their day in court only after several years of waiting. But insofar as an option available to parties to international contracts is submission to the courts of a relatively effective jurisdiction, the pertinent question faced by most contracting parties choosing between international arbitration and litigation is not whether arbitration is preferable to litigation in a jurisdiction that anyone would shun, but whether arbitration is preferable to litigation in jurisdiction that parties might reasonably choose.

Experience shows that international arbitration usually cannot be distinguished in terms of speed and cost from litigation in relatively efficient jurisdictions. Although most of the formalities of litigation are absent in arbitration, the preparation and resolution of complex commercial disputes takes time and is ordinarily not susceptible to substantial compression even by activist, private adjudicators.
Although the time limit that it takes to obtain an international arbitration award is usually less than the time that it takes to obtain a final court judgment where the decision of the court of first instance is appealed to a higher court (and perhaps two or three higher courts), international arbitration itself is increasingly subject to collateral or post-award challenge, and parties therefore not count on a dispute subject to arbitration being resolved without judicial involvement.[28]

The frequent parity of international arbitration and litigation in terms of speed and cost does not, however, mean that there is no reason to choose arbitration for international contracts. In fact, arbitration has during the last quarter of the 20th century become the standard dispute resolution method for international commercial contracts. Many of the companies and their many advisers who select international arbitration cannot all be wrong. There are three significant reasons for their preference for international commercial arbitration: availability, neutrality and enforceability.[29]

Arbitrators versus Judges and Juries:

[28] See, Friedland, supranote 9 at p. 2.
[29] Friedland, p. 2.

One of the most obvious differences between international arbitration and litigation is that arbitrations are decided by arbitrators selected by the parties or an arbitral institution and commercial court cases are decided by judges (in most nations) or juries (in a few, including the United States). How that difference influence should influence (if at all) the choice between arbitration and litigation is not obvious.

Where the choice is adjudication before international arbitrators or before a jury, the options are clear. As compared to juries, international arbitral tribunals can be presumed to be generally more educated and more expert in the subject matter. Most international arbitrators are lawyers; many others are selected precisely because they have experience in the industry in question.[30]

The distinction between international arbitrators and judges are less evident than those between arbitrators and juries, and provide in many situations an unreliable basis for choosing between arbitration and litigation. Arbitrators in theory may be more expert in the subject matter in question than judges, because arbitrators are often appointed with a particular case in mind. International arbitrators can also be expected to be more "internationally minded" than many judges who become exclusively habituated to application of their own local law and procedure. Yet there are jurisdictions where judges are chosen for merit and sophistication, and there are many arbitrations where the tribunal is in part selected from the same pool of jurists and sophisticated judges that comprise the judiciary. In such cases, there is often no appreciable distinction between the adjudicators in arbitration and those in a commercial court of first instance. In those cases, if there is distinction between the nature of the justice offered, it would arise out of the nature of the process rather than the nature of the adjudicators.

- Drawbacks of International Commercial Arbitration

A major weakness of the arbitral process is the limited powers which the arbitral tribunal may exercise. Indeed, an arbitral tribunal must depend for its full effectiveness upon an underlying national system of law. Powers possessed by arbitrators, whilst generally adequate for the purpose of resolving the matters in

[30] For a useful discussion of the considerations involved in selecting arbitrators, see Redfern and Hunter, supra note 6 at 205-8.

dispute, fall short of those conferred upon a court of law. For example there are some powers that a state cannot delegate to a private arbitral tribunal. Another perceived drawback of the arbitral process lies in the fact that, in general, it is not possible to bring multi-party disputes together before the same arbitral tribunal. Unlike a court of law, an arbitral tribunal generally has no power to order consolidation of actions. There are many cases in which at least one of the parties to an arbitration is content that this should be so, since the intervention of third parties is not always welcome; but leaving such cases aside, an arbitral tribunal cannot usually order consolidation of actions even if this would seem to be necessary or desirable in the interests of justice. An international construction project is a good example for this, in which the employer has entered into a contract with a main contractor who in turn has contracted with various sub-contractors and suppliers. If the employer has any complaints about the work done, he must arbitrate about the main contractor, who in turn must then seek to recover from the sub-contractors or suppliers concerned with the defective work by way of separate arbitrations. In court proceedings, all the relevant parties would usually be joined in one action; and so any liability owed to the employer may be passed down the chain of contracts and sub-contracts to the party or parties ultimately responsible.[31]

Moreover, arbitration is not necessarily a cheaper method of resolving disputes than litigation. First, the fees and expenses of arbitrators (unlike the salary of a judge) must be paid by the parties; and in international commercial arbitrations of any significance, these charges may be substantial. Secondly, it may be necessary to pay the administrative fees and expenses of an arbitral institution, and these too can be substantial, particularly when they are assessed by reference to the amounts in dispute. If the services of a specialized arbitral institution are not used, it may be necessary to appoint a secretary or a registrar to administer the proceedings. Once again, a fee must be paid. Finally, it will be necessary to hire rooms for meetings and hearings, rather than making use of the public facilities of the courts of law. This means that arbitration, particularly in international commercial disputes, is unlikely to be cheaper than the proceedings in court, unless there is a conscious effort to make it so. The arbitral process has its weaknesses, as well as its strengths. If its

[31] Ibid. P.25

strengths are not properly exploited, its weaknesses may lead to its gradual decline as an accepted method of resolving international commercial disputes.[32]

Consolidation as a drawback of arbitration:

In a project or transaction involving multiple parties and multiple contracts, international arbitration can present a distinct disadvantage as compared to litigation because consolidation of related arbitral proceedings is not assured regardless of the resultant efficiencies, unless the courts at the place of arbitration have an adequate basis to find that the parties consented to consolidated proceedings.

The prospect of multiple, parallel arbitral proceedings in an impediment that will lead many parties involved in multiple-party, multiple-contract deals to provide for litigation rather than international arbitration. This impediment can be negated by appropriate multi-party, multiple-contract arbitration agreements.

For some parties, the unavailability of consolidation poses no problem. Where, for example, a contractor seeks consolidation in order to guard against the risk of inconsistent awards in favor of the owner and subcontractor, the owner may be content to deal with the contractor alone without the distraction and expense of participating in the resolution of the contractors dispute with the subcontractor.[33]

International arbitration or national litigation

Where the dispute is set in an international context however, the balance comes down firmly in favor of arbitration. In a domestic context, parties who are looking for a binding decision on a dispute will usually have a choice between a national court and national arbitration. In an international context there is no such choice. There is no international court to deal with international commercial disputes. In this mean, there is a choice between national court and international arbitration.[34] For instance, a party entering into a contract has a free choice between arbitration and judicial litigation. In general, the right to arbitrate disputes has been codified in relevant Acts

[32] A.Redfern and M.Hunter, p.24.
[33] See Friedland, pp.12-13 consolidation as a drawback of arbitration.
[34] Unless these disputes are between states, in which case the states concerned may by agreement submit their case to the ICJ. The European Court of Justice may deal with disputes between private parties under community law.

within the national legal framework of the member states of the European Union. Although arbitration is still consensual and not mandatory, compulsory arbitrations do exist. The majority of arbitrations are conducted without the necessity to resort to the courts. Arbitration has the advantages of speed, simplicity, and economy. Judicial involvement in the process should be kept to a minimum to avoid undermining those goals. In fact, in the resolution of disputes, judicial and arbitration proceedings coexist, complement each other, and compete with each other. Arbitration should reduce court dockets; on the other hand, courts enforce every arbitration award and orders issued by an arbitrator. Arbitration statutes limit the right of judicial review of arbitration awards as much as possible. Limitation of judicial review is an efficient way of handling disputes with a minimum of procedure and a finality of result in a minimal amount of time. In setting aside arbitral proceedings, the function of the national court is restricted to the control with respect to fundamental principles of law and compliance with the *ordre public* international.

Finally, an important feature of arbitration is the *res judicata*, the binding effect of arbitral decisions that lead to a total or partial settlement of the dispute. The procedure for setting aside of an award is an exception to the general rule of the finality of arbitral awards.[35]

- The procedural distinctions between international arbitration and litigation:

A significant distinction between international arbitration and litigation is that, in the 125 or so nations that have ratified the New York Convention, arbitral awards rendered in other signatory nations must be enforced regardless of errors of fact or law, and those nations most likely to be chosen as places of arbitration similarly prohibit appeals (due to errors of fact or law) from international arbitral awards rendered in their jurisdictions, unless the parties specifically provide for this in their arbitration agreement.[36]

[35] Georgios, I. Zekos, "*The Treatment of Arbitration Under EU Law",* Dispute Resolution Journal; May 1999; 54, 2; ABI/INFORM Global p.8 et seq.

[36] A challenge of an award is usually accomplished by an action to "set aside," "vacate," or "nullify" the award in the country where the award was rendered. Under the UNCITRAL Model Law, Art. 34, the grounds for setting aside an award are similar to those set out in article V of the New York Convention.

One direct consequence of the limitation upon appeal from international arbitral awards is that, unlike the litigation process, the international arbitral process is usually not multi-staged, and hence is cheaper and quicker in this respect.[37] Critics of the international arbitral process, however, point to the absence of appellate or judicial review as permitting, and even promoting, a regime unfettered by the rule of law.[38]

The fact that international arbitrators are free to make mistakes of law, without risk of being reversed or corrected by a higher authority, does not by itself prove that international arbitration is a process that, in supposed contrast to court cases, is essentially free of the rule of law. The pertinent question is whether the outcome of international arbitration tends, more so than does litigation, to reflect the arbitrators' sense of the equities of the case rather than the requirements of the governing law.[39] There are no studies that show or disprove that international arbitrators make decisions based upon equitable considerations, at the expense of the law, any more than do judges and juries. The notion that courts of law are equity-free is in any event naive. Experienced trial council know that equitable arguments count in a court of law just as much, if not more than, strict legal arguments, whether the ultimate decision-maker is a judge or jury. The fear that international arbitration is, unlike litigation, an impressionistic process where arbitrators follow their hearts rather than the law is not one that should deter any party from agreeing to international arbitration. There is no proof that international arbitrators ignore or misapply the law more than judges or juries do. Experience shows that international arbitrators consistently seek to apply the governing law rigorously.

Another point is privacy or confidentiality. An important distinction between international arbitration and litigation is that arbitral proceedings are private, whereas

[37] [I]t should not be forgotten that arbitration is a form of 'one-stop-shopping', so that although its costs may not be less than that of proceedings in court (and may indeed be more) the award of the arbitrators is unlikely to be followed by a series of costly appeals to superior courts." Redfern & Hunter, supra note 6 at 25.
[38] The argument in favor of reviewing arbitral decisions in order to guard against mistakes of law is not difficult to make." Redfern & Hunter, supra note 3 at 433-34.
[39] On occasion, arbitrators are empowered and directed to decide a dispute on the basis of aquity by virtue of arbitration clauses that call for them to act as "amiable compositeur" or to decide "ex aequo et bono." Most arbitration laws recognize such agreements. See UNCITRAL Model Law, art 28(3).

litigation in many nations is open to the public and susceptible to be reported publicly.[40]

Privacy is nevertheless not the same as confidentiality. Arbitration permits confidentiality, but does not impose it. There is nothing in laws if most nations or in the rules of most of the leading arbitral institutions that forbids a party from disclosing to non-parties either the existence and nature of an arbitration, or what transpires in an arbitration, or even the contends of its adversary's submissions. This is because parties may have a legitimate interest, or need, to disclose certain facts pertaining to the arbitration to the third parties, such as shareholders, insurers, creditors, and it is difficult to draft in advance a rule that draws a workable line between legitimate and unjustified disclosure.

Moreover, parties can create far-reaching confidentiality duties either by selecting arbitral rules that impose such duties or by adding confidentiality restrictions to their arbitration agreement.

On balance, given (i) the power of the parties to impose confidentiality obligations, and (ii) the implied expectation and custom of confidentiality in international arbitration even in the absence of express restrictions, and the consequent risk of violating either the arbitrators' likely sense that an arbitration should be kept confidential or judicial views in certain nations regarding implied confidentiality obligations, the confidentiality of the arbitral process can be a decisive consideration in choosing between international arbitration and litigation whenever a company wishes either to shield the existence of a potential dispute from its customers or competitors or to preserve the confidentiality of a contracts subject matter.

Another point is summary procedures in international commercial arbitration:

---

[40] Article 21.3 of the ICC Rules of Arbitration provides that "persons not involved in the ……
Art. 19.4 of the LCIA Rules provides that "[a]ll meetings and hearings shall be in private unless the parties agree otherwise in writing or the [tribunal] directs otherwise." Art. 20.4 of the AAA International Arbitration Rules provides that "[h]earings are private unless the parties agree otherwise or the law provides to the contrary" and allows the tribunal to "require any witness or witnesses to retire during the testimony of other witnesses." Art. 25.4 of the UNCITRAL Arbitration Rules provides that "[h]earings shall be held in camera unless the parties agree otherwise" and permits the tribunal to "require the retirement of any witness or witnesses during the testimony of other witnesses."

According to the International Arbitral Rules, art.20.1, there will be a hearing during the Arbitration process. This is a consequence of the requirement of virtually all sets of arbitral rules that a hearing be held at the request of either party. The absence of summary procedures in international arbitration is a significant factor for many lenders who consider that the issue is most likely to arise in a dispute under a loan agreement is whether the borrower paid or not, an issue usually susceptible to summary treatment. For lenders (and other parties who foresee the possibility of resolving relatively simple disputes on the basis of the language of the agreement itself), an arbitration clause has the demerit not only of preventing summary disposition but also of suggesting that there may be something to arbitrate. Nonetheless, in any contract where the parties envisage the potential utility of summary disposition, they can empower the arbitrators to do so by agreement, any lenders typically have the bargaining power to impose such a provision.

Loan agreements aside, in the usual commercial contract it is not possible to know in advance that a dispute that may arise will be appropriate for summary disposition. In those cases, the absence of summary procedures in arbitration is usually not a deciding factor in the choice between arbitration and litigation at the contract drafting stage.

Presentation of Evidence is also differs. The rules of the leading arbitral institutions contain no particular standards respecting written submissions, other than the parties must be treated with equality and each party must be given a fair opportunity to present its case.[41] In addition, any documents or information submitted by a party to the tribunal must be simultaneously communicated to the other party or parties.[42]

The practice in international commercial arbitration of presenting evidence represents an amalgam of common law and civil law practices. As compared to common law practice, there is in international arbitration less emphasis on oral testimony and cross examination and more emphasis on written documentation. The common law rules of evidence do not apply, and also find greater resistance to discovery. As

[41] ICC Rules of Arbitration, art. 15.2; LCIA Rules, art 14.1; AAA International Arbitration Rules, art.16.1; UNCITRAL Arbitration Rules, art 15.1.
[42] ICC Rules of Arbitration, art. 3.1; LCIA Rules, art 4.1, 4.5; AAA International Arbitration Rules, art.16.4; UNCITRAL Arbitration Rules, art 15.3.

compared to practice in some civil law jurisdictions, the international arbitration process is adversarial rather than inquisitorial and involves relatively greater document exchange. There is no requirement in international arbitration that documents be introduced and accepted into evidence in the common law sense.

It is difficult to envision how these distinctions between international arbitral practice and the common law and civil law practices of national jurisdictions could be decisive in most instances in choosing between arbitration and litigation at the contract drafting state, and it is rare for a party to know when what nature of evidentiary submissions will be advantageous or disadvantageous for its position.[43]

1.3. Modes of International Commercial Arbitration

1.3.1. Generally

Institutional arbitration and ad hoc arbitration are distinct methods of proceeding. The parties to an ad hoc arbitration establish their own rules of procedure, which may be made to fit the facts of the dispute between them, whereas the parties to an institutional arbitration must conduct the arbitration in accordance with the procedural rules of the particular institution concerned.

In an ideal world, the choice between ad hoc and institutional arbitration would only be made once a dispute had arisen. It would then be possible to look at the nature of the dispute, to decide what kind of arbitral tribunal was needed to deal with it, what procedures should be followed and, most importantly, to assess the extent to which the parties are likely to co-operate in the conduct of the arbitration. In practice, however, the choice will usually have to be made at a much earlier stage. This is because most international commercial arbitrations are conducted pursuant to an arbitration clause in the original clause between the parties. If the clause provides for arbitration under the rules of a particular arbitral institution, this is the way in which the arbitration will proceed in practice—although it is possible for the parties to change their mind and to agree to proceed by way of ad hoc arbitration rather than by way of institutional arbitration, or vice versa. However, this can only be done by

[43] Friedland, p. 13 et. Seq.

agreement. A claimant who is faced with a dispute usually prefers to rely upon an arbitration agreement which is already in existence, rather than upon the hope of negotiating a new agreement. Accordingly the time to consider the relative advantages and disadvantages of institutional and ad hoc arbitration is usually when the original contract between the parties is being negotiated.[44]

1.3.2. Ad hoc Arbitration

An ad hoc arbitration usually takes place when the arbitration clause in the original agreement between the parties provides for arbitration without designating any arbitral institution and without referring to any particular set of institutional rules. An arbitration clause which provides, for instance, for disputes to be referred to arbitration in Paris "before a tribunal of three arbitrators, one of whom is to be chosen by each party and a third by agreement between the other two arbitrators" is a clause which provides for ad hoc arbitration.[45]

One distinct advantage of ad hoc arbitration is that it may be shaped to meet the wishes of the parties and the facts of the particular dispute. It needs the cooperation of the parties and their advisers for this to be done efficiently and effectively; but if such co-operation is forthcoming, the difference between an ad hoc arbitration is like the difference between a tailor-made suit and one which is bought "off-the-peg". It is, however, an expensive and time-consuming process to draft special rules for an ad hoc arbitration. Time and money can be saved by adopting, or adapting, rules of procedure which have been specially formulated for the purpose. There are various sets of rules which are suitable, of which the best known is the UNCITRAL Arbitration Rules. The greater flexibility offered by ad hoc arbitration means that many important arbitrations involving a state party are conducted on this basis. Many of the arbitrations under oil concession agreements which have taken place over the last 40 years or so were ad hoc arbitrations.[46]

---

[44] Dezalay, Yves; Garth, Bryant G., "*Dealing in Virtue: international commercial arbitration and the constitution of a transnational",* [1996], University of Chicago Pres.
[45] Redfern, pp.56-57.
[46] Including the Sapphire arbitration, the Aramco arbitration and the three Libyan oil nationalization arbitrations—Texaco, BP and Liamco) were ad hoc arbitrations.

One of the main disadvantages of an ad hoc arbitration is that it depends for its full effectiveness upon a spirit of co-operation between the parties and their lawyers, backed up by an adequate legal system in the place of arbitration. It is easy to delay arbitral proceedings by raising questions over procedural matters; and if one of the parties proves difficult or recalcitrant at the outset of the proceedings, there will be no arbitral tribunal in existence and no book of rules available to deal with the situation. It will then be necessary to rely on such provisions of law as may be available to offer the necessary support. Only when an arbitral tribunal is in existence, and a proper set of rules has been established, will an ad hoc arbitration proceed as smoothly as an institutional arbitration if one of the parties fails or refuses to play its in the proceedings.

1.3.3. Institutional Arbitration

Rules for international arbitration are established by the particular institution concerned; most notably the AAA, the ICC, ICSID, the LCIA, or the SCC. These rules will generally have passed the essential test of working well in practice. They are generally set out in a small booklet; and the parties who agree to submit any dispute to arbitration in accordance with the rules of a named institution effectively incorporate that institution's book of rules into their arbitration agreement. Automatic incorporation of a book of rules is one of the principal advantages of institutional arbitration. It will contain provisions under which the arbitration may proceed in the event of any default by one of the parties.[47] Another important advantage of institutional arbitration is that most arbitral institutions provide trained staff to administer the arbitration. They will ensure that the arbitral tribunal is appointed, hat advance payments are made in respect of the fees and expenses of the arbitrators, that time limits are kept in mind and, generally, that the arbitration is run as smoothly as possible. On the other hand, the major disadvantage of institutional arbitration is that it tends to be expensive. If the amounts at stake are considerable, and the parties are represented by advisers experienced in conduct of international commercial arbitration, it may be worthwhile to consider the possibility of conducting

[47] The 15.2 of the ICC Rules, for instance, stipulate that: "If one of the parties, although duly summoned, fails to appear, the arbitrator, if he is satisfied that the summons was duly received and the party is absent without valid excuse, shall have power to proceed with the arbitration, and such proceedings shall be deemed to have been conducted in the presence of all parties."

the arbitration ad hoc rather than institutional rules. A further disadvantage is the inevitable delays which result from the need to process certain steps in the arbitral proceedings through the bureaucratic machinery of the arbitral institution involved.

Conversely, the time limits imposed by institutional rules are often unrealistically short. A claimant is unlikely to complain about this, since he usually has plenty of time in which to prepare his case before he delivers it to the respondent, or to the relevant arbitral institution, and so set the clock running. However, a respondent is likely to find himself pressed for time, particularly in a case (such as a dispute under an international construction contract) which involves consideration of voluminous documents and where the claim which is put forward may, in fact, prove to be a whole series of claims on largely un related matters. Although extensions of time will usually be granted either by the institution concerned or by the arbitral tribunal, the respondent is placed in the invidious position of having to seek extensions of time at the very outset of the case. If the respondent is a state or a state entity, the problem is worse. The time limits laid down in institutional rules usually fail to take account of the time which a state or state entity needs to obtain approval of important decisions, through it own official channels.[48]

CHAPTER ONE: CHOICE OF LAW ISSUES IN PROCEDURAL MATTERS

1. Generally

Procedural rules reflect the process by which the courts exercise the powers conferred on them by their national law, and these rules embody the country's notions of how disputes should be resolved fairly and efficiently. Thus, the rules ensure the impartiality of judges, grant disputants adequate opportunity to prepare their cases, and safeguard the ability of the disputants to present their cases in a fair and equitable manner. Clearly, procedural rules vary among countries, for each country fashions its rules to conform as closely as possible to its notions of fair play, justice and efficiency.

[48] Redfern, p.22.

The position is different in an international commercial arbitration. Unlike judges, arbitrators in an international commercial arbitration do not necessarily derive their adjudicatory competence from the national law of their *situs*. An arbitration is essentially a product of the agreement of the parties involved, and the jurisdiction of international arbitrators is based on the arbitration agreement. This enables the parties to an arbitration to design their arbitral proceedings to suit their particular needs. With regards to the law governing arbitral procedure, the autonomy of the parties grants them the power to select suitable procedural rules.[49]

When we look at the situation in an international commercial arbitration, arbitrators do not necessarily derive their adjudicatory competence from the national law of their situs. Almost all the process takes power from the arbitration agreement made by the parties. This is why an award may be set aside or recognition denied if the arbitrators exceed the powers granted them by the parties.[50] According to this point, the preliminary award of ICC has to be reviewed where the arbitrator said:

"I myself do not see the need for referring to any particular set of national law rules or the court practice of any particular country. . . As arbitrator, I am myself no representative organ of any State. My authority as arbitrator rests upon an agreement between the parties to the dispute and by my activities I do not, as State judges . . . engage the responsibility of [a State]. Furthermore, the courts and other authorities of [a State] can in no way interfere with my activities as arbitrator, neither direct me to do anything which I think I should not do nor direct me to abstain from doing anything which I think I should not do nor direct me to abstain from doing anything which I think I should do."[51]

Parties to an international arbitration expect that by adopting private arbitration they would, at least to a considerable extent, escape the trappings and peculiarities of domestic judicial systems. They seek to resolve their dispute in an informal arena with flexible proceedings.[52]

---

[49] This is why an award may be set aside or recognition denied if the arbitrators exceed the powers granted them by the parties. See Article 52(1)(b) of the Washington Convention, Articles 34(2)(a)(iii) and 36(1)(a)(iii) of the Model Law, and Article V(1)(c) of the New York Convention.

[50] See Article 52(1)(b) of the Washington Convention, Articles 34(2)(a)(iii) and 36(1)(a)(iii) of the Model Law, and Article V(1)(c) of the New See Article 52(1)(b) of the Washington Convention, Articles 34(2)(a)(iii) and 36(1)(a)(iii) of the Model Law, and Article V(1)(c) of the New York Convention.

[51] Lauterpacht, Elihu; Lauterpacht, C. J., Greenwood, "*International Law Reports"* Published [1984] Cambridge University Pres. P.451.

[52] Ibid, pp. 451.

Parties can express their choice of procedural rules in variety of ways. They may set out their own detailed rules governing each aspect of the proceedings, or adopt the rules of an established arbitration institution. It should be noted that when parties consent to arbitration under the auspices of an arbitral institution, they are taken to incorporate into their agreement the rules of the institution.[53] The parties may also adopt the procedural rules prevailing in a particular national jurisdiction, or leave it to the discretion of the arbitral tribunal to decide how to contact the proceedings.[54]

2. Arbitration Agreement

Arbitration agreement - The agreement concluded between parties, providing for the submission of their dispute to arbitration, usually in a particular place, under a particular law governing the dispute along with rules of procedure governing the appointment of arbitrators and the arbitration process. The law applicable to the arbitration agreement, the laws applicable to the subject of the dispute, the law of the arbitral proceedings and the applicable conflict rules may all be different, each having a proper law of its own.[55]

The arbitration agreement is the cornerstone of arbitration because it embodies the consent of the parties to arbitration. It is in the arbitration agreement that the basis for the jurisdiction and powers of an international commercial arbitrator can be found. The necessity of examining the laws relating to arbitration agreements is therefore self-evident.[56]

The laws relating to the arbitration agreement are those that determine whether or not the parties consented to arbitration and the legal implications of the arbitration agreement. When reference is made to the law relating to arbitration agreements, it should be noted that this does not necessarily refer to one body of law; it is possible for different laws to apply to different areas of the arbitration agreement. For

[53] In the context of ICC arbitration, Article 8(1) of the ICC rules provides that "Where the parties have agreed to submit to arbitration by the International Chamber of Commerce, they shall be deemed to have submitted *ipso facto* to the present rules."
[54] Chukwumerije, pp.75 et seq.
[55] See Tetley, *Int'l C. of L.*, 1994 at pp. 400-410.
[56] Definitions are from the web site: <http://www.mcgill.ca/maritimelaw/glossaries/conflictlaws,> last visited in Mar. 19th 2006.

example, the law governing the capacity of the parties to enter into an arbitration agreement may differ from the law governing the arbitrability of the subject matter.

There are two types of arbitration agreements. The first, the submission, is an agreement to refer existing disputes to arbitration. This is known in continental parlance as a compromise. The second, the arbitration clause is an agreement to refer existing dispute to arbitration. In continental parlance it is known as the clause compromissoire. The arbitration clause, which is usually part of a large commercial agreement, is more common source of arbitration.[57]

2.1 Concept of Arbitration Agreement

In an international commercial arbitration the arbitration agreement fulfils several important functions. The most vital of these is that it shows that the parties have consented to resolve their disputes by arbitration.

This element of consent is essential. Without it, there can be no valid arbitration.[58] The fact that international commercial arbitration rests on the agreement of the parties is given particular importance by some continental jurists. The arbitral proceedings are seen as an expression of the will of the parties and, on the basis of party autonomy it is sometimes argued that international commercial arbitration should be freed from the restraints of national law and treated as denationalized and delocalized.

2.1.1 Theories Regarding the Nature of Arbitration Agreement

Once parties have validly given their consent to arbitration, this consent cannot be unilaterally withdrawn. Even if the arbitration agreement forms part of the original contract between the parties and the contract comes to an end, the obligation to arbitrate survives. It is an independent obligation separable from the rest of the contract.

The issue may arise whether or not an arbitration clause survives the invalidity of the substantive agreement in which it is contained. Does the invalidity of the main

[57] Chukwumerije, p.29

[58] There are circumstances in which arbitration may be a compulsory method of resolving disputes. Domestically, arbitrations may take place compulsorily under legislation governing, for example, agricultural disputes or labor law.

contract adversely affect an arbitration clause contained therein? If the question is answered in the affirmative, an arbitrator cannot assume jurisdiction in situations where one of the parties contends that the substantive agreement containing the arbitration clause is invalid, at least until the validity of the substantive agreement is determined (perhaps by a national court). In this mean, the most important theories will be touched on in this section.

2.1.2 Autonomy of Arbitration Agreement

It does not take much effort to see that if the validity of the arbitration clause is dependent on the validity of the main contract, a party seeking to frustrate or delay the arbitration process need only plead that the main contract is invalid in order to preempt the arbitrator's jurisdiction and seek a court resolution of that preliminary objection. The principle of the autonomy of the arbitration agreements is designed, in part, to prevent the use of this kind of tactic in stalling the process of arbitration.

The principal of the autonomy of the arbitration agreement proclaims that an arbitration agreement is autonomous in relation to the contract from which it originates. In this sense, an arbitration clause is independent of the commercial agreement in which it is contained, and cannot be automatically affected by the fortunes of the substantive contract. One effect of the principle is that the arbitration clause survives the invalidity of the substantive contract unless it is shown that the cause of the invalidity also specifically applies to the arbitration clause. This principle is recognized in many countries. [59]

For example, it has yet fully accepted in England. English law draws a distinction between the autonomy of the arbitration agreement in the sense that it constitutes to exist where the main contract has come to an end due to performance or frustration, and the autonomy according to which an arbitration agreement survives the invalidity of the main contract. In the latter case, the traditional English position was that where the main contract is invalid *ab initio,* the arbitration agreement contained therein is

[59] See W. Craig, Supra note 1, p.66. In their view, if the invalidity of the substantive contract reaches the arbitration agreement,
It is presumed that even though the parties may have signed an invalid contract (because, for example, it is contrary to competition law) they nevertheless expressed a separate and valid intend that any dispute arising in connection with the contract should be resolved by arbitration. That intend is then viewed as extending to cover the consequences of the invalidity of the contract (assuming the arbitral tribunal in fact finds it to be invalid).

also invalid *ab initio*: “In English law, no arbitrator can have jurisdiction, however wide the wording of the arbitration clause which the parties or alleged parties insert into their contract, to decide a dispute as to the initial existence or validity of the alleged contract in which the arbitration appears.” The English courts have therefore held that, absent a subsequent agreement arbitrate, an arbitration agreement and the main contract must be tested in court in situations where it is alleged that the main contract was invalid as a result of its illegality or due to the incapacity of one of the parties. On the other hand, where the contract comes to an end as a result of its performance or frustration, the arbitration clause is regarded as being executory as long as there are outstanding disputes between the parties with respect to any obligation under the main contract.

The autonomy principle accords with practicality in that it frees an arbitration clause from allegation of invalidity of the substantive contract in which it is contained. The principle is founded more on practical needs than any credible theoretical basis,[60] because logic suggests that where the invalidity of a contract is alleged, all provisions of the alleged contract be held in abeyance until the question of validity is resolved by the courts, as opposed to an arbitral tribunal to be constituted under the disputed agreement. The juridical autonomy of arbitration agreements has led to a trend toward the acceptance of the powers of an arbitral tribunal to determine its jurisdiction. The *Kompetenz-Kompetenz*[61] rule empowers arbitral tribunals to determine their jurisdiction. The practical implication of the rule is that whenever the jurisdiction of an arbitral tribunal is challenged, the tribunal itself has to determine its jurisdiction, without the need to immediately refer the matter to a national court.[62]

It has been suggested that this trend is a product of the “inherent power” of arbitrators to determine their own jurisdiction. This argument is preposterous, for how can an arbitral tribunal exercise its so called ‘inherent power’ if the foundation for its exercise of jurisdiction, the arbitration agreement, is called in question. The better view is that the rule is a product of practical necessity, in that without it a party may

[60] See S. Schwebel, *International Arbitration: Three Salient Problems* (Cambridge: Grotious, 1987) at 60.
[61] For the term *Kompetenz-Kompetenz*, see section 3 of this chapter.
[62] It should be pointed out that countries that do not accept the autonomy principle would deny an arbitral tribunal the power to determine its jurisdiction in cases where the validity of the arbitration agreement is in question.

stall the arbitration process by raising jurisdictional objections that can only be resolved by potentially lengthy court proceedings.

This trend (that is the acceptance of the *Kompetenz-Kompetenz* rule) is reflected in international conventions and treaties dealing with arbitration. Article 16(1) of the Model Law, for example provides that "The arbitral tribunal may rule on its own jurisdiction, including any objection with respect to the existence and validity of the arbitration agreement. A decision of the arbitral tribunal that the contract is null and void shall not entail *ipso jure* the invalidity of the arbitration clause."[63] The rule is also contained in the arbitration rules of institutional arbitration bodies. These bodies pride themselves as places where parties can resolve commercial disputes with limited interference by, or recourse to, national courts. Article 8(4) of the ICC Rules, for example, provides that: Unless otherwise provided, the arbitrator shall not cease to have jurisdiction by reason of any claim that the contract is null and void or allegation that it is inexistent provided that he upholds the validity of the agreement to arbitrate. He shall continue to have jurisdiction, even though the contract itself may be inexistent or null and void, to determine the respective rights of the parties and to adjudicate upon their claims and pleas.

The Kompetanz-Kompetanz rule is also accepted in some States.[64] According to the Supreme Court of Hong Kong, "arbitrators should not pull down the shutters on the arbitral process as soon as one party objects to the jurisdiction of the tribunal. The arbitrator can rule on the question as to whether he (or her) has jurisdiction…" However, a number of states do not accept the rule in cases where the validity of the arbitration agreement itself is n dispute. The argument is that where the validity of the arbitration agreement itself is questioned by one of the parties, the consensus of the parties needed for a valid arbitration is lacking, and that is only a court that could then determine the consensual basis of the agreement. This point was made by the English House of Lords in Heyman v. Darwins Ltd.. "If the dispute is as to whether the contract which contains the clause has ever been entered into at all, that issue cannot go to arbitration under the clause, for the party who denies that he has ever

[63] See also Article V(3) of the European Convention on International Commercial Arbitration.
[64] An example is Switzerland. Article 186 of the Swiss Private International Law Act provides that the "arbitral tribunal shall decide on its own jurisdiction." See also Article 1466 of the French Code of Civil Procedure.

entered into the contract is thereby denying that he has ever joined in the submission." This position could promote the use of dilatory tactics by parties who wish to frustrate an arbitration. [65]

What is needed is a kind of compromise that allows the arbitral tribunal to determine its jurisdiction while reserving to the parties the right to challenge such ruling in court if they are not satisfied with the tribunal's award. This type of compromise is contained in the Model Law, which reconciles the need for arbitral autonomy with the demands of those who insist on an avenue for judicial rectification of an arbitral tribunal's excess of jurisdiction. It allows the arbitral tribunal to determine its jurisdiction subject to the possibility of appeal to a national court. It checks the prospect of unnecessary delays by limiting the time for such appeal, making the court decision final, and giving the arbitrator the discreation to continue with the proceedings while the court review is in progress.[66]

Another aspect of the autonomy principle is that the substantive agreement and the arbitration clause may be governed by different laws. Even where the parties expressly subject the substantive contract to the laws of a particular country, the autonomy principle ensures that the arbitrator does not necessarily have to apply such a law in relation to the arbitration agreement. This point was made by he arbitrators in Dow Chemicals France v. Isover Saint Gobain:[67]

The source of law applicable to determine the scope and the effects of an arbitration clause providing for international arbitration does not necessarily coincide with the law applicable to the merits of a dispute submitted to such arbitration. Although this law or these rules of law may in certain cases concern the merits of the dispute as well as the arbitration agreement, it is perfectly possible that in other cases, the latter,

---

[65] For the details of this case visit the web on, http://www.publications.parliament.uk/pa/ld199900/ldjudgmt/jd000727/alp-2.htm [1942] 1 All E.R. 337. (last visited on May 5th , 2006.

[66] Article 16(3) of the Model law provides: "*The arbitral tribunal may rule (on its jurisdiction) either as a preliminary question or in an award on the merits. If the arbitral tribunal rules as a preliminary question that it has jurisdiction, any party may request, within thirty days after having received notice of that ruling, the court specified in article 6 to decide the matter, which decision shall be subject to no appeal; while such a request is pending, the arbitral tribunal may continue the arbitral proceedings and make an award.*

[67] Dow Chemical France et al. v ISOVER Saint Gobain, ICC Award No. 4131, in: Journal du Droit International (Clunet) 1983 (Volume 110), at 899 *et seq.*

because of its autonomy, is governed –not only as to its scope, but as to its effect– by its own specific sources of law, distinct from those that goven the merits of the dispute.

The arbitrators then went on to hold that the scope and the effect of the arbitration agreement in the instant case was not intended to be governed by the law that the parties had chosen to govern the merits of the dispute. Rather, they relied on the common intention of the parties as evidenced in the conclusion and performance of the contract, and usages conforming to the needs of international commerce. National courts also recognize that the law applicable to the substantive contract and the arbitration clause may differ.

The autonomy of the arbitration agreement helps us to view an arbitration clause as a regime independent of the substantive contract. Viewing the arbitration clause as separate from the substantive contract enables us to understand that the legal regime applicable to the former may differ from that applicable to the latter.[68]

2.1.3 Arbitrability

The concept of arbitrability, relates to public policy limitations upon arbitration as a method of settling disputes. Each state may decide, in accordance with its own economic and social policy, which matters may be settled by arbitration and which may not. In international cases, arbitrability involves a balancing of competing policy considerations. The legislators and courts in each country must balance the importance of reserving matters of public interest (such as human rights or criminal law issues) to the courts against the public interest in the encouragement of arbitration in commercial matters. The latter interest may be for reasons of reducing the burden on overloaded courts, the promotion of the country as a venue for international arbitrations, the promotion of international trade generally or maintaining respect for international comity. There are some commercial agreements which would probably not be made if the parties were compelled to settle the disputes in one or the other's courts. If the arbitration agreement covers matters incapable of being settled by arbitration, under the law of the agreement or under the law of the

[68] Chukwumerije, pp. 29-34

place of arbitration, the agreement is ineffective since it will be unenforceable. Moreover, recognition or enforcement of an award may be refused if the subject-matter of the difference is not "arbitrable" under the law of the country where enforcement is sought.[69]

Arbitrability, then, is concerned with the question of whether a dispute is capable of settlement by arbitration under the applicable law; in other words, is this the kind of dispute which the relevant law allows arbitrators to resolve, or 'does it fall within the reserved domain of the courts?' This is a different question from that with which it is sometimes confused, namely whether the dispute is within the scope of or covered by the wording of the arbitration agreement. It is unfortunate that occasionally the term "arbitrable" is used to describe this second question as well.

'What kind of disputes may not be arbitrable?':

It thus becomes necessary to consider the types of dispute which states might consider not capable of settlement by arbitration. Relevant subject-matters for consideration include securities law, competition laws and antitrust matters, matrimonial status, bankruptcy, and certain intellectual property rights. Some matters of a public law nature, such as criminal law, do not admit of settlement by private parties.

Public policy limitations on arbitrability do not always mean that the arbitral tribunal must refuse to consider any issue which touches upon a forbidden field. It is often a simply a matter of the tribunal accepting the law in respect of the issue as that law has been determined by the state involved. Thus if a party to an arbitration claims a license or a patent, then the arbitral body must accept any such license or patent at face and may not go behind the determination of the regulatory agency which granted it. Neither may the parties seek to circumvent mandatory laws by choice of law or forum provisions in an arbitration agreement if those laws would otherwise apply to the activities of the parties in the performance of the contract.

[69] New York Convention, Art. V.2(a). This introduces a further complication. In determining the arbitrability of a particular subject –matter it might in theory be necessary to take account of

- the law governing the arbitration agreement;
- the law of the place of arbitration (the *lex locus arbitri*); and
- the law of the place of enforcement (to the extend that the place of enforcement is known).

If an arbitral tribunal makes an award in respect of a dispute which is not arbitrable (that is to say not capable by arbitration), that award is unlikely to be enforceable.
The problem is complicated by the fact that at least three different national systems of law may be involved in the decision as to whether or not a particular dispute is arbitrable–and they may not necessarily reach the same conclusion. The question may fall to be determined first, under the law governing the arbitration agreement; secondly, under the law of the place of arbitration; and, thirdly, under the law (or laws) of the country (or countries) of enforcement.[70] It is doubtful whether the parties may validly extend the scope of arbitrability by choosing a law to govern the merits of the case, or the arbitral proceedings, so as to bring a dispute within the bounds of what is arbitral, when it might not otherwise be arbitrable. In broad terms, most commercial disputes are arbitrable under the laws of most countries. [71]

2.2 The Concept of Lex Arbitri

The "lex arbitri" is the Latin term for "law of the place where arbitration is to take place" in private international law. It is possible to envisage an ideal world in which the country or place in which a particular arbitration is held makes no difference to the legal principles applied or the procedure followed. In such a world, the arbitral tribunal would be guided by the agreements of the parties, or failing such agreement, by its own judgment; it would decide the substantive matters in issue before it on the basis of the applicable law or legal rules—or , if the parties so wished, *ex aequo et bono*; and it would make an award which was enforceable on the same conditions in any state in which the losing party had assets. Moreover, its award would be the same, uninfluenced by national laws or attitudes of mind, in whichever state the arbitral tribunal happened to sit for the purpose of conducting the arbitration.[72]

The aim of the international conventions such as the New York Convention and the Model Law is to move towards such an ideal world; but it is still a long way away. Each state has its own national habits, its national characteristics, its own concept of how arbitrations should be conducted in its territory; and states with highly developed

[70] This the combined effect of the New York Convention, Art. II.1, Art. V.1(a) and Art. V.2(a).
[71] Redfern, pp.137 – 146.
[72] See the definitions in detail at web site <http://www.nationmaster.com/encyclopedia/Lex-loci-arbitri> last visited in Mar.20th 2006.

laws of arbitration are particularly (and understandably) reluctant to adopt simplified models, which may leave many difficult problems unresolved. Accordingly, it is essential to have regard to the law of the place in which the arbitration takes place, since this law will regulate many aspects of the arbitral process.

It is a feature of international commercial arbitration that it usually takes place in a country which is "neutral" in the sense that is not the place of business or residence of the parties to the dispute. This means that, in practice, the law which governs the arbitration is likely to be different from the law which governs the arbitration is likely to be different from the law which governs the substantive matters in dispute or the "proper law" in Dicey's celebrated phrase. Thus an arbitral tribunal sitting in Switzerland, for example, may be required to apply the law of France or some other jurisdiction to the merits of the dispute; but its own proceedings will be regulated by the law of the place in which the arbitration takes place.[73]

2.2.1. Connecting Factors Establishing Lex Arbitri

The difference between the lex arbitri and the proper law is demonstrated by an English case which concerned an international contract for the carriage of crude oil *"the Compagnie d'Armement Maritime case"*.[74] The contract was negotiated in Paris between a French company and a Tunisian company. The oil was to be carried between the Tunisian ports by a number of vessels over a period of months. The parties used a standard form of charter-party printed in English, of which some additional typed clauses were added, to provide that any ensuing dispute should be resolved by arbitration in London. The arbitrators held that the contract of carriage was governed by French law, whereas the law applicable to the arbitration was English law. The court said:

"It is not now open to question that if parties to a commercial contract have agreed expressly upon the system of law of one country as the proper law of their contract and have selected a different curial law by providing expressly that disputes under the contract shall be submitted to arbitration in another country, the arbitrators must

[73] The parties might choose to have the proceedings themselves governed by a law different from the law of the place of arbitration.

[74] *Compagnie d'Armement Maritime S.A. v. Compagnie Tunisienne de Navigation S.A.* [1971] A.C. 572

apply as the proper law of the contract that system of law on which the parties have expressly agreed."[75]

So, on appeal to the House of Lords, the decision of the arbitrators was affirmed. In the law lords' view, although the arbitration was governed by English law, the substance of the dispute was governed by French law as the law most closely connected with the contract.

The distinction between the law governing the arbitration and the law applicable to the matters in issue before the arbitral tribunal is of general application; and, as a matter of principle, it s right that it should be so. In many cases the parties do not choose for themselves the place of arbitration. Frequently, they leave the decision to the arbitral tribunal itself. Even more frequently, they leave the choice to a third party responsible both for the appointment of a sole arbitrator (or presiding arbitrator) and for the selection of the place of arbitration. The selection of the place of arbitration is then likely to depend on considerations which have no connection with the dispute between the parties, the dominant consideration usually being that the arbitration should take place in a country which is neutral in the sense that it is not the home of either of the parties to the arbitration. For instance, when the ICC appoints a sole arbitrator, or presiding arbitrator, it almost invariably appoints a person who is of a different nationality from that of the parties; and when the ICC selects the place of arbitration, it usually chooses the country of the sole arbitrator of the presiding arbitrator.[76] In such cases which are common, it is evident that the chosen place of arbitration has nothing to do with the parties, or with the agreement under which the dispute arises. It is, so to speak, an accidental choice. In these circumstances, it would be capricious to hold that the law of the place of arbitration was also, and necessarily, the law applicable to the issues in dispute.

Connecting factors (contacts) - In the conflict of law, connecting factors, or contacts, are facts which tend to connect a transaction or occurrence with a particular law or jurisdiction (e.g. the domicile, residence, nationality or place of incorporation of the parties; the place(s) of conclusion or performance of the contract; the place(s) where

[75] Collins, Lawrence, "*Essays in International Litigation and the Conflict of Laws*",[1994] Oxford University Pres p.428
[76] ICC Rules Arts.2.6 and 12.

the tort or delict was committed or where its harm was felt; the flag or country of registry of the ship; the shipowner's base of operations, etc.). Connecting factors are taken into consideration and weighed by courts and arbitrators, in determining the proper law *(infra)* to apply to decide the case or dispute.[77]

2.2.1.1. Party Autonomy

The principle of party autonomy enables the parties to an arbitration to design their arbitral proceedings to suit their particular needs. With regard to the law governing arbitral procedure, this principle grants the parties the power to select suitable procedural rules.

Party autonomy is a principle which has been endorsed both by national laws and international arbitral institutions and organizations. The working papers for the Model Law show the principle being adopted without any contrary view being expressed; and the text of the Model Law itself contains the following provision:

"*Subject to the provisions of this Law, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings."*[78]

This provision follows the position adapted by many states, either by legislation or by case law. It also follows in the steps of the Geneva Protocol of 1923 which provided that "the arbitral procedure, including the constitution of the arbitral tribunal, shall be governed by the will of the parties…"[79]; and the New York Convention, under which recognition and enforcement of a foreign arbitral award may be refused if "the arbitral procedure was not in accordance with the agreement of the parties."[80]

The ICC Rules, historically a champion of the principle of autonomy of the parties, provide: "the rules governing the proceedings before the arbitrator shall be those resulting from these rules and, where these rules are silent, any rules which the parties (or, failing them, the arbitrator) may settle…"[81]

---

[77] See **Tetley**, William, "**International Conflict of Laws**: Common, Civil, and Maritime", Montreal. QC, Canada: International Shipping Publications: Biais, 1994 at pp. 41, 195-196.
[78] Model Law, Art. 19(1).
[79] Geneva Protocol of 1923, Art. 2.
[80] New York Convention, Art. V.1(d).
[81] ICC Rules, Art. 11.

Adopting the same approach, the LCIA Rules state:

“

1. The parties may agree on the arbitral procedure and are encouraged to do so.
2. In the absence of procedural rules agreed by the parties or contained herein, the Tribunal shall have the widest discretion allowed under such law as may be applicable to ensure the just, expeditious, economical, and final determination of the dispute. ”[82]

ICSID adopts a similar line. Although detailed provisions are set out with regard to the conduct of the proceedings, the ICSID Arbitration Rules state:

“(1) As early as possible after the constitution of a Commission, its President shall endeavor to ascertain the views of the parties regarding questions of procedure. For this purpose he may request the parties to

(a) the number of members of the Commission required to constitute a quorum at its sittings;

(b) the language or languages to be used in the proceeding;

(c) the evidence, oral or written, which each party intends to produce or to request the Commission to call for, and the written statements which each party intends to file, as well as the time limits within which such evidence should be produced and such statements filed;”

(d) the number of copies desired by each party of instruments filed by the other; and

(e) the manner in which the record of the hearings shall be kept.

(2) In the conduct of the proceeding the Commission shall apply any agreement between the parties on procedural matters, except as otherwise provided in the Convention or the Administrative and Financial Regulations.”[83]

The Commercial Arbitration Rules of the AAA are less liberal in the sense that no equivalent to the ICSID provision is present, and the Rules set out a defined “order of proceedings”.[84] However, in practice any specific agreement of the parties as to procedure will be respected both by the AAA and the arbitral tribunal.

[82] LCIA Rules, Art. 5.
[83] ICSID Arbitration Rules, Rule 20(1) and (2).
[84] AAA Commercial Arbitration Rules, Art. 29.

Other rules of arbitration are drawn so as to transfer effective control of the proceedings from the parties to the arbitral tribunal at a comparatively early stage of the proceedings. This is a particularly so with the UNCITRAL Arbitration Rules which provide:

"*Subject to these rules, the arbitral tribunal may conduct the arbitration in such manner as it considers appropriate…*"[85]

Nevertheless, considerable freedom still rests with the parties; for example, they may requests hearings; agree upon the place of arbitration; agree upon the language or languages to be used in the arbitration; and so on.

Parties to an international arbitration expect that by adopting private arbitration they would, at least to considerable extend, escape the trappings and peculiarities of domestic judicial systems. They seek to resolve their dispute in an informal and flexible arena well suited for the resolution of disputes among business associates, and devoid of the acrimony and aggression often present in judicial proceedings. One way the informality of the arbitral process is guaranteed for the parties themselves to select the rules for procedure. When parties decide to arbitrate under the auspices of the International Chamber of Commerce, for example, they scarcely expect the arbitration to be burdened by multifarious procedural rules of a national jurisdiction. They see in ICC arbitration a means of escaping from the procedural peculiarities of local courts, of adopting the more flexible ICC procedural rules, and granting to the arbitrators the powers to supplement the ICC rules.

On the other hand, there are some restrictions on party autonomy. In the exercise of their autonomy, the parties may confer upon the arbitral tribunal such powers and duties as they consider appropriate to the specific case. They may choose formal or informal methods of conducting the arbitration; documentary or oral methods of presenting evidence; and so forth. The exercise of this autonomy is, however restricted by certain requirements.

[85] UNCITRAL Arbitration Rules, Art. 15.1.

If party autonomy is the first principle to be applied in relation to arbitral procedure, equality of treatment is the second—and it is of the same importance. This principle is given express recognition both in the New York Convention and in the Model Law, which states:

"*the parties shall be treated with equality and each party shall be given a full opportunity of presenting his case."*[86]

The concept of treating the parties with equality is fundamental to all systems of justice.

Another point for restriction is public policy. The parties may not confer powers upon an arbitral tribunal which would cause the arbitration to be conducted in a manner contrary to the public policy of the state in which the arbitration is held. Any agreement by the parties conferring a power on the arbitral tribunal to perform an act in conducting the arbitration contrary to a mandatory rule or public policy would be unenforceable.

Lastly, for the position of third parties, there is a restriction. Parties to an arbitration agreement may not validly confer any powers on an arbitral tribunal which directly affect a third party, unless there is a special provision of the governing law which enables them to do so. The award of an arbitral tribunal cannot properly direct a person who is not a party to the arbitration agreement to pay a sum of money or to perform a particular act.

2.2.1.2. The Place of Arbitration

Parties to an international arbitration are generally free to choose themselves where that arbitration should take place.[87] The parties may take the choice of a place at any time before the arbitration begins; or they may leave it to be made on their behalf by an arbitral institution (if the arbitration is to be conducted under institutional rules) or by the arbitral tribunal itself. At some stage, however, a choice will have to be made. The question which then arises is where should an international commercial arbitration be held?

[86] Model Law, Art 18.
[87] As an exception to this general rule: see ICSIDArbitration Rules, Rule 13(3).

There is no simple or universal answer to this question. The nationality of the parties to the arbitration will have to be taken into account, since the general practice is to hold an arbitration in a country which is neutral, in the sense that it is not the country of any of the parties to the dispute. The usual residence or place of business of the parties must be taken into account too, because of the need to cut down as far as possible on the expense and inconvenience of traveling. There are political factors such as the general acceptability of the particular location to the parties and, in particular, the question of whether any restriction is likely to be imposed on the entry of the arbitral tribunal, the parties, their advisors and witnesses.

There are economic factors, such as freedom to transfer the necessary funds to and from the country concerned. There may well be a need for skilled local support—from lawyers competent to ad vise on matters relevant to the conduct of the arbitration, or from engineers, surveyors, accountants and other professional men to provide expert assistance and evidence. Such assistance is less expensive if it is available at the place of arbitration. There are practical considerations too, such as the availability of suitable rooms for the hearing, and suitable accommodation for the parties, their advisers and witnesses. Transportation facilities, communications and some other services form part of the infrastructure of an arbitration. Another possibility is a determination of place of arbitration, whether made by the parties, by the arbitral tribunal or by an arbitral institution, does not necessarily mean that all meetings and hearings must be held at that place. Subject to any agreement of the parties to the contrary, the arbitral tribunal is not prohibited from holding hearings, or meetings either privately or with the parties, in any other country to suit the convenience of witnesses or of the parties themselves.[88] Modern arbitration laws will often expressly provide for the arbitral tribunal to hold hearings at any place which it deems appropriate.

The suitability of a particular place for an international arbitration will depend in part on whether there is a sufficient infrastructure to accommodate the parties; but the more important considerations have to do with the legal environment of the

[88] See, e.g. UNCITRAL Arbitration Rules, Art. 16.2 and 3.

prospective place of arbitration. This will be relevant both to the conduct of the arbitration and to the enforceability of any award rendered.

The importance of the enforceability of the award in relation to the choice of the place of arbitration cannot be overstated. As global trade expands, and the number of international arbitration increases, so does the participation of transnational corporations. The assets of these transnationals may be located in a number of different countries and their presence in any one country may disappear. It is accordingly necessary to have an award which is "portable".

2.3. Applicable Law to Arbitration Agreement

An arbitral tribunal may not exceed its mandate by deciding issues which are not covered by the wording of the arbitration agreement. The determination of the scope of the agreement involves the interpretation of that agreement and is accordingly governed by the proper law of the agreement. This will usually be the same law as that which governs the substantive contract in which an arbitral clause is embedded, but the parties may choose different proper laws for the main contract and the arbitration agreement. This is more likely to occur in the case of a submission agreement to refer an existing dispute to arbitration.

Where the agreement to arbitrate is contained in a submission agreement, the parties should make an express choice of the law which is to govern that agreement. If this is not done, it may become necessary for the law applicable to the arbitration agreement to be ascertained by the arbitral tribunal itself, as part of its task of determining the dispute, or by a court of competent jurisdiction, if the award is challenged or if recognition or enforcement of it is opposed.

One ground for the challenge of an award consistently found in national laws (and which is set out in the Model Law) is the invalidity of the arbitration agreement. Similarly, the invalidity of the arbitration agreement is a ground for refusal of recognition or enforcement of an award in both the New York Convention and the Model Law. In each case, the question of the validity of the arbitration agreement falls

to be determined by its proper law, or if this is not indicated in the agreement, by the law of the place of arbitration.[89]

Where the agreement to arbitrate is contained in an arbitration clause which itself forms part of a wider contract, the arbitration clause is normally governed by the same law as the rest of the contract.[90] If there is no choice of law by the parties the validity of the arbitration agreement may have to be decided both under its proper law and under the law of the place of arbitration. For example, an arbitral tribunal may decide that the arbitration agreement is valid under its proper law, being the law which the arbitral tribunal selects as appropriate (in the absence of any indication by the parties of their choice); and it will accordingly allow the arbitration to proceed. If recognition and enforcement of the ensuing award is opposed, on the basis that the arbitration agreement is invalid, the question will be determined by the appropriate court by reference to the law of the place of arbitration, since the proper law of the agreement was not indicated in it.

Once again (as with the question of capacity to enter an agreement) this is a theoretical rather than a practical complication for the draftsman of an arbitration agreement, since it is highly unlikely that an arbitration agreement which is valid under its proper law would be held to be invalid under the law of the country where the award was made. The problem can be avoided altogether by the simple expedient of incorporating a choice of law clause.

2.3.1. Applicable law to formal validity of arbitration agreement

The final requirement for an internationally effective arbitration agreement is that it should be valid “under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made” This requirement is imposed by Article V.1(a) of the New York Convention which provides that recognition and enforcement of an award may be refused if the arbitration agreement is not valid. A similar requirement is imposed by the Model Law, which provides that invalidity of the arbitration agreement is a ground for challenging an

[89] New York Convention, Art V(1)(a); Model Law Art. 36(1)(a)(i).
[90] It would be unusual (although not impossible) for provision to be made that the arbitration clause be governed by one law whilst the rest of the contract is governed by another law.

award or for refusing recognition and enforcement of it.[91] These provisions contain their own choice of law clause, since the question of validity of an arbitration agreement is to be decided under the proper law of the agreement ("the law to which the parties have subjected it") or, failing any indication of the proper law, under the *lex locu arbitri* ("the law of the country where the award was made" in the New York Convention or "the law of this state" in Model Law).

Many different situations may be envisaged in which the validity of an arbitration agreement may be called into question; usually, however, this occurs even at the beginning or at the end of the arbitral process. At the beginning of the process, for example, a party may challenge a submission to arbitration on the basis that the arbitration agreement is invalid; this challenge may be made to the arbitral tribunal itself or to a court of competent jurisdiction. At the end of the arbitral proceedings, any question as to the validity of the arbitration agreement will normally be raised in the context of an action by the loosing party to challenge the award or to resist recognition or enforcement of it; the unsuccessful party will attempt to deny the validity of the arbitration agreement, whilst the successful party will naturally attempt to uphold it.

The validity of an agreement is of crucial importance. In general terms, the legal principles to be applied are those applicable in determining the validity of an ordinary commercial contract; indeed the arbitration agreement will generally be set out in an arbitration clause which is itself part of an ordinary commercial contract. However there are certain features which distinguish an arbitration agreement from other types of agreement. These special features relate to capacity and arbitrability, which have already been mentioned; and to form and applicable law.

2.3.2. **Applicable law to existence of arbitration agreement**

An agreement to arbitrate is the foundation stone of the arbitral process. It may be contained in an arbitration clause which forms part of the main contract between the parties; or it may take the form of a specially drawn submission to arbitration.

[91] Model Law, Arts. 34(2)(a)(i) and 36(1)(a)(i).

Where the agreement is contained in an arbitration clause, it is recognized that it has its own autonomous existence, independent of the main contract;[92] but it will usually be governed by the same law as that which governs the substantive rights and obligations of the parties under the main contract.

The position may be the same where the parties have drawn up a special submission to arbitration (a submission agreement). However, since a submission agreement does not form part of the main contract between the parties—and indeed, is drawn up after a dispute has arisen—it may very well be subject to a different governing law from that to which the main agreement was subject.

Any problems concerning the recognition and enforcement of the agreement are likely to arise at the outset of arbitral proceedings or at the end, when enforcement of the award is sought. At the outset of the arbitral proceedings, a party which is unwilling to arbitrate may then claim that the agreement is not binding—for example, because it was not a party to the agreement, or because the agreement is in some other manner defective. Or it may claim that the dispute is not "arbitrable" –that is to say, that it involves matters which are not capable of being resolved by arbitration, because they belong to a special domain which is reserved to courts of law. Claims of this kind have, most notably, been put forward in disputes concerning competition law and antitrust matters generally.

Alternatively (but more dangerously) a challenge to the validity of the arbitration agreement may be reserved until the end of the arbitral process, when enforcement of the award is sought.

The New York Convention and the Model Law both emphasize the necessity for a valid arbitration agreement as a precursor to a valid arbitration and an enforceable award. The New York Convention states that recognition and enforcement of an award may be refused if the arbitration agreement: "is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made."[93]

[92] The validity, effect and interpretation of an arbitration agreement are governed by its proper law.
[93] Model Law, Art. V.1(a): to the same effect are Arts. 34(2)(a)(i) and 36(1)(a)(i).

The validity of the arbitration agreement may thus be seen to be of crucial importance; and any question concerning the agreement, its scope and its performance will fall to be determined under the law which governs that agreement. As already indicated, this may well be a law different from that which governs the arbitration itself—the *lex arbitri.*

2.3.3. Applicable law to capacity of the parties to arbitration agreement

The law applicable to the merits of a dispute is not necessarily the same as the law applicable in determining the capacity of the parties. While parties to a commercial agreement can as a general rule choose the law to govern their contractual relationship, it would be unrealistic to use such law in determining the capacity of the parties, because that would imply that in choosing the proper law of their contract, the parties could effectively confer capacity on themselves. The proper law chosen by the parties to govern their contractual agreement may therefore differ from the law governing their capacity to contract.[94]

The parties to a contract must have legal capacity to enter into that contract; otherwise, it is invalid. The position is no different if the contract concerned happens to be an arbitration agreement. This is recognized in the New York Convention and the Model Law; under both, enforcement of an award may be refused if the parties to the arbitration agreement were "under some capacity".[95]

The rules governing the capacity of a person to enter into a contract are by no means uniform. For a natural person, capacity may depend on his nationality or on his place of usual residence; for a corporation, it may depend on the place of incorporation or the place of business. The New York Convention specifies that capacity should be decided "under the law applicable" to the party without specifying how this law is to be determined.[96] The Model Law by contrast, does not specify which law is to

[94] Chukwumerije, Okezie, "*Choice of Law in International Commercial Arbitration",Quorum Boks, Westport-Connecticut/London* (1994). p.39
[95] New York Convention, Art. V.1(a); Model La Art. 36(1)(a).
[96] Van den Berg, The New York Arbitration Convention of 1958 (1981), p. 276, suggests that this is a matter fort he conflict of law rules of the forum state.

determine the "incapacity" of a party. Presumably, however, this must be the relevant party's personal law, as with the New York Convention; and of course this law may well be different from the law governing the arbitration agreement.

2.3.3.1. Capacity of parties to make an arbitration agreement

The court of the forum in which recognition and enforcement are sought will look to its own conflict of law rules to decide which law applies to the question of capacity. These rules may vary but some general propositions are common to most systems. In the case of a natural person, the law governing the capacity of the individual to enter into an arbitration agreement will usually be the law of the place where the arbitration agreement was entered into. For example, if a 17-year-old resident of X (where the age of majority is 18) were to travel to Y (where the age of majority is 16) and there enter into an arbitration agreement, he would not (by reason of lack of capacity as a minor) be able to avoid enforcement by a claim of lack of capacity under the law X. However, in the case of a legal person, such as a corporate entity, an act which is *ultra vires* the corporation remains so wherever it travels by its directors or agents. The law of country Y does not have exterritorial reach to breathe life into an *ultra vires* act of the legal person created in X. When ascertaining the law applicable to the capacity of a legal person reference must generally be had to the law which created that person, be it a corporate or state entity.[97]

2.3.3.2. Capacity to representatives acting on behalf of parties to arbitration agreement

"Should the arbitration agreement not be signed by the party itself, but by an authorized agent, the authorization to conclude such an arbitration agreement forms a part of the arbitration agreement itself and completes it in such a way that the arbitration agreement cannot be acknowledged as valid agreement without such a power of attorney. …"[98] says the Arbitral Tribunal sitting in Zurich, Switzerland, and hearing a case involving claimant from Liechtenstein and an Austria. The Austrian Party as a Respondent was whether the arbitration agreement had been signed by

[97] A. Redfern and M. Hunter, pp. 72-73.
[98] Naon, Horacio A. Grigera, Choice-of-Law Problems in International Commercial Arbitration, p.102

authorized persons and in particular which law governs the authority of executive organs, employees or representatives of the company. The Arbitral Tribunal indicated that under "Swiss private international and procedural law" such issue is generally not subject to the *lex fori*. Different laws may become applicable depending on whether a representative is acting under a power of attorney for "an executive organ" or under an ordinary power of attorney. In the latter case also the issue of the existence or scope of such power of attorney is at stake. In the first case, the existence and scope of the power of attorney is to be decided in accordance with "the personal statute of the respective legal entity". In the latter case, if the representative is not acting "in his capacity as an executive organ, but as an authorized agent of the litigant party, the issues of 'existence and scope' of the power of attorney have to be separated". The first one, "i.e. the question whether the arbitration agreement had been concluded by a person who was authorized to act on behalf of the principal, has to be decided in accordance with the law of the registered office or domicile of the represented person". The question as "to the scope of a power of attorney has to be decided in accordance with the law of the place where the representative concluded the arbitration agreement with the third party" or the "so called law of effect". The Arbitral Tribunal indicated that the respondent is a company having its registered office in Vienna and that is representative used its alleged power of attorney in Linz, so that Austrian law would apply both on the basis of its personal statute and the effect statute. The personal statute of Claimant, incorporated in Vaduz, would be the law of Liechtenstein, and the statute of effect would be either Liechtenstein or Austrian Law. The Arbitral Tribunal indicated that it would not decide on the legal situation regarding Claimant since it found that the form of the power of attorney on behalf of Respondent was not in agreement with Austrian law. The Arbitral tribunal indicated that under Austrian law both the arbitration agreement and the agency relationship between principal and agent for the conclusion of an arbitration agreement must be in writing. Since "a tacit granting of an authorization is not valid under Austrian law and that a written power of attorney has not been issued" there was no arbitration clause validly entered into by Respondent. This conclusion could not be shaken under a theory, either under Austrian or Swiss law, based on the principle of reliance in good faith.[99]

[99] Naon, Grigera H.A.,Recueil des Cours, pp.101-102

2.4. Interpretation of Arbitration Agreement

Arbitrators generally establish the meaning of the arbitration clause or the agreement essentially by directly resorting to general or autonomous principles of interpretation and general practice (of, for instance ICC arbitration without identifying any applicable national laws or going through any choice-of-law reasoning to identify the law or rules of law governing the interpretation of the arbitral clause). Thus, the autonomous interpretation of the arbitration clause may be premised upon interpretation criteria directly identified and found in general principles of contract or commercial law. An arbitral tribunal acting under the ICC rules has to consider the reasonable intention of the parties, and if such were not possible, as they would be interpreted by reasonable persons of the same condition and placed in the same situation. Contractual clauses should be interpreted in a way permitting to give them effect rather than by assigning a sense to them that would deprive them of any. For the interpretation of an arbitration agreement same approach has to be followed in order to establish the subject matter of disputes covered by it. An arbitral tribunal directly resorts to general principles of contractual interpretation without identifying any national law setting forth such principles, and the *lex arbitrii.* The principle of convergence has an important role in determining the applicable law. [100]

An arbitral tribunal interprets the arbitration agreement according to the proper law of the contract incorporating the arbitration clause that had been stipulated by parties. Since the parties stipulates the that English law governed the arbitration agreement, that arbitral tribunal interprets according to English law although the contract containing it was governed by a different law. For matters of interpretation, as well as for other matters, international commercial arbitrators pay strong attention, in a large majority of cases, to the national laws relevant for the solution of the dispute along "false conflict" lines of reasoning. Thus, an Arbitral Tribunal sitting in Paris, France (the parties had chosen Paris as the place of arbitration), had to interpret the scope of the arbitration clauses contained in two contracts (governed by Swiss law stipulated by the parties) to see if they covered claims under a memorandum of

[100] NAON p.93

agreement that did not contain an arbitration clause and would have novated those two contracts". [101] The Arbitral Tribunal also found in this very award that such memorandum was equally governed by Swiss law. The Arbitral Tribunal, b relying primarily on the opinion of French authors, concluded that in circumstances where the place of arbitration was neutral (the case involved a Zimbabwe Claimant and a Romanian Respondent) and differs from the national jurisdiction the law of which governs the contract giving rise to the dispute, the arbitration clause (and its interpretation as well as scope) should be judged according to the laws of the place of arbitration. On the basis of French law and "given the international nature of the contract and the dispute", and also "international and comparative law and practice", the Arbitral Tribunal concluded that the arbitration clauses were independent from the underlying contracts and that their novation did not necessarily extent to the arbitration clauses incorporated by them. The arbitration clauses had therefore not been novated and covered claims under the memorandum of agreement. The Arbitral Tribunal finally concluded that: "the survival of the arbitration clause in case of a settlement or novation agreement, as a matter of principle, is a general rule of arbitration law . . . In any event, the rule is firmly established in the law of France and Switzerland, the two legal systems which, by the Parties' choice of the seat of arbitration and the law applicable to the substance of the dispute, are the conceivably relevant laws for the present case."

The law of the place of arbitration may also play a significant role when interpreting contractual provisions in the same document variously referring to the jurisdiction of national courts and to arbitration. Such was the situation an a case where an Arbitral Tribunal sitting in Paris, France, decided both on the basis of French doctrine and French case law that the references to arbitration in the contractual documents should prevail over those to the jurisdiction of the courts of another State, the reference to the latter being just of supplemental value in connection with matters not covered by or for any reason excluded from the arbitration agreement.[102]

[101] Award of 2001 in ICC case 9473.
[102] Award of 1997 in ICC case 7564.

2.4.1. Scope of Arbitration Agreements relating to contracting documents covered by an arbitration clause

An arbitral tribunal may not exceed its mandate by deciding issues which are not covered by the wording of the arbitration agreement. The determination of the scope of the agreement involves the interpretation of that agreement and is accordingly governed by the proper law of the agreement. This will usually be the same law as that which governs the substantive contract in which an arbitral clause is embedded, but the parties may choose different proper laws for the main contract and the arbitration agreement. This is more likely to occur in the case of a submission agreement to refer an existing dispute to arbitration. The arbitrator will look at the proper law of the arbitration agreement to decide whether the wording of the clause covers the dispute which is sought to be arbitrated. The safest course to take when drafting an arbitration clause in an international commercial contract, is to adopt one of the wide clauses suggested by an arbitral institution such as the ICC or the LCIA, or as recommended in the UNCITRAL Rules.[103]

For the determination of the scope of arbitration clauses within the context of a grouping of contracts or contractual documents, may be seen as evidencing the existence of substantive rules of law or principles in the lex arbitri specially adapted to international commercial transactions. From a functional choice of law perspective, such substantive rules of law or legal principles would express a strong forum policy in favor of arbitration which would privilege their application when international commercial arbitrations are at stake over any national rules of different origin or domestic rules of law of the forum which otherwise might have claims to govern the dispute. Arbitrators ground their decisions on the direct interpretation of contractual clauses and surrounding circumstances without identifying an applicable law or rules of law to base their decisions without having recourse to any choice of law analysis. Arbitrators take very much into account, also within this context, previous courses of dealing between the parties. In this sense, Award of 1981 in Icc case 3779: "The clause attributing jurisdiction to the ICC occurs in two preceding and similar contracts that were signed by both parties, as well as in the third contract, that although it was not signed, was not protested against within a reasonable delay

[103] Redfern, Hunter, p. 150.

either. Although the contracts are independent from one another from a juridical point of view, the three contracts form a group from an economic point of view. If, in principle, silence does not mean acceptance, this meaning is, however, attributed to it in view of the circumstances, in particular, the previous business relations of the parties. Consequently, within their juridical relation and according to their obligations of good faith, the exception of incompetence does not apply."

2.4.2. Scope of Arbitration Agreement relating to parties covered by an arbitration clause

Third parties who deal with the corporations cannot properly be regarded to have united themselves with the corporation in a venture to be controlled by the law of the corporation's creation. This is especially true of third parties from other countries who are necessarily less acquainted with the law of the state of incorporation. According to an award of ICC in 1995 case 8385; "in international intercourse, the tribunal regards it as preferable to apply standards that are geared to conditions in the international market place that strike a reasonable balance between a corporation's reliance on respect for its separate corporate personality and protection of persons who may be victimized by a corporation's undue manipulation of its control of a subsidiary to deprive a creditor of the benefits it bargained for. Application of international standards offers many advantages. They apply uniformly and are not dependent on the peculiarities of any particular national law. They take due account of the needs of international intercourse and permit cross-fertilization between systems that may be unduly wedded to conceptual distinctions and those that look for a pragmatic and fair resolution in the individual case. This area offers an ideal opportunity for applying what is increasingly called increasingly called *lex mercatoria.* While the tribunal therefore judges it preferable to apply the standards of international commerce dictated by the needs of the international market place, it has reached the conclusion that the same result is reached, irrespective of whether New York or Belgian Law or international legal standards are applied. For all three systems recognize that, at least in some instances, the corporate veil may be pierced, and the tribunal has concluded that, in the particular circumstances of the case at hand, all three systems permit the requisite piercing of the corporate veil."

In the light of some other ICC arbitral awards, which in the view of the arbitral tribunal "progressively create case law which should be taken into account because it draws its conclusions from economic reality and conforms to the needs of international commerce, to which rules specific to international arbitration, themselves successively elaborated should respond", that "irrespective of the distinct juridical identity of each of its members, a group of companies constitutes one and the same economic reality…" and, accordingly, that "the arbitration clause expressly accepted by certain of the companies of the group should bind the other companies which, by virtue of their role in the conclusion, performance, or termination of the contracts containing said clauses, and in accordance with the mutual intention of all parties to the proceedings, appear to have been veritable parties to these contracts or to have been principally concerned by them and the disputes of which they may give rise".[104]

Another point which must be noted when considering the scope of the arbitration agreement is that the parties, by their conduct in referring a matter to arbitration, may be taken as impliedly agreeing to confer on the arbitrator jurisdiction beyond that which would have existed pursuant to the arbitration clause. A claim in tort, which may not be within the scope of the arbitration clause, may come within an arbitrator's jurisdiction where the parties address that claim in their pleadings without reservation as to jurisdiction.[105]

3. THE LAW GOVERNING ARBITRAL PROCEEDING

3.1 General

Municipal courts, created and empowered by the national laws of their situs, coduct their proceedings in accordance with rules contained in these national laws. A judge sitting in municipal court is thus constrained to apply the conflict and procedural rules of his or her situs. Even in situations where a dispute implicates matters of international business or involves parties who reside outside jurisdiction, a municipal judge remains obliged to utilize domestic conflict and procedural rules in resolving the dispute, although in some cases the law applicable to the substance of the dispute may be a foreign law.

[104] ICC case Interim Award of 1982, case 4131. (I Collection 146 (1990)
[105] Redfern, Hunter, p. 154.

When a party submits to the jurisdiction of a municipal court, the party concurrently acknowledges that the court will exercise its jurisdiction in conformity with the procedural rules of its situs. Indeed, it is never the case that a municipal court sitting in one country conducts its proceedings according to the procedural laws of another country. The only question that sometimes arises in this connection is where to draw the line between procedural and substantive law, because although a judge is constrained by national procedural law, the judge may find that a foreign substantive law is applicable to the merits of the dispute.

3.2 Identifying the applicable procedural law:

Parties have the powers regarding the choice of the procedural rules governing an international commercial arbitration, including a-national procedural rules of law applying to the arbitration agreed upon by the parties, such as the ICC arbitration rules, as well as limitations to such powers traced by the mandatory law of the place of the arbitration. Both elements (the parties' choice and the mandatory law of the place of arbitration) are choice of law influencing factors the arbitral tribunal cannot ignore when establishing the procedural rules of law it has to abide by without jeopardizing the effectiveness and even validity of its mission and decisions. Certainly, the determination of the applicable procedural rules of law, normally depending on the agreement of the parties (e.g., when the parties refer to the ICC Arbitration Rules in their arbitration agreement) brings about the autonomous application of such rules according to self-contained criteria of interpretation which rely on the text of such rules and the general arbitral or institutional practice regarding their application.[106] This is illustrated by a recent ICC award in which the Arbitral Tribunal decided on the procedural limits to submit and amend counterclaims under the ICC Arbitration Rules on the very basis of such rules and "the general established practice of the ICC Arbitration".[107]

[106] Procedural rules of the lex fori or otherwise—however mandatory for a court of law—are not binding on international commercial arbitrators. An arbitral tribunal sitting in London held as follows in its award of 1995 rendered in ICC case 7626: "this is an international arbitration proceeding. The strict rules of evidence as they apply in England where the tribunal is sitting, or in India, do not apply. In accordance with the power given to the arbitrators in the Terms of Reference, and under the ICC Rules, the tribunal has the right to determine whether and what evidence should be admitted."

[107] ICC award in 2000, case 8307.

In another award, the arbitral tribunal decided that a counterclaim had been filed by respondent despite the fact that Claimant had argued that the ICC court's secretariat should not have extended the time-limit to file the counterclaim. After pointing out that the ICC Court's Secretariat should not have extended the time-limit to file the counterclaim. After pointing out that the ICC Court's Secretariat has discretion on this matter, the Arbitral Tribunal indicated that the Secretariat had weighed the "conflicting considerations" raised by the parties as to the extension of the time limit and thus "properly exercised its power of discretion". However, the laws of the place of the arbitration regarding procedure may prevail not only when they are of mandatory nature but also when they govern issues not settled in the applicable arbitration rules.[108] Finally, it should not be forgotten that the freedom of the parties to choose the applicable procedural rules—a cornerstone of international commercial arbitration enjoying universal recognition and firmly entrenched in arbitration rules and in national legislations—may be seen as depending on a conflicts rule of the place of arbitration, as illustrated by an arbitral award rendered by an arbitral tribunal sitting in Paris which had to decide on ICC Rules regarding the powers of the ICC Court to extend time-limits provided in the ICC arbitration rule should apply.[109]

Whether or not a particular legal environment is right for the conduct of an international arbitration is as much a matter of personal judgment as of legal analysis. There are certain minimum requirements on which most arbitrators and practitioners agree. For instance, the local law must be prepared to enforce international arbitration agreements in line with the New York Convention. It must be prepared if necessary, to assist in the constitution of the arbitral tribunal; and to give the arbitral tribunal, either directly or through its courts, such powers as it may need to carry out its task efficiently and effectively. Again it must be prepared to recognize and enforce foreign arbitral awards, if it expects awards made on its own territory to be recognized and enforced in other countries. Beyond such minimum requirements as these, however there is room for different points of view as to what does and what does not constitute a suitable legal environment for the conduct of an international

[108] For example, Award of 1982 in ICC case 2730: since the ICC arbitration rules would not have any rule concerning the extinguishment of arbitral proceedings by the passing of time without procedural activity, the Arbitral tribunal applied the domestic procedural law of the place of the arbitration.
[109] Award of ICC in 2001, case 10508.

commercial arbitration. Moreover, the point of view change according to whether the interest represented is that of claimant, respondent or arbitrator.[110]

3.3 Kompetenz – Kompetenz[111]

An independent (or autonomous) arbitration clause gives an arbitral tribunal a basis to decide on its own jurisdiction, even if it is alleged that the main contract has been terminated by performance or by some intervening event. Some commentators go further and suggest that the arbitration clause will survive even if the main contract which contains it proves to be null and void.[112]

The autonomy of the arbitration clause was discussed during the preparation of the Model Law. It was considered that its main purpose was to give the arbitral tribunal a basis to decide on its own jurisdiction: "*The main practical advantage of this principle is that it constitutes a serious bar for a party who desires delay or wishes to repudiate his arbitration agreement, to subvert the arbitration clause b questioning court the existence or validity of the arbitration agreement, to subvert the arbitration clause by questioning in court the existence or validity of the arbitration agreement [by questioning the validity of the main contract]*."[113]

In the line with the provisions of the provisions of the UNCITRAL Arbitration Rules, the Model Law provides: "*The arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause*."[114]

---

[110] Redfern, Hunter p.297

[111] This term is sometimes described in a form of *Competence/Competence*; it is expressed in German as *Kompetenz/Kompetenz* and in French as *Competence de la Competence*.

[112] The UNCITRAL Arbitration Rules, Art. 21(2) states that a decision by the arbitral tribunal that the contract is null and void "shall not entail *ipso jure* the invalidity of the arbitration clause"; and the Model Law itself adopts this terminology, Art. 16(1).

[113] Szurski, "Arbitration Agreement and Competence of the Arbitral tribunal" in ICCA Congress Series, No.2: UNCITRAL's Project for a Model Law on International Commercial Arbitration (Lausanne Meeting 1984), p.76

[114] Model Law Art. 16(1)

However, this must depend on the reason for which the contract is found to be null and void. Suppose, for example, that one of the parties claims that he was not a party to the main contract (and therefore not a party to the arbitration clause within that contract). If he is right there can be no valid arbitration and no valid award. No amount of insistence upon the autonomy of the arbitration clause can make it valid if the respondent was not a party to it. Thus in the Pyramids case, for example, the Egyptian Government's claim that it was not a party to the contract was upheld by the court at the place of arbitration; and in consequence the award against the Government, made on the basis that it was a party, was set aside by the competent court.

There is direct connection between the autonomy of the arbitration clause and the power (or competence) of an arbitral tribunal to decide upon its own jurisdiction (or competence). This power (that of Competence/Competence), is referred as an "inherent" power. However, the usual practice under modern international and institutional rules of arbitration is to spell out in express terms the power of an arbitral tribunal to decide upon its own jurisdiction or, as it is often put, its competence to decide upon its own competence.

Furthermore, this implicit power is not merely spelt out. It is often extended. For example, the UNCITRAL Arbitration Rules provide:

1. The arbitral tribunal shall have the power to rule on objections that it has no jurisdiction, including any objections with respect to the existence or validity of the arbitration clause or of the separate arbitration agreement.
2. the arbitral tribunal shall have the power to determine the existence or the validity of the contract of which an arbitration clause forms a part. For the purposes of [this article], an arbitration clause which forms part of a contract and which provides for arbitration under these rules shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail *ipso jure* the invalidity of the arbitration clause."[115]

[115] UNCITRAL Arbitration Rules, Art. 21 (1) and (2).

Under ICC Rules, the position is slightly more complex. When any question is raised as to the jurisdiction of the arbitral tribunal a two-stage procedure is followed. At the first stage, if one of the parties raises "*one or more pleas concerning the existence or validity of the agreement to arbitrate.*" The ICC Court must satisfy itself of "*the prima facie existence of such an agreement*."[116] If the ICC's Court must satisfied, it may decide that the arbitration shall not proceed so that, at the second stage "any decision as to the arbitrator's jurisdiction shall be taken by the arbitrator himself.

In practice, the result is that a claimant may lodge with the Secretariat a Request for Arbitration which includes a statement of his claims, a copy of the purported agreement which contains the arbitration clause and the fee required by the ICC. The Secretariat simply checks whether a clause providing for ICC arbitration appears in the documents submitted by the claimant. The ICC's Court will then establish an arbitral tribunal and refer the case to it under Article 8.3. This happened in a case[117] where the respondent governmental authority claimed that it did not have any agreement with the claimant because the agreement submitted to the ICC with the Request for Arbitration had been assigned to another party. The ICC's Court merely indicated that the matter would be considered by the arbitral tribunal pursuant to the provisions of Article 8.3 of the ICC Rules. This left the respondent in the position of having the issue heard before an arbitral tribunal which (if the respondent was correct) could have no valid existence, and no valid mandate as regards the two parties in question; thus in certain circumstances he ICC Rules have the effect of permitting an arbitral tribunal to be established, and purporting to confer on it the power to make rulings relating to jurisdiction, where the requirement of consensuality between the parties may not exist. This may also occur in arbitrations under rules other than those of the ICC.

The ICC Rules then provide, in terms similar to those adopted in the UNCITRAL Arbitration Rules as follows:

"*Unless otherwise provided, the arbitrator shall not cease to have jurisdiction by reason of any claim that the contract is null and void or allegation that it is inexistent*

[116] ICC Rules, Art. 8.3.
[117] ICC Case number 4357 (unreported)

provided that he upholds the validity of the agreement to arbitrate. He shall continue to have jurisdiction, even though the contract itself may be inexistent or null and void, to determine the respective rights of the parties and to adjudicate upon their claims and pleas."[118]

The modern national laws governing international arbitration also spell out the power of an arbitral tribunal to rule on its own jurisdiction. The Model Law provides that:
"*The arbitral tribunal may rule its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause*."[119]

The intention of such provisions as these is to ensure that the arbitration clause can survive, even if the main contract which contains it is struck down for invalidity. Most countries, including Switzerland, Germany, Russia, and the United States are prepared to accept this principle.[120] Traditionally, English law was thought to take a narrower view, so that, for example, a dispute as to whether the contract containing the arbitration clause was properly concluded would fall outside the scope of that clause.[121] However, English law may be giving way to what has been called "the realism of the separability doctrine." An eminent judge has said:
"Admittedly, no English court has yet been asked to take the final step of ruling that an arbitration clause, which forms part of a written contract, may be wide enough to cover a dispute as to whether the contract was valid *ab initio*. An arbitration agreement separately executed at the same time as the principal contract is capable of conferring authority on an arbitrator to decide an issue as to the validity *ab initio* of the contract. If that is so, why should the same not apply to the arbitration agreement which physically forms part of the contract? After all, it has been recognized as having an independent existence. But I am not asked to take this final step in this case. Given the development of English arbitration law, this step may be a logical

[118] ICC Rules, Art. 8.4.
[119] Model Law, Art. 16.
[120] The Swiss PIL Act, Chap. 12, Art. 178(3).
[121] Steyn and Veeder, "England" in ICCA International Handbook on Commercial Arbitration.

and sensible one which an English court may be prepared to take when it arises. In the meantime it is possible to say with confidence that the evolution of the separability doctrine in English law is virtually complete."[122]

3.4 Interim Measures

The practical importance of interim measures of protection is well understood by litigation and arbitration practitioners alike. From, and in some cases even before, the outset of court or arbitration proceedings, problems may arise that can have a major, at times determinative, effect on the final outcome. A classic example is when existing evidence that would influence the result may be destroyed or "lost." Another example is when there is a risk that identifiable assets that could satisfy a claim may be placed out of reach and therefore will not be available if the claim were to succeed.

The laws of many countries give an arbitral tribunal power to make orders for the preservation or detention of the subject matter of the dispute, where it is within the possession or control of one of the parties. However, where the property in respect of which protection is sought is not within the possession or control of one of the parties, the arbitral tribunal is usually powerless. Any effective remedy must be exercised by the court which has jurisdiction over the relevant poverty or funds. The laws of most developed countries contain provisions to enable their courts to intervene in such circumstances, in order to enhance the effectiveness of the arbitral process. In the United States, there is some controversy over whether or not pre-arbitration award attachment of assets by a court is barred on the basis that the New York Convention requires that all matters be referred to the arbitral tribunal unless the agreement to arbitrate is null and void, inoperative or incapable of being performed. This would not be an impediment in countries whose law specifically empowers the court to order conservatory relief (such like England)[123]; or in countries which have adopted the Model Law, since this expressly provides that it is not inconsistent with the agreement to arbitrate for a court to order interim measures of protection.[124]

[122] Steyn J. in Paul Smith Ltd. v. H& S International Holding Co. Inc. [1991] 2 Llyod's Rep. 127, 130.
[123] English Arbitration Act 1950, s.12(6).
[124] Model Law Art. 9.

From time to time it may be necessary for an arbitral tribunal to issue mandatory orders and, in particular, to order interim measures of protection. For example it may be necessary for a party to ask for the suspension of work which is being carried out; or it may be necessary to ask for the preservation, custody or sale of goods which are the subject matter of the arbitral proceedings. Similarly it may be necessary to ask for an order for the inspection of any property in dispute. The general rule is that an arbitral tribunal may only issue mandatory orders directed to the parties. If the orders are to go beyond this ambit, they must be issued by the competent local or national court. One classic example is where a claimant wishes to obtain an order freezing or attaching sums held in a bank account, where the beneficiary is the respondent; such orders may usually only be issued by courts of competent jurisdiction, vested with the authority of the state.

Concurrent powers of the arbitral tribunal and of the courts

There is a distinction between those powers which the arbitral tribunal and a court may exercise concurrently and those which belong exclusively to the court. For example, arbitral tribunals sitting in England, have the power to make such orders for inspection. But a party could also make the same application to the court; indeed it would need to do so if the subject-matter of the proposed inspection had passed out of the hands of either of the parties, since the arbitral tribunal has no power over third parties.

The position under international or institutional rules of arbitration:

The established international and institutional rules of arbitration generally contain provisions as to the making of provisional and conservatory measures. The UNCITRAL Arbitration Rules provide:

“1- At the request of either party, the arbitral tribunal may take any interim measures it deems necessary in respect of the subject-matter of the dispute, including measures for the conservation of the goods forming the subject-matter in dispute, such as ordering their deposit with a third person or the sale of perishable goods.

2- Such interim measures may be established in the form of an interim award. The arbitral tribunal shall be entitled to require security for the costs of such measures.

3- A request for interim measures addressed by any party to a judicial authority shall not be deemed incompatible with the agreement to arbitrate, or as a waiver of that agreement."[125]

3.5 Res Judicata

This term is a common law doctrine meant to bar relitigation of cases between the same parties in court. Once a final judgment has been handed down in a lawsuit, subsequent judges who are confronted with a suit that is identical to or substantially the same as the earlier one will apply *res judicata* to preserve the effect of the first judgment. This is to prevent injustice to the parties of a case supposedly finished, but perhaps mostly to avoid unnecessary waste of resources in the court system. *Res judicata* does not merely prevent future judgments from contradicting earlier ones, but also prevents them from multiplying judgments, so a prevailing plaintiff could not recover damages from the defendant twice for the same injury.

CHAPTER TWO: CHOICE OF LAW ISSUES IN MERIT

1. General

When questions of procedure have been settled, the principal task of the arbitral tribunal is to establish the material facts of the dispute. It does this by examining the agreement between the parties, considering other relevant documents, and by hearing witnesses if necessary. The arbitral tribunal then builds its award on this foundation of facts, making its decision either on the basis of what it considers to be fair and reasonable or, more usually, on the basis of law.

Once the relevant facts have been established, the arbitral tribunal may not need to go outside the confines of the agreement originally made between the parties in order to determine the dispute. This agreement, particularly in international commercial transactions, will generally be quite detailed. For example, international construction contracts run to many hundreds of closely printed pages accompanied by detailed drawings and specifications. Properly understood such an agreement will

[125] UNCITRAL Arbitration Rules, Art. 26.

generally make clear what the parties intended, what duties and responsibilities they each assumed and, in consequence, which of them must be held liable for any failure of performance which has occurred. However, as already mentioned, an agreement intended to create legal relations does not exist in a legal vacuum. It is supported by a system of law known equally well as "the governing law", "the applicable law" or "the proper law" of the contract. These various terms all denote the particular system of law which governs the interpretation and validity of the contract, the rights and obligations of the parties, the mode of performance and the consequences of breaches of the contract.

Accordingly, it is not enough to know what agreement the parties have made; in addition it is essential to know what law is applicable to that agreement. In a purely domestic contract, the applicable law will usually be that of the country concerned. If a French woman purchases a dress in a Paris boutique, French law will be applicable or proper law of that contract; equally, Scottish law will be applicable or proper law when a Scotsman buys a bottle of whisky in Edinburgh. Yet further complexity is inevitable when the contract is in respect of an international transaction. There may then be two or more different national systems of law capable of qualifying as the proper law of the contract; and (although it is important not to exaggerate the possibilities) these different national systems may contain contradictory rules of law on the particular point or points in issue.[126]

A workable and contemporary arbitration agreement should also include a provision that clearly establishes the governing law and the role it is to play as to the different facets of the transaction and the agreed upon process of dispute resolution. Such a provision could provide the parties and a supervising court with both clarity and direction in difficult circumstances. The parties could choose a law to govern the interpretation of the contract (including the arbitration agreement) and the merits of any dispute that might arise under the contract. They could also decide that the agreement to arbitrate is governed by a separate law. They could designate yet another law to regulate any subsequent arbitration and its proceedings. Such a designation should endeavor to accommodate the law designated to govern the

[126] Redfern, Hunter, pp.95, 96.

arbitration and the law of the place of arbitration (the so-called *lex loci arbitri).*[127] It should also define the significance of the arbitration rules of the administering arbitral institution, especially as they relate to the chosen law and the law of the place of arbitration. The U.S. Supreme Court has attributed some type of legal standing to the rules of arbitral institutions. As incredible as that position may seem, the parties need to address it and deal with it in a way that protects and even advances their interests.[128]

Choice-of-law considerations may have greater relevance to transborder arbitrations. There, the problem of "lawlessness" is particularly acute. In this setting, distinguishing between the law of the contract, the adjudication, and the place of arbitration may be critical. Obviously, in some jurisdictions, law may trump contract. Therefore, party provision may not be controlling. Also, the distinctions may be too complicated and, as a result, may become unworkable or pathological. Their intricacy could overwhelm the possibility of practical implementation. Allowing arbitrators to decide these matters on an ad hoc basis may be a functional alternative to party provision. The reference to the application of a more universal, transborder law represents another possibility that can be combined with arbitrator discretion. The parties can select the *lex mercatoria,* the *lex mercatoria arbitraiis,* the CISG,[129] the UNIDROIT *Principles,* or the UNCITRAL frameworks[130] to govern the arbitration.

These considerations exemplify the conundrum associated with the attempt of the contracting parties to anticipate difficulties in the transaction and to establish the delegation of authority that occurs when problems arise. The contracting parties must make their choices at the outset of the transaction and in the abstract. Once a dispute arises, their ability to agree is more painstaking and can be significantly minimized. The arbitrators are in a better position to make determinations as problems arise, and it is their task to make the proceedings work. In addressing the problems, however, the arbitrators may not decide the matter as the parties might have decided it

[127] See generally Park, William p., The Lex Loci Arbitri and International Commercial Arbitration, [1983]
[128] Vanderbilt Journal of Transnational Law, Vol. 36, "*The Exercise of Contract Freedom in the Making of Arbitration Agreements"* Number 4, p. 1219
[129] The United Nations Convention on Contracts fort he International Sale of Goods (CISG), [1980], U.N. Doc A/Conf. 97/18.
[130] The UNCITRAL Model Law on International Commercial Arbitration

prior to the finalization of the contract; they may not be able to follow the parties' instructions because of practical considerations; or they may have—or may believe they have—a better solution than the one provided for by the parties. The decision to act in accordance with any one of these variations could compromise either the functionality of the arbitral proceeding or its lawful character. The question centers upon how valuable the party right to decide may be, how much protection against arbitrator discretion is warranted for party rights, and what value is placed upon the practical effectiveness of the procedure.[131]

2. Applicable to the Substance

2.1. The main conflict of laws trends

The law applicable by international commercial arbitrators to the substance of the dispute has been the subject of much debate and study. From the criteria to identify the applicable law or the choice-of-law methodology to be observed to such effect, to the very nature, substance or sources of the applicable "law" ("law", "rules of law"), there is apparently no legal angle that has not been explored or possible aspect that has been left untouched by the copious literature covering the different possible solutions or approaches. The degree of detachment of arbitral choice-of-law considerations from those observed by national courts, and the right or duty of international commercial arbitrators to take into account or apply mandatory rules or *"lois de police"* not belonging to the proper law of the contract have been, and still are, in their own right, at the centre of cogitations and debates on these topics.

In the recent decades, two distinct and apparently conflicting trends in international commercial arbitration concerning the determination of the law or rules of law governing the substance of the dispute may be identified.[132]

2.1.1. The trend favoring the de-nationalization of arbitral choice of law

On one hand, arbitral choice-of-law determinations regarding the merits of the dispute are frequently made on the basis of criteria largely detached from the private international law of any specific national forum. Such criteria do not

[131] Vanderbilt Journal of Transnational Law, Vol. 36, Number 4, p. 1220.
[132] Naon, Horacio A. Grigera, "*Choice-of-Law Problems in International Commercial Arbitration*", p.183

necessarily respond, in full or in part, to traditional jurisdiction-selecting choice-of-law methodologies. This circumstance has had, in turn, an impact on the substantive solution of the disputed issue at stake. The more detached from national private international law the choice-of-law methodology, the greater the chances that the substantive law solution attained will be free from the parochial influences of any particular national legal system. Functional choice-of-law methodologies advancing the most appropriate substantive solution for the dispute on the basis of a comparative weighing and balancing of interests and policies underlying the different substantive rules at stake and consciously or unconsciously resorting to the false conflicts technique also contribute to such results.

This choice-of-law trend is clearly a de-localizing and de-nationalizing one. It favors the search for substantive solutions to international disputes specially adapted to the needs and multinational or transnational nature of the issues at stake. It privileges or permits to privilege such specialized solutions — showing varying degrees of detachment from those commanded by specific national laws — over solutions found in any particular national legal system. It encourages the exclusion of parochial mandatory rules which, because aimed at furthering domestic policies, are unfit to govern international disputes. It furthers the formation or recognition of the existence of substantive rules governing international business transactions enjoying international recognition and not necessarily finding their source in a particular national legal system.[133]

Although this de-nationalizing trend regarding choice-of-law has often found expression in arbitral choice-of-law determinations on procedural matters. It has more clearly and constantly come to light through arbitral decisions on the law applicable to the merits of the dispute. A possible explanation for this is that an important number of arbitral choice-of-law determinations that may be classified as procedural, such as those touching upon jurisdictional matters, validity of the arbitration agreement or arbitrability, are more likely to be attacked before the courts of the place of the arbitration or lead to court orders or injunctions for the stay of arbitral proceedings issued by such courts. Such circumstance increases

[133] Von Mehren, A.T., "Substantive Rules for Multistate Problems – Their Role and Significance in Contemporary Choice of Law Metodology",[1974], 88 Harvard Law Review 347-371

the chances of possible interference in arbitral proceedings of State courts situated in the forum and accordingly of the advancement by such courts of the application of their own laws in connection with such proceedings. No wonder then that Arbitral Tribunals are much more aware and pay greater attention, when making choice-of-law determinations regarding such matters, to the laws of the forum, including oftentimes such forum's private international law. On the contrary, as far as choice-of-law matters regarding the law applicable to the merits of arbitral disputes are concerned (except for certain reservations that will, be considered later in this chapter such as the compatibility of the substantive results or outcome of the arbitral award with the forum's essential notions of morality and justice), the courts of the place of the arbitration normally do not exercise any controls, and thus are unable to influence arbitral choice-of-law reasoning or conclusions on the law or rules of law applicable to the merits, a circumstance perhaps decisively explaining the detachment of arbitral choice-of-law regarding the substance of the dispute from the private international law of the place of the arbitration.[134]

2.1.2. The nationalizing trend in arbitral choice of law

On the other hand, a growing number of Arbitral Tribunals have been or are being confronted with the need to consider whether certain national mandatory rules ("international mandatory rules" or *"lois de police")*[135] should necessarily be applied or taken into account to resolve specific disputed issues of international character as a matter of public policy, irrespective of the explicit or implicit choice-of-law stipulations of the parties or the proper law of the contract. Such international mandatory rules are directly or indirectly concerned with the protection of the political, social or economic organization of the country that enacted them. They may govern matters as diverse as specific types of illicit contracts (e.g., contracts for the trafficking of influence or to corrupt public servants), commercial agency, consumer protection, foreign investment, foreign exchange restrictions, or antitrust. They may proscribe or seek to deter certain types of conduct, such as racketeering[136]. They are closely associated with public interest notions[137]. So

[134] Naon, Horacio A. Grigera, "*Choice-of-Law Problems in International Commercial Arbitration*", p.185
[135] Also known as "peremptory rules of necessary or overriding application" or *"Eingriffsnormen"*.
[136] See M. Blessing, *Introduction to Arbitration — Swiss and InternationalPerspectives* 229-233 (1999).

far, only in cases involving antitrust issues is there a string of awards whereby international Arbitral Tribunals have consistently applied or taken into account regulations not belonging to the proper law of the contract, and this primarily in respect of European antitrust provisions in the Treaty of Rome[138]. To the extent that this trend may lead international commercial arbitrators not to fully follow the choice-of-Law stipulations of the parties or their expectations, it can be argued that they are going beyond the authority granted to them by the parties. Consistently with such views, certain arbitration awards have denied the application of *lois de police* not belonging to the proper law. Nevertheless, at present, opinions or decisions contrary to the possible application of *lois de police* by international commercial arbitrators do not seem to prevail.

It is relevant to underline that if the first trend goes in the sense of de-nationalizing or internationalizing arbitral substantive solutions for international business cases, the. second at least envisages the possibility that whatever the will of the parties, there is still room to consider that certain national mandatory rules must necessarily govern the disputed issue at stake and, to that effect, unilaterally extend their extraterritorial application. In other words, the explicit or implicit will of the parties as to the choice-of-law is one element — no matter how important — that must be balanced together with other elements (e.g. the intensity of the goals, policies or purposes of specific substantive national legal rules commanding their extraterritorial application to international disputed issues) in the process of determining the applicable law or rules of law. The first trend responds to the notion that international business disputes belong to a sphere that cannot be always adequately governed by national laws, which are normally equipped to deal only with domestic matters. International disputes, by their very nature, fall within the scope of overlapping national jurisdictions and laws, none of them properly adapted to capture their special characteristics. The second trend favours the nationalization in full or in part of otherwise international disputes and permits

[137] This would be a strict or narrow Notion of the *loi de police* concept: See preliminary award of 1983 in ICC case 4132 (I Collection 164 (1990)). .

[138] See ICC Award of 1992 in case 6773 *The ICC International Court of Arbitration Bulletin* 66-71 (1995) considered the possible application of US antitrust legislation and whether it can be characterized as a *loi de police* in respect of a transaction governed by French law chosen by the parties.

that such disputes or certain of their aspects be exclusively governed by national substantive mandatory rules[139].

The application of such mandatory rules — even *ex officio* or on the initiative of the Arbitral Tribunal when none of the parties has pleaded their application[140] – has been advocated or justified along lines purporting to reconcile it with the legitimate expectations of the parties. The rationale is that not applying *lois de police* or not taking them into account might lead to the nullity or non-enforcement of the arbitration award in national jurisdictions having enacted such rules, thus defeating the parties' expectation that the ensuing award shall be valid and enforceable. Another explanation is that international mandatory rules of the place of the arbitration or of the place of enforcement of contractual obligations or possibly enacted by a national jurisdiction bearing significant contacts with the parties or the dispute may be legitimately applied, although the parties chose a different law to govern their transactions, since they could not or should not have failed to anticipate that such mandatory rules of such fora might govern their dispute in full or in part irrespective of the parties' choice-of-law stipulations[141]. Despite these justifications, the truth is that it belongs to the essence of the *lot de police* methodology that certain national mandatory rules must govern international disputes because there are superior public or societal interests commanding their application even in situations where none of the parties could foresee it. In fact, to the extent that the application of such mandatory rules does not primarily or essentially depend on the geographical localization of connecting factors and is indifferent to whether the parties could expect their application or not, international commercial arbitrators would have to advance such application as soon as they have found that the objectives, goals or policies underlying or advanced by such rules are affected by the dispute at stake even if the mandatory rules the consideration or application of which is envisaged do not

---

[139] See generally P. Mayer, "Mandatory Rules of Law in International Commercial Arbitration", 2*Arb. Int'l* 274(1986)

[140] As to such possibility or duty of international Arbitral Tribunals from the perspective of European- antitrust law, also reflected in some ICC arbitration awards, see H. Verbist, 'The Application of European Community Law in ICC Arbitration", in *International Commercial Arbitration in Europe, The ICC International Court of Arbitration Bulletin,* Special Supplement 33-55, ICC Publication N 537 (1994). See. also, Y, Derains, *Application of European Law by Arbitrators — Analysis of Case Law, Arbitration and European Law* 67-78 (1997).

[141] See Y. Detains, "Public Policy and the Law Applicable to the Dispute in International Arbitration", in *Comparative Arbitration Practice and Public Policy in Arbitration,* ICCA Congress Series 3, 227 (P. Sanders, ed., 1987).

belong to the legal system of the country where the award is made or expected to be enforced or to the contractual proper law.

Thus, *from the perspective of the national forum enacting such mandatory rules,* their application and the ensuing degree of nationalization of the dispute for regulatory purposes should be imposed on the parties whatever their expectations or forecasts.

Defining whether a domestic mandatory rule is a *loi de police* or not and its scope of application presupposes a preliminary analysis premised upon the comparison and weighing of the interests protected, the policies advanced or the objectives pursued by such mandatory rule,' as viewed from the standpoint of the national forum enacting it, against other considerations, such as the will and expectations of the parties (including parties to the dispute not belonging to such forum) or systemic considerations such as the interests of international trade (also as perceived from such forum's national vantage point) and the purposes or objectives underlying or furthered by other forum legal rules or principles concerning the possible application or relevance either of other forum substantive rules, substantive legal rules of other (foreign) fora or a-national or transnational legal principles or rules of law. The relative importance assigned to such aspects by the forum enacting the mandatory rule at stake depends then on a weighing and balancing process carried out from such forum's perspective by taking into account values and criteria also exclusively determined by such forum. A domestic, mandatory rule can only be considered as a *loi de police* claiming extraterritorial application if, as a result of such necessarily teleological analysis, the goals, policies or objectives underlying or pursued by it are so intense in light of the controverted issue at stake as to outweigh any other considerations that might lead to the application of other laws or rules of law. In order to determine whether a national mandatory rule is a *loi de police* and its scope of application as a part of the process aimed at establishing whether it covers the dispute or not, an international commercial Arbitral Tribunal must carry out the foregoing analysis by initially taking into account the notions, criteria and policies relevant to that effect of the forum enacting such rule.[142]

[142] Naon, Horacio A. Grigera, "*Choice-of-Law Problems in International Commercial Arbitration*", p.p.188, 189.

2.2. The ICC Perspective relating to arbitral choice of law

The powers of an international commercial Arbitral Tribunal to apply *lois de police,* international mandatory rules or transnational legal principles may be in practice limited by mandatory provisions of the national forum where the arbitration takes place. For example, these mandatory provisions could forbid international commercial arbitrators to decide on issues or apply legal rules — such as *lois de police* not belonging to the forum's legal system — excluded by the will of the parties, not expressly or implicitly agreed by them to be relevant for the decision of the case or not alleged or raised by any of them in the course of the arbitration.[143]

The same may be true in connection with transnational legal rules or principles or *ordre public vraiment international* notions developed as a result of the de-nationalizing trend regarding arbitral choice-of-law.[144] An arbitration award advancing the application of transnational legal principles or rules or *lois de police* not expressly or implicitly agreed by the parties or alleged or raised by any of them beyond the limits allowed by the *lex arbitrii* may be considered *ultra petita* or an exercise of *ex aequo et bono* powers not granted to the Arbitral Tribunal and lead to its successful challenge before the courts of the place of the arbitration. An award expressly or implicitly relying on notions of transnational public policy not endorsed by the courts of the place of the arbitration may also lead to the setting aside of such an award. *A loi de police,* the application of which may be considered by an international commercial Arbitral Tribunal to be required under transnational public policy principles, may prove ineffectual if the ensuing award is set aside on the basis of forum public policy considerations advanced by the courts of the place of the arbitration, either because such *loi de police* is considered contrary to the public policy of the forum or because any choice-of-law methodology aimed at advancing the application of *lois de police* not belonging to such forum would constitute an infringement of its own public policy. Similar circumstances may affect the extraterritorial enforcement or recognition of the award if constituting a violation of the public policy of the forum where the enforcement of the award is sought. In this respect, it should not be forgotten that Article 35 of the 1998 ICC

[143] China Time Ltd. v. Benetton International NV before the European Court of Justice, Case C-126/197.
[144] See E.Gaillard, "La distinction des principes generaux du droit et des usages du commerce international", [1991], pp.203-217.

Rules require international commercial arbitrators to make every effort to ensure that their award shall be enforceable. Based on a similar provision contained in a previous version of the ICC arbitration rules, an ICC Arbitral Tribunal held that it could not render an award contrary to fundamental principles belonging to the public policy of the country of the enforcement of the award. In the view of the Arbitral Tribunal, this provision responded to the need to maintain the reputation of international arbitration in response to the requirements of the *societas mercatorum* or business world. Also, Article 6 of Appendix 2 to the 1998 ICC Rules provides that in the course of scrutinizing ICC arbitration draft awards pursuant to Article 27 of the 1998 ICC Rules, the ICC International Court of Arbitration shall consider "to the extent practicable" the requirements of mandatory law of the place of arbitration. All of these factors suggest that in practice there may be more or less covert choice-of-law controls on arbitral choice-of-law determinations on the merits of the dispute exercised either by the courts of law of the place of the arbitration or of the country or countries where enforcement of the award may be sought which may not be lightly dismissed by international commercial arbitrators when deciding on the applicable law and should sound a note of caution to them when exercising their broad *de facto* and *de jure* choice-of-law powers described in these lectures.[145]

3. Applicable law to the merits established by Parties

An arbitral tribunal accomplishes its central mission, the resolution of the parties' dispute, by determining the contractual obligations of the parties and using the balance of obligations as a guide in resolving the dispute. As contractual documents are generally designed to allocate contractual duties and obligations, an arbitral tribunal called upon to resolve a contractual dispute would logically be drawn, as a first step, to an examination of the parties' contractual provisions. [146]

But on what grounds are contractual provisions binding on parties, and why is the choice of law of the parties, as expressed in their contract, effective in law? Are parties bound to choose only national laws to govern their agreements or can they

[145] Naon, Horacio A. Grigera, "*Choice-of-Law Problems in International Commercial Arbitration*", pp.367-371
[146] Chukwumerije, Okezie, "Choice of Law in International Commercial Arbitration", Quorum Books, Westport, Connecticut, London, 1994, p.107.

submit their agreements to non-national standards, such as the *lex mercatoria?* What happens in cases where the parties do not make a choice of law? These are the issues that will be considered within this section (3).

3.1. Party autonomy

So far as the law of contract is concerned, there is a principle of law which is generally accepted, and which directs international commercial arbitrators to the correct choice of the law applicable to an international commercial contract. This is the principle of the autonomy of the parties which is about the freedom of the parties to choose for themselves the law applicable to their contract.[147]

The doctrine of party autonomy, which was first developed by academic writers and then adopted by national courts, has gained extensive acceptance in national systems of law. The principle has since become generally accepted[148] and, according to one commentator, is now *"a* general principle of law recognized by civilized nations."[149] Both civil and common law jurisdictions endorse the principle:

"*... despite their differences, common law, civil law and sodalist countries have all equally been affected by the movement towards the rule allowing the parties to choose the law to govern their contractual relations. This development has come about independently in every country and without any concerted effort by the nations of the world; it is the result of separate, contemporaneous and pragmatic evolutions within the various national systems of conflict of laws.*"[150]

The main advantage of party autonomy is that it allows parties to select, the law that is well known to them and whose allocation of contractual risks and obligations is suitable for their purposes, it also makes for certainty and predictability because the parties know precisely what they can legitimately expect from each other. In this era of free market theory and privatization, the doctrine of party autonomy meshes neatly with

---

[147] Redfern, Hunter, p.97.

[148] P. North and J. Fawcett, *Cheshire and North Private International Law,* 11th ed. (London: Butterworths, 1987) at 449.

[149] O. Lando, 'The Law Applicable to the Merits of the Dispute" in P. Sarcevic (ed.) *Essays on International Commercial Arbitration* (London: Graham and Trotman, (1989) 129 at 134.

[150] J. Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards* (Dobbs Ferry, NY: Oceana Publications, 197S) at75.

the attempt to reduce the role of government in the marketplace and the emphasis on individual choices and personal freedom.

Party autonomy is engrafted in virtually all international conventions dealing with arbitration and contract law. For example, Article 28(1) of the Model Law provides: "The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute." Also, Article 7(1) of the European Convention on Commercial Arbitration stipulates that "[t]he parties shall be free to determine by agreement the law to be applied by the arbitrators to the substance of the dispute." Similarly, Article 3 of the European Convention on the Law Applicable to Contractual Obligation provides that a "contract shall be governed by the law chosen by the parties."

Party autonomy is also a consistent and pervasive feature of international arbitral practice. Some arbitrators base their respect for the will of the parties on some national law (for example the law of the arbitral seat), whereas the more common practice is for arbitrators to apply the doctrine without reference to national law.[151] Tribunals that apply the doctrine without reference to national law do so on the basis that the doctrine is so generally accepted as to deserve arbitral notice. According to the tribunal in *ICC Case No. 1512 of1971:*

[I]t is possible to speak, to a large extent, of a common or universal private international law, at least whenever the question is that of the law governing the contract when there is an expressed choice by the parties. There are a few principles more universally admitted in private international law than that referred to by the standard terms of the- "proper law of the contract," according to which the law governing the contract is that which has been chosen by the parties, whether expressly or (with certain differences or variations according to the various systems) tacitly.[152]

[151] See W. Craig, W. Park, and J' Paulsson, *International Chamber of Commerce Arbitration,* 2d ed. (Dobbs Ferry, NY: Oceana Publications, 1990) at 621.
[152] Extracted in S. Jarvin and Y. Derains, *Collection of ICC Arbitral Awards: 1974-WS5* (Deventer, The Netherlands: Kluwer Law and Taxation Publishers, 1990) 3 at 4-5. See also the award in *ICC Case No. 5865 of 1989,* extracted in (1990) 1:2 *The ICC Int'l Commercial of Arbitration Bull* at 23.

Party autonomy is, however, not without its limitations in national law. Under English law and its progeny, a choice of law may be disregarded if the choice is not *bona fide* or there is otherwise a public policy ground for avoiding it. The scope of these limitations is not particularly clear; these limitations are evidently aimed at situations where the choice of law is unfairly designed to avoid the application of mandatory rules of an otherwise applicable national law.[153] These limitations, sometimes called *frauds a la loi,* are also applied in other jurisdictions. The practical effect of these limitations is, in appropriate cases, to delegitimize the parties' express choice of law, thereby reverting the determination of the applicable substantive law to traditional conflicts principles.

Some writers suggest that these limitations also apply to international commercial arbitrations.[154] On this view, an arbitrator would disregard the choice of law of the parties if the choice is not *bona fides,* that is, if the choice is aimed at avoiding the application of an otherwise applicable mandatory rule of law. This writer disagrees with this view. International commercial arbitrators can and in fact do apply the mandatory rules of national laws that are substantially connected to the contract, regardless of the law chosen by the parties. That is, the parties' choice of law in no way precludes a tribunal from determining that their contract is so closely connected with a jurisdiction that the mandatory rules of that jurisdiction must be applied to the contract, regardless of the fact that the national law of that jurisdiction is not the law applicable to the contract. There is thus no reason for an arbitral tribunal to entirely disregard a choice of law on the grounds of lack of *bona fides.* The tribunal nonetheless ensures that those mandatory rules that the parties sought to circumvent/and that are substantially connected to the contract, are enforced. Once it is recognized that a choice of law cannot preclude the application of relevant "foreign" mandatory rules of national law, there is little need to erect the limitation of *bona fides* or public policy. This is the approach adopted by the European Convention on the Law Applicable to Contractual Obligations. Article 3(3) of the convention provides as that *"[t]he fact that the parties have chosen a foreign law, whether or not accompanied by the choice of a foreign tribunal, shall not, where all*

[153] See A. Anton and P. Beaumont, *Private International Law,* 2d ed. (Edinburgh: W. Green, 1990) at 267.
[154] See A. Redferrn and M. Hunter, *Law and Practice of International Commercial Arbitration,* 2d ed. (London: Sweet and Maxwell, 1991) at 101.

the other elements are connected with one country only, prejudice the application of rules of the law of that country which cannot be derogated from by contract [mandatory rules]."

It is generally believed that parties can exercise their autonomy in two ways. First, they may expressly designate their choice of law. Second, they could, by their words or actions, manifest their expectation to have their agreement regulated by a particular national law.[155] The most common choice of law made by arbitrating parties is national law. Parties usually search for a well-developed and sophisticated national law that is suitable to their needs. Often this law is that of a leading financial or commercial center, or in other instances, that of one of the parties to the transaction. In some cases, however, arbitrating parties choose nonnational standards such as the *lex mercatoria* or amiable composition. These latter choices are somewhat controversial in that their legal status is not yet fully determined in some jurisdictions, and their scope and scheme of application are not entirely settled. It is therefore necessary to examine them in some detail.[156]

The international conventions and the model rules on international commercial arbitration bear witness to this freedom of the parties to choose for themselves the law applicable to their contract. The European Convention of 1961 provides: "*The parties shall be free to determine, by agreement, the law to be applied by the arbitrators to the substance of the dispute."*[157] The Washington Convention provides: "*The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties.*"[158] The UNCITRAL Arbitration Rules provide: *"The arbitral tribunal shall apply the law designated by the parties as applicable lo the substance of the dispute*".[159]

Amongst the rules of arbitral institutions, the ICC Rules provide:

"The parties shall be free to determine the law to be applied by the arbitrator to the merits of the dispute."[160]

---

[155] See "implied choice of law".
[156] Chukwumerije, p109.
[157] European Convention of 1961, Art. VII.
[158] Washington Convention Art.42.
[159] UNCITRAL Arbitration Rules Art. 33.1.
[160] ICC Rules Art. 13.3.

It will be seen that there is a striking unanimity on the rule of party autonomy. Indeed it is one of the few principles of law which appears to be of general, if not universal, application In the field of international commercial arbitration, although some conflict of law systems require a connection between the law chosen and the transaction itself:

"There are few principles more universally admitted in private international law than that referred to by the standard terms of the 'proper law of the contract'— according to which the law governing the contract is that which has been chosen by the parties, whether expressly or (with certain differences or variations according to the various systems) tacitly."[161]

Another question can be focused on the time to choose the applicable law:

At its origin the rule of party autonomy related to the freedom of the parties to choose the applicable law at the time of making their contract. It now extends (under the international conventions and rules cited) to the right of the parties to choose the law as it is to be applied at the time of the dispute. Indeed, in some cases, the choice may be made when the dispute is actually being heard. For instance, the award at an important ICC arbitration it is stated:

"The parties have agreed that Argentine law is the proper law of the commission agreement (or agreements), and should their choice of law, which was only made during the course of the arbitration proceedings, not by itself be binding upon me, I have no doubts about the correctness of their conclusion in that respect."[162]

There is undeniable logic in allowing the parties to choose the law which is to govern their contract at the time when they make it. In their contract the parties set out the rights and duties which they undertake towards each other. It is logical that they should also set out, at the same time, the system of law by reference to which that contract is to be governed (that is, the law which is to sustain their contract) because that law forms an essential element of the agreement between them. There is less logic in allowing the parties to choose the applicable law when a dispute has arisen. Indeed, if they are free to do this, they may choose to subject their dispute to a different law from

[161] Recueil Des Cours v. 217 (1989-v) - Page 238.
[162] Decision of Lagergren J., cited by Lew, op., p. 98

that which governed the contract when it was made. This point was considered by the arbitral tribunal in the *Aminoil* arbitration:

"Although it may in theory be possible for a litigation to be governed by an assemblage of rules different from that which, before the arbitration, governed the situations and matters that are the subject of the litigation, there must be a presumption that this is not the case."[163]

Such a presumption seems sensible. Nevertheless, it appears that, in practice, parties may make an agreed choice of law where a dispute has arisen (or when it is being heard) even if this differs from their previous choice of law; and, indeed, the Rome Convention makes express provision for this.[164]

If some justification for this delayed choice, or even change, of law is sough t in legal philosophy, it appears to lie in the concept of the autonomy of the parties. Parties are usually free to vary the terms of their contract by agreement. In the same way, they should be free to vary by agreement the law applicable to a dispute arising out of that contract. If the parties agree that their dispute should be decided in accordance with a particular law, the arbitral tribunal should make its determination in accordance with that law; otherwise, it will not have carried out the task entrusted to it by the parties.

On the other hand there are some restrictions on party autonomy:

For lawyers who practice in the resolution of international trade disputes, and who are accustomed to wending their way through a maze of national laws, the existence of a general transnational rule of law supporting the autonomy of the parties seems almost too good to be true. The natural inclination is to ask whether there are any restrictions on the rule, and if so, what? However, so long as the intention expressed is bona fide and legal and there is no reason for avoiding the parties' choice on the grounds of public policy, it is difficult to see why the rule should be qualified.

The concepts of bona fide choice, and of no offence against public policy, are reflected in the Rome Convention, to which reference has already been made. As to bona fides, the mandatory rules of the law of a country to which all the factual elements of a contract point cannot be avoided by the choice of another law as the proper law of the

[163] *American Independent Oil Company Inc. (Aminoil)* v. *The Government of the State of Kuwait* [1982| 21 I.L.M. 976, 1000

[164] The Rome Convention, Art. 3, expressly provides that a choice of law, or a variation of a choice, can be made at any time after the conclusion of the contract by agreement between the parties.

contract.[165] As to public policy, a court which applies a foreign law as the law chosen by the parties is not obliged to apply provisions of that law which are incompatible with its own mandatory rules or those of another country with which the contract has a close connection.[166]

Subject only to the qualifications of bona fides and of no public policy objection, the conventions and rules on arbitration which have been mentioned are categoric in their affirmation that the parties may choose for themselves the law applicable to the dispute. it is sensible for parties to an international commercial agreement to make use of this freedom and to insert a "choice of law" clause into their agreement. If this is not done, it is likely to be a cause for regret if a dispute should arise, since (as will be seen) the search for the proper law can be a long and expensive process. A choice of law clause may be drawn in very simple terms. It is usually sufficient, for instance, to say "This agreement shall in all respects be governed by the law of England" (or of Singapore, or of the State of New York, or of any other appropriate place).[167]

What system of law should the parties choose as the law applicable to the dispute? Is their choice limited to the choice of a national system of law or may it extend beyond this, perhaps to rules of law such as those of the law merchant *(lex mercatoria)?* Indeed, are the parties limited to choosing any law at all as the reference point for the determination of their obligations? May they not, for instance, agree that the dispute shall be decided according to considerations of equity and good conscience? it is to these questions that attention must now be turned.

The options which may be available to the parties include:

- national law;
- public international law;
- international development law;
- general principles of law;
- concurrent laws;
- competing laws;
- international trade law (*lex mercatoria);* and
- equity and good conscience.

[165] Rome Convention, Art. 3, para. 3.
[166] Rome Convention, Art. 7, para. 1. In order to decide whether such a tie exists, the court must take into account the natura, object and consequences of applying or failing to apply these imperative provisions.
[167] Redfern, p.101

3.2. **Choice of a national law**

In most cases, parties who choose a law to govern their contract, or any subsequent dispute between them, will choose an autonomous system of law. This may be the law of a federal state (for instance, that of New York) or it may be a national law (for instance, of France or of Italy). There is much sense in such a choice of law. An autonomous system of law (which in this context will be referred to as a "national" system of law, the term being intended to cover also the law of a federal state) is complete. It is not merely a set of general principles or of isolated legal rules. It is an inter-connecting, inter-dependent collection of laws, regulations and ordinances, enacted by or on behalf of the state and interpreted and applied by the courts. It is a complete legal system which should be inherently capable of providing an answer to any legal question which might be posed. Furthermore, a national system of law will be a known and existing system, capable of reasonably accurate interpretation by experienced practitioner.

In law, as in life, there is no certainty. However, a national system of law provides a known (or at least, determinable) legal standard, against which the rights and responsibilities of the parties can be measured. In the event of a dispute, the parties can be advised with reasonable confidence as to their legal position; or, at the very least, they can be given a broad indication of their chances of success or failure. If, for example, parties to a dispute which is to be heard in Switzerland agree that the arbitral tribunal shall apply the law of France, then everyone concerned (arbitrators, parties and advisers alike) knows where he stands. The arbitrators will know to what system of law they have to refer, if such reference becomes necessary. They will know, too, what sort of legal arguments they will have to present; and what sort of legal arguments (as to fault, compensation and so on) they may be required to meet.

Choice of a system of national law

Experience indicates that the choice of a suitable system of national law is the choice most commonly made in international commercial contracts. The reason for the selection of a particular national law may be because of its connection with the parties to the contract. Or it may be chosen simply because the parties regard it as a system of Law which is well suited to govern modern commercial relations. Many contracts

incorporate a choice of a particular country's law although they have no connection with that country. For example, construction contracts, commodity contracts, shipping and freight contracts and contracts of insurance often contain a choice of English Law, because the commercial Law of England is considered to reflect and to be responsive to the needs of modern international commerce.[168]

There may be arguments against the choice of a national system of law. Much will depend upon the circumstances of the particular dispute between the parties. However, four possible objections to the choice of a national system of law can be pinpointed:

- inadequacy;
- unsuitability for international trade;
- national interests;
- unfair treatment.

- Inadequacy:

At a given moment in time, a national system of law may be inadequately developed to deal with modern international commercial relationships. For example, in the Petroleum Development arbitration the sole arbitrator indicated that he would have applied the law of Abu Dhabi concerning modern commercial instruments to the dispute, but that "no such law can reasonably be said to exist."[169] Again, in the Aramco arbitration, the arbitral tribunal referred to the concession agreement between the parties as filling "a gap in the legal system of Saudi Arabia, with regard to the oil industry."[170] However, both cases were decided in the 1950s; the same observation could not properly be made now in respect of the two national laws mentioned.

- Unsuitability for International trade:

Even well-developed and modern commercial law codes are not necessarily well suited to the needs of international (as opposed to purely domestic) commerce. The law of a country reflects the social, economic and above all the political environment of that country. For example, if a country habitually controls the import and export trade (perhaps permitting such activities only through state corporations) and prohibits the free

[168] See Redfern p.102 footnote 8 "*there is commercial court users committee, which aims to keep the court in touch with the requirements of businessmen who may have recourse to the court.*"
[169] Petroleum Development Ltd. v. The Sheikh of Abu Dhabi (1952) 1 I.C.L.Q. 247.
[170] Aramco Arbitration (1963) 27 I.L.R. 117, 118.

flow of currency across the exchanges, these restrictions will permeate the national law. Whether or not this benefits the particular country, it is not an environment in which international trade and commerce will flourish. A national Law which does not permit the free flow of goods and services across national frontiers may not be the most suitable law to govern international commercial contracts—and the disputes which may arise from them.

- National interests:

Even in countries with free market economies, national laws often impose restrictions on international transactions. Grain embargoes, import quotas, trade boycotts, and currency restrictions may from time to time be applied. Since such restrictions are imposed through the mechanism of the national law, contracts which are governed by that Law may well be affected, even though these developments were never contemplated by the parties.

- Unfair treatment:

State contracts involve particular risks as the state may legislate to change the terms of a contract to which it is a party. Such changes are familiar in the context of economic development agreements where a foreign Corporation makes a long-term investment of men, money and resources in a country, under a contract with the government of that country. This is because the state, in the exercise of its public powers as a legislator, may by changing the national Law alter in its favor the contract to which it is a party. For example, it may introduce import or currency restrictions, or trade embargoes, which alter totally the balance of a contract. Changes in national law affect all persons contracting subject to that law, but the risk of a change for the worse is more real when the state is not only the legislator but also a party to the contract.
The problem of protecting a party from changes in the local law was considered in the Sapphire arbitration:

"*Under the present agreement, the foreign company was bringing financial and technical assistance to Iran, which involved it in investments, responsibilities and considerable risks. it therefore seems normal that they should be protected against any legislative changes which might alter the character of the contract and that they*

should be assured of some legal security. This would not be guaranteed to them by the outrİght application of Iranian law, which it is within the power of the Iranian State to change."[171]

Various devices have been borrowed from private law contracts, in an attempt to maintain the balance of the contract. These include revision clauses, hardship clauses and force majeure clauses, all of which have a part to play in helping to maintain the balance of the contractual relationship. in some long-term economic development agreements, the national law has even been "frozen", by the parties agreeing that the law of the state party will apply as it was on a given date.[12] The state law does not then operate as the applicable law, but as an immutable code of law incorporated into the contract. it will not change, whatever changes may occur in the state law itself. The problem, however, (apart from the lack of flexibility which this device introduces into the contract) is that the state party may still introduce a law avoiding such clauses in its own territory. In other words, the problem of entrenching such clauses has to be faced; and whilst initially attractive, the "freezing" solution seems to fly in the face of political, social and economic realities.[172]

- Stabilization clauses:

Another method which has been tried, particularly in oil concession agreements, is the inclusion of stabilization clauses, these being an undertaking on the part of the contracting state that it will not change the terms of the contract by legislative action, without the consent of the other party to the contract. In one of the arbitrations which arose out of the Libyan oil nationalizations, the arbitrator held that the Libyan government's act of nationalization was in breach of certain stabilization clauses and was accordingly an illegal act under international Law, entitling the companies to restitution of their concessions. (Texaco Arbitration decision is generally criticized as going too far, in its rejection of Libyan law as a basic ingredient of the governing law clause, in its so-called "internationalization" of the oil concession agreement, and in its decision in favor of restitutio in integrum. in any event, restitution was obviously impracticable; the only purpose it could serve was to indicate the basis on which damages should be paid for the allegedly illegal expropriation.) In another of the

[171] Sapphire International Petroleum Limited v. The National Iranian Oil Company (1964) 13 I.C.L.Q. 1011, 1012.
[172] For further discussion of this topic, see Jennings, "State Contarcts in International Law" (1961) 37 B.Y.I.L. 156; and Mann, "The Proper Law of Contracts concluded by International Persons" (1959) 35 B.Y.I.L. 34.

Libyan oil nationalization arbitrations, where the facts were almost identical, the sole arbitrator did not regard the stabilization clauses as preventing the government's act of nationalization. He held that this nationalization was a legitimate exercise of sovereign power, as long as it was accompanied by equitable compensation. Similarly, in the Aminoil arbitration, the arbitral tribunal held by a majority (with a separate opinion by Sir Gerald Fitzmaurice G.C. attached to the award) that properly interpreted the stabilization clause in the concession agreement (which was to run for a period of 60 years) did not prevent the government's act of nationalisation.[173]

Stabilization clauses, like provisions which seek to freeze the Law, attempt to maintain a particular legal regime in existence, often for a considerable period of time, irrespective of any changes which may occur in the political, social and economic environment of the country concerned.

3.3. Choice of a-national systems or principles

"They [the parties] may,… provide that the tribunal shall apply principles of law common to the two countries involved, or "general principles of law" or a national law as in effect at the time of the investment (incorporation), or a national law as in effect from time to time but excluding any post-investment adverse changes."[174]

Accommodating national interests into the development of a non-national system is via the choice of law analysis has to be taken into consideration. Because nations, in many cases, will have a strong claim to prescribe conduct even in cyberspace, the legitimacy of the rules that are applied and developed non-nationally requires respect and consideration of those national claims to prescribe. In the decision-making context, this is the function of choice-of-law principles. Choice-of-law rules reflect the "external objectives"[175] of a political unit, namely, the policy values of how it seeks to effectuate its (internal) substantive policy preferences where another political unit also has a claim to exercise prescriptive authority over a particular dispute. Choice of law rules in the UDRP are thus at the epicenter of nonnational - national relations,

[173] Aminoil arbitration [1982] 21 I.L.M. 976, 1027.
[174] Broches, "Settlement of Disputes arising out of investment in Developing Countries" (1983) 11 International Business Lawyer, pp. 206, 207.
[175] William, F. Baxter, *Choice of Law and the Federal System*, 16 STAN. L. REV. 1, 17 (1963).

because they embody the values that the non-national system will seek to apply where national political units have a competing claim to prescribe conduct.[176]

National interests are not only, by virtue of their normatively persuasive prescriptive claim, appropriately part of the non-national system; they are, by virtue of their practical ability to affect its legitimacy, an essential partner in its development.[177]

Moreover, the lack of direction on choice of law, and hence the absence of guidance on which laws will govern particular circumstances, implicates checking functions. What then should be the choice-of-law rule? What should be the terms and conditions of the bargain that the non-national structure offers national institutions? The answer is far from clear. The choice-of-law dilemma is troubling courts and scholars in all aspects of cyberspace, and settled approaches have not yet received widespread support— even in the less complicated environment of nation to nation relations. It may be that, as in those other contexts, the question cannot be settled with absolute certainty. The illusion that any choice-of-law questions could be resolved with such assurance was disturbed by the realist conflicts scholars in the United States throughout the twentieth century.[178] However, some general parameters must be established, especially if a non-national model is to supplant (or at least legitimately supplant) national regulation in any respect. The choice-of-law rules should permit panels to draw from the variety of relevant national laws as well as the non-national policies in constructing applicable substantive rules.[179]

- Authority to apply a non-national system of law:

The authority of an arbitral tribunal to apply a non-national system of law (such as the lex mercatoria) will depend upon (1) the agreement of the parties and (2) the provisions of the applicable Law. The Washington Convention, for example, is clear on this point. it states: "The Tribunal shall decide a dispute in accordance with such rules of

[176] Choice of law rules can also be shaped by public international lawmaking and thereby constrain the scope of choices available to national and non-national lawmakers.
[177] www.kentlaw.edu/depts/ipp/intl-courts/docs/ last visited in 05.09.2006
[178] See.,Friedrich K. Juenger, Choice of Law And Multistate Justice (1993)
[179] Laurence R. Helfer & Graeme B. Dinwoodie, "*Designing Non-National Systems: The Case Of The Uniform Domain Name Dispute Resolution Policy",* William And Mary Law Review, 2001 Vol.43: P.141.

law as may be agreed by the parties. ""The reference to "rules of law" rather than to "law" or "a system of law" is seen as a coded reference to the applicability of appropriate legal rules, even though these may fail short of being an established and autonomous system of law:

> "They [the parties] may, for example, provide that the tribunal shall apply principles of law common to the two countries involved, or "general principles of law" or a national law as in effect at the time of the investment (incorporation), or a national law as in effect from time to time but excluding any post-investment adverse changes."[180]

However, since ICSID awards cannot be reviewed by the courts, an arbitral tribunal which is governed by the Washington Convention is in a much stronger position to apply such rules of law than is an arbitral tribunal which is governed by the national law of the place of arbitration. Within different states, different positions are adopted. France and Switzerland, for example, allow arbitrators to decide according to rules of law.[79] The Model Law, however, whilst leaving it to the parties to make an express choice of "such rules of law" as they wish, appears to require an arbitral tribunal to apply "the Law determined by the conflict of law rules which it considers applicable," if the choice is left to the tribunal.[181]

3.3.1 Lex mercatoria

Parties to arbitration sometimes choose to apply the *lex mercatoria* to their transaction. In choosing the *lex mercatoria,* parties seek to regulate their transaction by a system of rules that is amenable to the realities of international commerce and that avoids the vagaries of national laws. As one commentator notes, by utilizing the *lex mercatoria* the parties oust the technicalities of national legal systems and avoid the application of rules that may be unfit for international commerce. Thus, the *lex mercatoria* is essentially a means of escaping the application of conflicting national laws whose disparity, Redfern and Hunter note in evocative words, "resembles a modern Tower of Babel from which some escape is sought"[182] As a transnational body of rules, the *lex mercatoria* would render it unnecessary to localize commercial transactions in any

[180] Broches, "Settlement of Disputes arising out of investment in Developing Countries" (1983) 11 International Business Lawyer, pp. 206, 207.
[181] Redfern, Hunter, p.187.
[182] M. Medwig, "The New Law Merchant: Legal Rhetoric and Commercial Reality" (1993) 24 *Law & Policy Int'l Bus.* 589.

jurisdiction, with the result that, in appropriate cases, the *lex mercatoria* becomes immediately applicable.[183]

What then is the *lex mercatoria?* A brief historical introduction is appropriate. It has long been recognized by commercial people and jurists that the fulcrum of commerce lies in customs, not law. Thus, in the Middle Ages, international merchants who engaged in European and Eastern trade developed customs and usages to regulate their trade. These customs and usages, the *lex mercaioria,* were handed down orally by merchants and their binding effect was presumed by these merchants. With time, the law merchant was developed in different areas of trade and was accepted in various marketplaces as binding rules of an international character. The emergence of the concept of nation-states around the sixteenth century led to the incorporation of this medieval *lex mercatoria* into national laws by codification (in the civil law systems), and by incorporation into the common law and statutes (in the common law systems). The medieval law merchant did not, however, completely lose its character, as it was still possible in most jurisdictions to incorporate new customs and usages into contract law.[184]

The contention of those who support the application of the *lex mercatoria* to international commercial relations is that a new *lex mercaioria* has since evolved, an autonomous brand different from the old *lex mercaioria* that was incorporated into national laws. The root of this new *lex mercatoria* is said to lie not in national laws, but in crystallized and evolving practices and usages of international commercial relations. As one commentator points out, the new *lex mercatoria* is "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."[185] O. Lando explains the concept of the new *lex mercatoria* as follows:

[Parties to an international contract may submit their disputes] to customs and usages of international trade, to the rules of Jaw which are common to all or most of the States

[183] C. Schmitthoff, *Commm-cial Law in a Changing Economic Climate,* 2d ed. (London: Sweet and Maxwell, 1981) at 20.
[184] F. Pollock, "Introduction to the Commercial Law of Great Britain and Ireland" in W. Bowstead and Sir Thomas Scrutton (eds.) *Commercial Laws of the World,* vol. XII (Boston Book Co., 1911) at 11.
[185] B. Goldman, 'The Applicable Law: General Principles of Law—The Lex mercatoria" in J. Lew (ed.) C*ontemporary Problems of International Arbitration* (London: Centre for Commercial Law Studies, 1986) at 114.

engaged in international trade or to those States which are connected with the dispute. Where such common rules are not ascertainable, the arbitrator applies the rules or chooses the solution which appears to him to be the most appropriate or equitable. In doing so he considers the law of several legal systems. This judicial process which is partly an application of legal roles and partly a selective and creative process, is here called application of the lex mercatoria.[186]

The conventional method of ascertaining the law applicable to the merits of a dispute is to select a national system of law by identifying and applying the relevant "conflict" rules of private international law. The law so chosen is then regarded as the proper law of the contract. It is sometimes suggested, however, that this search for the proper law is out of touch with the realities of modern international trade; and that what is needed is not a particular national system of law, but a modern law merchant. Such a Law, it is argued, would meet the requirements of international commerce in much the same way as the lex mercatoria met the requirements of traders living under the Roman Empire; or as enactments of customary law met the needs of sailors and merchants in the Mediterranean in the fourteenth century.

This modern law merchant goes under various descriptions, including "transnational law," "the international law of contracts," "international lex mercatoria" and "international trade Law." Whatever the description, the purpose is clear; it is to regulate international commercial transactions by a uniform system of law which avoids the vagaries of different national systems.

The idea of a modern international lex mercatoria has been actively promoted by a number of eminent authorities, mainly in Continental Europe. Among the leading proponents are Professor Berthold Goldman of France and Professor Pierre Lalive of Switzerland.[187] The reaction of commentators in England and the United States has been mixed. Some have greeted the "new law" with approval whilst others have been politely skeptical or, (in the context of state contracts) have dismissed the lex mercatoria as a concept whose time has passed, since there are now more

[186] O. Lando, "The Lex Mercatoria and International Commercial Arbitration" (1985) 34*I.C.L.Q. 747.*
[187] B. Goldman, 'The Applicable Law: General Principles of Law—The Lex Mercatoria" in J. Lew (ed.) *Contemporary Problems of International Arbitration* (London: Centre for Commercial Law Studies, 1986) at 113.

sophisticated laws and techniques for dealing with the problems which are likely to arise. Despite these doubts (and indeed, outright hostility from some commentators) there have been arbitration awards in which reliance (to a greater or lesser degree) was placed upon the new lex mercatoria; and some of these awards have come before national courts.

In one such case, an arbitral tribunal, finding it difficult to distinguish between two national systems of law, applied a rule of the lex mercatoria requiring good faith in the execution of contracts. The Court of Appeal in Vienna set aside part of the award and referred to the lex mercatoria as "world law of doubtful validity." The Austrian Supreme Court reversed the Court of Appeal, and whilst not criticizing the quoted comment, did uphold the ICC award based on the lex mercatoria since the award did not violate any mandatory provision of either of the relevant national laws which might otherwise have applied. Further, recognition and enforcement of the award was granted in France.[188]

In another ICC arbitration, which took place in Geneva, arising out of an oil and gas exploration agreement, the arbitrators determined the proper law governing the substantive obligations of the parties to be "internationally accepted principles of law governing contractual relations." Recognition and enforcement of the award was sought in London. it was argued in the English Court of Appeal that it would be contrary to public policy to enforce an award which determined the rights of the parties, not on the basis of any particular law but, "upon some unspecified, and possibly ill-defined, internationally accepted principles of law." That argument was rejected by the Court of Appeal in the following terms:

"Considerations of public policy can never be exhaustively defined, but they should be approached with extreme caution. As Burrough J. remarked: 'it is never argued at all but when other points fail.' it has to be shown that there is some element of illegality or that the enforcement of the award would be clearly injurious to the public good or possibly, that enforcement would be wholly offensive to the ordinary reasonable and fully informed member of the public on whose behalf the powers of the state are exercised.[189] By choosing to arbitrate under the rules of the ICC and, in particular, art. 13.3, the parties have left the proper Law to be decided by the arbitrators and have not in terms confined the choice to national systems of law. I can

[188] See Lord Wright in *Vita Food Products* v. *Unus Shipping Co.* [1939] A.C. 277 at 290.
[189] in Richardson v. Mellish (1824) 2 Bing 229 at 252 [1824-1834] AH E.R. 258 at 266

see no basis for concluding that the arbitrators' choice of proper Law, a common denominator of principles underlying the laws of the various nations governing contractual relations, is out with the scope of the choice which the parties left to the arbitrators."[190]

However, even if the lex mercatoria is regarded as being, in appropriate circumstances, an acceptable choice of law—or of legal rules—there remains the problem of identifying the content of this Law. It appears to consist principally of legal maxims which are on the whole admirable but scarcely add up to a complete and comprehensive system of law: the principle that contracts should be performed (pacta sunt servanda) but that circumstances may alter cases (rebus sic stantibus); that good faith is an important element in the formation and performance of contracts; that substantial failure of performance by one party to a contract relieves the other and so on. To this list the cynical reader may feel like adding other well-known maxims of the "a stitch in time saves nine" variety. [191]

Trade usages:

Article 13.5 of the ICC Rules requires the arbitrators to take account not only of the applicable Law but also of the provisions of the contract and the relevant "trade usages." A similar provision is to be found in Article 33(3) of the UNCITRAL Rules and Article 28(4) of the Model Law. it may also be found in national laws such as the Netherlands Arbitration Act 1986 which provides in Article 1054 that: "in all cases the arbitral tribunal shall take into account any applicable trade usages."

Trade usages will presumably have to be established by evidence in any given case (unless the arbitrators are familiar with them and make this clear). However, such organizations as the ICC have been prominent in attempting to establish a commonly understood meaning for terms which are in frequent use in international trade contracts. Terms such as "ex works," "CIF," "FOB Airport" and so on are intended to impose defined rights and obligations upon the parties and the precise extent of these rights and obligations is spelt out as "Incoterms" or "International Rules for the Interpretation of Trade Terms." An arbitral tribunal should take account of these international rules, if it is appropriate to do so.

---

[190] Ibid.
[191] Redfern, pp. 119, 120

In much the same way, the Uniform Customs and Practice for Documentary Credits (formulated as long ago as 1933) have proved valuable in moving towards a single international Standard for the interpretation of these important instruments of world trade. [192]

These are just examples of a general tendency for international standards and rules to become established in any service, trade or industry which crosses national frontiers and is of significant size. Standard form contracts are commonplace in the shipping trade, in the commodity markets, in the oil industry and so on. It is only a small step from the establishment of international terms and conditions to the establishment of uniform rules for the interpretation of these terms and conditions. Such uniform rules only apply within the ambit of a national system of law; but if the same rules are uniformly applied by many different national courts, or by arbitral tribunals, the basis is laid for the establishment of a customary Law which has been created by merchants and traders themselves (rather than by lawyers) and which has achieved international importance.

In conclusion, arbitrating parties are better advised not to choose the *lex mercatoria* as their governing law, unless they are prepared to have their arbitrators play the role of innovators. In assessing the position of the new *lex mercatoria* after its first 20 years, Lord Mustill was able to gamer only a "modest haul" of 20 principles,[49] most of which are too broad and too general to be helpful in resolving complex commercial disputes. This means that in most instances arbitrators applying the *lex mercatoria* would have to innovate or, as it is sometimes put, act as "social engineers." Perhaps parties who are tempted by the lures of the concept of the new *lex mercatoria* should read the words of one of its ardent advocates, O- Lando:

If the parties direct the arbitrator to apply the *lex mercatoria* they will know its merits and demerits, one of which is scarcity of "authority" on which the arbitrator can base his [or her] decision. They will know that the arbitrator cannot make scientific investigations to ascertain the "common core" of many legal systems and that he [or she] will have often to use his [or her] *bono sens.*[193]

[192] ICC Publication No. 400.
[193] O. Lando, "The Lex Mercatoria and International Commercial Arbitration" [1985], 34 I.C.L.Q. 747.

3.3.2 International Customs and Practice

The uniform laws, of international trade are to be found in multilateral conventions and model laws that are adopted by States. These laws, elaborated by jurists from different parts of the world, are said to represent a consensus (more often, a compromise) on the legal principles governing certain aspects of international trade. Examples of these uniform laws are the Uniform Law for Bill of Exchange and Promissory Notes and the Model Law on International Commercial Arbitration. These uniform laws are drafted by institutions such as the International Institute for the Unification of International Private Law (UNIDROIT) and the United Nations Commission on International Trade Law (UNCITRAL),[194] whose primary objective is the harmonization of international trade laws.

However, these uniform or model laws a»e authoritative only when they are adopted by a majority of States. Where they are so adopted (for example the New York Convention on the Enforcement of Foreign Arbitral Awards), it would be legitimate to assume that such laws or conventions embody principles of general application and are therefore representative of international practice. On the other hand, where the law is not adopted in a majority of States, it is difficult to see how it could in any reasonable sense be said to constitute part of a new lex mercatoria. It would seem that if a lex mercatoria exists, only those uniform laws that receive general acceptance can constitute part of it.

Customs and usages are another source of the new lex mercatoria. Customs and usages are said to be found in international rules and standard form contracts. Some international organizations, like the International Chamber of Commerce, develop rules and regulations that are designed for application in certain areas of international trade. These rules, commonly drafted by experts in the particular area of trade, embody the experience and practices in that area of trade. Examples of such rules are the ICC Incotermsand the ICC Uniform Customs and Practice for Documentary Credits. If these rules are generally accepted and considered binding by commercial people, they become directly relevant in the resolution of international commercial disputes. As Mustill rightly points out, customs and usages of this sort are commonly

[194] See G. Herrmann, 'The Contribution of the ICC to the Development of International Trade Law" in N. Horn and G Schmitthoff (eds.), *The Transnational Law of International Commercial Transactions* (Deventer, The Netherlands: Kluwer Law and Taxation Publishers, 1982) 35.

applied by courts and tribunals and there is nothing peculiar about the lex mercatoria in this respect. [195]

It is also suggested that standard form contracts are another source of the new lex mercatoria. These form contracts are said to be a "dynamic process through which rules of law are elaborated in fairly spontaneous fashion." One wonders how these contracts can create rules of law. Standard form contracts are usually formulated by trade groups or associations as models or prototypes on which parties may base their contractual arrangements. Most seasoned lawyers use these standard contracts only as a starring point for negotiation. Aware of how the standard contracts deal with risk allocation, lawyers in appropriate cases seek to amend them to reflect their clients' particular interests in business arrangements. As mere prototypes, it is unclear how these standard form contracts could be seen as customary practices that constitute part of a new lex mercatoria. The unlikelihood of standard form contracts being embodiments of customary practices is heightened by the fact that they often vary from one trade association to the other, and from one country to the next. For example, the trade rules of the Canadian grain association may not be the same as those of their Russian counterparts. Indeed, some institutions issue a repertoire of standard form contracts from which the parties choose the one most suitable to their needs. In such cases where there is no homogeneity in the provisions of standard form contracts, which of them could be said to constitute part of the new lex mercatoria? In sum, standard form contracts are by definition prototypes that do not necessarily evince binding customary practices.[196]

4. Applicable law to Merits Established by Arbitrators

As discussed above, the parties have the right to choose for themselves the law applicable to their dispute. Various options are open to them. Consideration must now be given to the difficult situation which arises when the parties do not expressly agree upon the applicable law. Even if the parties have not expressed a clear choice of the applicable law in their contract, it may be possible to interfere a choice of law from the terms of the contract and the relevant surrounding circumstances:

---

[195] J. Robert and T. Cwbonneau, *Trie French Law of Arbitration* (New York: Matthew Bender, 1983) at 11:4-19.
[196] Chukwumerije, pp.112,113.

"*Where the intention of the parties to a contract with regard to the law governing the contract is not expressed in words, their intention is to be inferred from the terms and nature of the contract, and from the general circumstances of the case, and such inferred intention determines the proper law of the contract."*[197]

In the absence of an express choice of law, the arbitral tribunal must look for the law which the parties might be presumed to have intended to choose. This is often referred to as a tacit choice of law; it may also be known as an implied, inferred or implicit choice. There is a certain artificiality involved in selecting a governing law for the parties and attributing it to their tacit choice, particularly where (as often happens in practice) it is apparent that the parties themselves gave no thought to the question of governing law. The Rome Convention, to which reference has already been made, provides, in Article 3, paragraph 1, that a choice of law must be "expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case." This makes it clear that a tacit choice must only be found where it is reasonably clear that it is a genuine choice by the parties.[198] Nevertheless, it is a process which is usually followed by international commercial arbitrators.[199]

4.1. General

Quite often parties to an arbitration fail to exercise their right to select the applicable law to govern the substance of their contract. Arbitrators had to deal with the problem of applicable law because the parties failed to make a choice of law. There are a variety of reasons why some parties do not include a choice of law in their agreement. The first is that the parties may simply have failed to reach an agreement on which law to select, perhaps as a result of each party insisting on its own national law. Another reason is that the parties may have been much more interested in making a deal than in addressing the issue of applicable law. In one case, the witnesses before a tribunal explained that the parties did not want to risk a rupture

[197] Dicey and Morris, *The Conflict of Laws* (7th cd., 1958). Cited with approval by Lord Wilbcrforce in *Campagnie d'Armement Marine* [1971] A.C. 572, 595. Dicey and Morris, *The Conflict of Laws* is now in its ll th edition (1987). See also *Amin Rasheed Shipping Corporation* v. *Kuwait Insurance Co.* [1984] A.C. 50.
[198] See Jaffey, "The English proper law doctrine and the EEC Convention" (1984) 331.C.L.C 531, 545.
[199] For further discussion of this practice, and criticism of it, see Lew, *Applicable Law in International Commercial ArbitratIon,* p. 181.

of their negotiation process by drafting a clause on applicable law.[200] Still, it could be that the parties simply had incompetent lawyers who forgot to engraft a choice of law clause into their contract. Whatever the reason for the absence of a choice of law clause in a contract, the fact is that it places arbitrators in a legal quandary.

Arbitrators are in a somewhat unique position in this regard. National judges faced with a similar problem would be obliged to refer to their national conflict of law rules. However, arbitrators, unlike judges, do not have national conflict rules to which they could seek recourse in these cases. As one tribunal put it, "The international arbitrator has no *lex fori* from which he can borrow rules of conflict of laws.[201] Yes, arbitrators sit in national jurisdictions, but they are not bound by the conflict of law rules of these jurisdictions because they are not instruments of a State's judicial process in the same way that national courts are.[202] Moreover, national conflict of law rules are designed for national courts, not for international commercial arbitrators.

The general trend in international conventions on arbitration and in institutional arbitration rules is to confer on arbitrators the responsibility to determine applicable law in the absence of an express choice by the parties. A few examples will suffice to illustrate this position. Article 7 of the European Convention on Commercial Arbitration provides; *inter alia,* that "Failing any indication by the parties as to the applicable law, the arbitrators shall apply the proper law under the rule of conflict that the arbitrators deem applicable." This provision has inspired similar provisions in the Model Law,[203] the ICC Rules,[204] and the UNCITRAL Rules.

---

[200] I*CC Case No. 2997 of 1978.*
[201] I*CC Gise No. 1512 of 1971.*
[202] P. Lalive affirms this fact as follows: "The arbitrator exercises a private mission, conferred contractually, and it is only by a rather artificial interpretation that one can say that his powers arise from—and even then very indirectly—a tolerance of the State of the place of arbitration, or rather of the various States involved (States of the parties, of the *siege,* of the probable places of execution of the award), which accept the institution of arbitration, or of the community of nations, notably those which have ratified international treaties in the matter. Would it not be to force the international arbitrator into a kind of Procrustean bed if he were assimilated to a State Judge, who is imperatively bound to the system of private international law of the country where he sits and from which he derives his power of decision.

[203] Article 28(2) of the Model Law provides that 'Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of law rules which it considers applicable.
[204] Article 13(3) of the ICC Rules provides that "In the absence of any indication by the parties as to the applicable law, the arbitrator shall apply the law designated as the proper law by the rule of conflict which he deems appropriate."

Most arbitrators do not, however, have as their starting point a search for appropriate conflict rules. Rather they examine the parties' contractual provisions to see whether they are sufficient to resolve the dispute. This attitude is consistent with the doctrine of party autonomy, for a contract is after all an embodiment of the parries' expectations on how their transaction should be organized. Contracts contain provisions that seek to express the parties' contractual obligations and the manner and under what conditions these obligations should be enforced. Normally, the more complex a commercial transaction, the more detailed the contractual provisions. This is because the parties' objective is to set out their expectations as clearly as is necessary to dispel possible misunderstanding of their respective contractual duties.[205] Where the provisions of the contract are sufficiently detailed to resolve the dispute at hand and they do not infringe the provisions of relevant mandatory rules, arbitrators usually apply them without having to determine what the applicable law is. This approach was adopted by the arbitral tribunal in *ICC Case No. 1990 of 1977.* Dealing with the question of applicable law, the tribunal stated that "[i]n so far as the questions in dispute are regulated by the parties in their contract and this contractual regulation does not contravene the mandatory rules of the two laws in question, it is permitted to resolve them on the basis of the contract. . . . These can be resolved without a preliminary decision on the applicable law."

The application of contractual provisions has its in-built limitations. First, however widely contracts are drafted, they rarely contain provisions to govern the entire field of potential areas of dispute.[206] Second, some phrases in contractual provisions may need to be defined within the context of a national law. For example, the delimitation of the precise scope and ramifications of *force majeure* may necessitate reference to a national law. Consequently the use of contractual provisions can not be a substitute in ail cases for the making of a positive choice of law. In most cases arbitrators would have to exercise their discretion to select a governing law. [207]

---

[205] This is why building contracts can in some cases run into hundreds of pages.
[206] See M. Hunter, J. Paulsson, N. Rawding, and A. Redfern, *The Freshfield Guide to Arbitration and ADR: Clauses in International Contracts* (Deventer, The Netherlands: Kluwer Law and Taxation Publishers, 1993) at 32.
[207] See the interim award in *ICC Case No. 5717 of 1988,* extracted in (1990) 1:2 *ThelCCInt'l Court of Arbitration Bull,* at 22.

In what ways do arbitrators decide on applicable law in the absence of the parties' express choice? Let us examine each of these methods.

4.2. Choice of conflict of law system

This approach is based on the presumption that certain principles of conflict of laws are common to the world community, or at any rate to a majority of them. It is thus premised on the possibility of distilling common principles from national conflict rules. There is no doubt that if there are indeed such principles that are generally accepted, they should be applied by arbitrators not only because their application would be deemed to be within the expectations of the parties, but also because their general acceptance argues the case for their application in international commercial relations.

Some arbitral tribunals have applied conflict rules that they claimed were generally accepted. For example in *ICC Case No. 4650*[208] the tribunal held that it "does not deem it necessary to decide o a specific rule of conflict to designate the proper law of the contract in view of the fact that most major rules in some form or other point to the place of characteristic or dominant work".[209] Similarly, in *ICC Case No 6527 of 1991,* the tribunal found it "more appropriate to apply the general principles of international private law as stated in international conventions."[210] The tribunal relied on the provisions of the Hague Convention on the law applicable to international sales of goods and the EEC Convention on contractual obligations.

This approach is commendable as it seeks to free the determination of applicable law from the conflict rules of any particular national jurisdiction-and to locate it in rules that are common to most jurisdictions or embodied in generally accepted conventions and international commercial practice. The harmonization of national conflict rules through the adoption of conventions, such as the EEC Convention on Contractual Obligation, contributes to the evolution of uniform rules and practices in determining applicable law. Nonetheless, it is important that arbitrators do not hide behind the olive branch of general principles to mask their convenient conclusions as principles of general application.

---

[208] (1987)12 Y. *Comm. Arb.* 111.
[209] Id. at 112. See also *ICC Case No. 3043* (1979) Clunet 1001.
[210] (1993) *Y.Comm. Arb. 44* at 46.

Article 33 of UNCITRAL Arbitration rules of 1976 provide:

1. The arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.
2. The arbitral tribunal shall decide as *amiable compositeur* or *ex aequo et bono* only if the parties have expressly authorized the arbitral tribunal to do so and if the law applicable to the arbitral procedure permits such arbitration.
3. In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction.

This provision follows the traditional, open-ended formula for designating the applicable substantive law. It refers to an agreement between the parties on the applicable law and, in case of absence of such agreement, prescribes a method of finding it. Therefore, under the first sentence of paragraph 1 the tribunal is bound by the choice of law as agreed by the parties. However, the choice of conflict of laws rules that will determine the applicable substantive law in the absence of such agreement on applicable law is at the tribunal's discretion. This means that the tribunal is not bound by any national conflict of laws rules.[211]

There are various systems of law which may govern an international commercial contract where no express or tacit choice of law has been made. These include the law of the place where the contract was made (the so-called *lex locus contractus)*; the law of the place where the contract was to be performed (the *lex locus solutionis);* and, if one of the parties to the contract was a state or state entity, the national law of the state concerned.

An arbitral tribunal which is faced with the problem of choosing between these different laws must first decide whether it has a free choice or whether (more conventionally) It must follow the conflict of law rules of the seat of the arbitration—the conflict rules of the *lex fori.* Every developed national system of law contains its own rules for the conflict

[211] Begic, Taida, "Applicable Law in International Investment Diputes", Eleven International Publishing, [2005], p, 6-7

of laws (sometimes called private international law, in the narrower sense of that phrase). These conflict rules will usually serve, *inter alia,* to indicate what law is to be chosen as the law applicable to a contract, where the parties have failed to make a choice and where more than one law may be involved. To carry out this role, the relevant conflict rules will generally select particular criteria which serve to link, contact or connect the contract in question with a given system of law. These criteria are often referred to as "connecting factors." However, they differ from country to country. Accordingly the answer to the question "What is the applicable law?" will also differ from country to country.

Some of the rules which are applied to connect a particular contract with a particular national law or set of legal rules now look decidedly out of date. Under the conflict rules of Algeria or of Egypt, for instance, the applicable law (in the absence of an express or tacit choice) is likely to be the law of the place where the contract was concluded (the *lex locus contractus).* No doubt the place of conclusion of a contract was at one time a factor of some significance, since it would usually be the place of business or residence of one of the parties. However, with contracts being concluded nowadays by telephone or by fax or by meetings at an airport or some other convenient (or inconvenient!) location, the place in which the contract was finally concluded is often a matter of little or no significance.

There are indications of a softening of traditional strict conflict rules. The Rome Convention, for instance, adopts a flexible approach to the search for the applicable law when no express or tacit choice has been made. Article 4, paragraph 1, states that in such a case the contract is governed by the law of the country with which it presents a "stricter connection." This is close, if not analogous, to the test of "the closest and most real connection" used in many common law countries. The Convention then sets out certain presumptions as to stricter connection, including the presumption of a stricter connection with the country in which the "characteristic" performance of the contract has to take place.[212]

Recent arbitral awards demonstrate the flexibility open to arbitrators in deciding which law to apply to the merits of the dispute when the arbitration agreement does not

[212] Rome Convention, Art. 4(2). For discussion of "characteristic" performance see Jaffey.,*p.* 553.

contain a choice of law provision. in one case, the claimant argued for international principles of law and the *lex mercatoria* to apply. The defendant argued for English law to apply because the place of arbitration was London and English was the language of the contract. The arbitrator applied the test of which substantive law had the greatest connection with the dispute and chose Swiss law. The connecting factors included the fact that Switzerland was the place where the contract was concluded, where relevant documents were located and where payments were to be made under the contract.[213]

If we consider whether an international arbitrator has a lex fori or not we see that national rules differ from one country to another. A judge or arbitral tribunal in one country may select the applicable law by reference to the place where the contract was made,[214] whereas in another country it may be selected by reference to the law with which the contract has the closest connection. In short, the same question may produce different answers, depending upon where the judge or arbitral tribunal happens to be sitting.

In the context of international commercial arbitration, this is plainly unsatisfactory; the seat of the arbitration is usually chosen for reasons other than the conflict rules of the forum. This has led to the formulation of a doctrine which has found support both in the rules of arbitral institutions and in the practice of international arbitration. The doctrine provides that, unlike the judge of a national court, an international arbitral tribunal is not bound to follow the conflict of law rules of the country in which it has its seat. This doctrine has many powerful advocates, particularly amongst German, French and Swiss lawyers. So the almost total abandonment of the application of the rules of conflict is so-called arbitral forum.

Indeed, it is sometimes said in this context that an international arbitral tribunal has no *lex fori.* The new doctrine bas been followed in arbitral practice by arbitrators who are themselves distinguished international lawyers. For instance, in the *Sapphire* arbitration the sole arbitrator, who was a judge of the Swiss Federal Tribunal, said:

[213] ICC Award, para. 5717 (1988); excerpt in (1990) 1 *The ICC International Court ofArbitration* Bulletin, p. 22.
[214] ICC Award, para. 5865 (1989); *Ibid.,* 23. There are other case excerpts related to the determination of the applicable substantive law in the same Bulletin.

"Since the arbitration has its seat in Switzerland, Swiss private international law might be applicable, as the *lexfori,* for determining the substantive law applicable to the interpretation and performance of the agreement. However, in the view of some eminent specialists in private international law, since the arbitrator has been invested with his powers as a result of the common intention of the parties, he is not bound by the rules of conflict in force at the forum of the arbitration. Contrary to a State judge, who is bound to conform to the conflict law rules of the State in whose name he metes out justice, the arbitrator is not bound by such rules. He must look for the common intention of the parties, and use the connecting factors generally used in doctrine and in case law and must disregard national peculiarities in a more recent arbitration, held under the ICC Rules, the arbitral tribunal agreed that it was not obliged to follow the conflict of laws rules of the country in which the arbitration had its seat.[215] The new doctrine has much to commend it; and appears to have the tacit support of the leading international conventions and institutional rules of arbitration. (Batiffol, *Revue de l'Arbitrage,* 1957, p. 111; Carabiber, *L'Arbitrage International de droit prive,* Paris, 1960, pp. 50, 92)."[216]

4.3. Choice of national law

Experience indicates that the choice of a suitable system of national law is the choice most commonly made in international commercial contracts. The reason for the selection of a particular national law may be because of its connection with the parties to the contract. Or it may be chosen simply because the parties regard it as a system of law which is well suited to govern modern commercial relations. Many contracts incorporate a choice of a particular country's law although they have no connection with that country. For example, construction contracts, commodity contracts, shipping and freight contracts and contracts of insurance often contain a choice of English law, because the commercial law of England is considered to reflect and to be responsive to the needs of modern international commerce.

In some cases, however, there may be arguments against the choice of a national system of law. Much will depend upon the circumstances of the particular dispute

[215] 95 (1980) V *Yearbook Commercial Arbitration,* p. 168.

[216] 94 The *Sapphire* arbitration (1964) 13 I.C.L.O- 1011.

between the parties. However, four possible objections to the choice of a national system of law can be located:

— inadequacy;
— unsuitability for international trade;
— national interests;
— unfair treatment.

- Inadequacy:

At a given moment in time, a national system of law may be inadequately developed to deal with modern international commercial relationships. For example, in the *Petroleum Development* arbitration the sole arbitrator indicated that he would have applied the law of Abu Dhabi concerning modern commercial instruments to the dispute, but that "no such law can reasonably be said to exist."[217] Again, in the *Aramco* arbitration, the arbitral tribunal referred to the concession agreement between the parties as filling "a gap in the legal system of Saudi Arabia, with regard to the oil industry."[218] However, both cases were decided in the 1950s; the same observation could not properly be made now in respect of the two national laws mentioned.

- Unsuitability for International trade:

Even well-developed and modern commercial law codes are not necessarily well suited to the needs of international (as opposed to purely domestic) commerce. The law of a country reflects the social, economic and above all the political environment of that country. For example, if a country habitually controls the import and export trade (perhaps permitting such activities only through state corporations) and prohibits the free flow of currency across the exchanges, these restrictions will permeate the national law. Whether or not this benefits the particular country, it is not an environment in which international trade and commerce will flourish. A national law which does not permit the free flow of goods and services across national frontiers may not be the most suitable law to govern international commercial contracts—and the disputes which may arise from them.

---

[217] *Petroleum Development (Trucial Coast) Ltd.* v. *The Sheikh of Abu Dhabi* (1952) 11.C.L.Q. 247.

[218] *Aramco* arbitration (1963) 27 I.L.R. 117, 168

- National interests:

Even in countries with free market economies, national laws often impose restrictions on international transactions. Grain embargoes, import quotas, trade boycotts, and currency restrictions may from time to time be applied. Since such restrictions are imposed through the mechanism of the national law, contracts which are governed by that law may well be affected, even though these developments were never contemplated by the parties.

- Unfair treatment:

State contracts involve particular risks as the state may legislate to change the terms of a contract to which it is a party. Such changes are familiar in the context of economic development agreements where a foreign Corporation makes a long-term investment of men, money and resources in a country, under a contract with the government of that country. This is because the state, in the exercise of its public powers as a legislator, may by changing the national law alter in its favour the contract to which it is a party. For example, it may introduce import or currency restrictions, or trade embargoes, which alter totally the balance of a contract. Changes in national law affect all persons contracting subject to that law, but the risk of a change for the worse is more real when the state is not only the legislator but also a party to the contract.

The problem of protecting a party from changes in the local law was considered in the *Sapphire* arbitration:

> "*Under the present agreement, the foreign company was bringing financial and technical assistance to Iran, which involved it in investments, responsibilities and considerable risks. it therefore seems normal that they should be protected against any legislative changes which might alter the character of the contract and that they should be assured of some legal security. This would not be guaranteed to them by the outright application of Iranian law, which it is within the power of the Iranian State to change.*"[219]

---

[219] *Sapphire International Petroleum Limited* v. *The National Iranian Oil Company* (1964) 13 I.C.L.Q. 1011, 1012.

Various devices have been borrowed from private law contracts, in an attempt to maintain the balance of the contract. These include revision clauses, hardship clauses and *force majeure* clauses, all of which have a part to play in helping to maintain the balance of the contractual relationship. In some long-term economic development agreements, the national law has even been "frozen", by the parties agreeing that the law of the state party will apply as it was on a given date.[220] The state law does not then operate as the applicable law, but as an immutable code of law incorporated into the contract. It will not change whatever changes may occur in the state law itself. The problem, however, (apart from the lack of flexibility which this device introduces into the contract) is that the state party may still introduce a law avoiding such clauses in its own territory. In other words, the problem of entrenching such clauses has to be faced; and whilst initially attractive, the "freezing" solution seems to fly in the face of political, social and economic realities.[221]

4.4. Application of a-national Rules[222]

(j) Equity and good conscience

Arbitrators are from time to time required to settle a dispute by determining it on the basis of what is fair and reasonable, rather than on the basis of law. Such power is conferred upon them by so-called "equity clauses" which state, for example, that the arbitral tribunal shall "decide according to an equitable rather than a strictly legal interpretation"[223] or, more simply, that they shall decide as *amiable compositeurs.*

This power to decide "in equity," as it is sometimes expressed, is open to several different interpretations. It may mean, for instance:

— that the arbitral tribunal should apply relevant rules of law to the dispute, but may ignore any rules which are purely formalistic (for example, a requirement that the contract should have been made in some particular form); or
— that the arbitral tribunal should apply relevant rules of law to the

[220] See, for instance, the *Lena Goldfields* arbitration between the Soviet Union and a British Corporation, with respect lo mining concessions: Stuyt, *Survey of International Arbitrations 1794-I970 (1976),* App. 1, No. A10.

[221] For further discussion of this topic, see Jennings, "State Contracts in International Law" (1961) 37 B.Y.I.L. 156; and Mann, "The Proper Law of Contracts concluded by International Persons" (1959) 35 B.Y.I.L. 34.
[222] The effect of the parties for the choice of a-national systems or principles is seen above at section 3.3.
[223] As, for instance, in the Orion Compania case [1962] 2 Lloyds Rep. 257.

dispute, but may ignore any rules which appear to operate harshly or unfairly in the particular case before it; or

— that the arbitral tribunal should decide according to general principles of law; or

— that the arbitral tribunal may ignore completely any rules of law and decide the case on its merits as these strike the arbitral tribunal.

This fourth alternative is generally rejected by commentators; to the extent that they do agree, they seem to suggest that even an arbitral tribunal which decides "in equity" must act in accordance with some generally accepted legal principle. in many (or perhaps most) cases this is likely to mean that, as indicated at the outset of this chapter, the arbitral tribunal with reach its decision based largely on a consideration of the facts and on the provisions of the contract, whilst trying to ensure that these provisions do not operate unfairly to the detriment of one or other of the parties.

Direct Application of a Conflict of Law Rule without Reference to Any National law

It is becoming increasingly commonplace for arbitrators to apply a conflict rule without grounding its application on a particular national law. Here the arbitrators examine the important factors connecting the contract to a particular jurisdiction, with the aim of determining which country is most closely connected to the transaction. This is parallel to the English proper law doctrine, and it has the benefit of circumventing the rigors of the conflict of law methodology.

It should be recalled that the European Convention,[224] the Model Law,[225] and the ICC Rules,[226] among others, require arbitrators to make a choice of law by reference to the "conflict of law rules which [they] deem applicable." This would seem to suggest that arbitrators should anchor their choice of applicable law on the conflict of law rules of a particular jurisdiction. This interpretation is, however, not generally accepted;[227] some commentators argue that an arbitral tribunal need not rely on any national conflict of law rule in determining the governing law. To avoid this controversy, in all

[224] Article 7.
[225] Article 28(2).
[226] Article 13(3).
[227] *In Compania,* the Court of Appeal of Paris held that the ICC Rules did not require an arbitrator "to make use of a conflict rule belonging to a given legal system in order to determine the law applicable to the substance."

common law provinces and the territories in Canada the legislation adopting the Model Law were modified to free arbitrators from the requirement of applying national conflict rules.[228] For example, Article 28(3) of the British Columbia International Commercial Arbitration Act[229] provides that failing an express choice of law by the parties "the arbitral tribunal shall apply the rules of law it considers appropriate given all the circumstances surrounding the dispute." Explaining the rationale behind this provision, J. Blom, a member of the task force that recommended British Columbia's adoption of the Model Law, notes that "the task force hoped that freeing the arbitral tribunal from having to proceed to a decision via conflict of laws, would allow the tribunal to decide on the merits of the dispute in the most direct manner and with a minimum of artifice."[230] Similarly, in its resolution on The Autonomy of the Parties in International Contracts between Private Persons or Entities, the Institute of International Law stipulated that "[i]n the absence of an express agreement, the choice [of law] shall be derived from those circumstances which indicate clearly the intention of the parties."[231]

Arbitrators often use this direct method in determining the applicable law. In *ICC Case No. 4237,* the tribunal in exercising its discretion to make a choice of law declined to do so through the national conflict of laws methodology:

In view of the international character of the present arbitration, the arbitrator deems it appropriate to apply those conflict rules which are generally followed in international arbitrations of this kind under consideration. The derided international awards published so far show a preference for the conflict rule according to which the contract is governed by the law of the country with which it has the closest connection. The country with which it has its closest connection is the country where the party who has to carry out the most characteristic performance has its head office.

---

[228] See J. Castel, "International Commercial Arbitration" in P. Emond, (ed.) *Commercial Dispute Resolution: Alternatives* to *Litigation* (Ontario: Canada Law Book, 1989) 121 at 142.
[229] S.B.C.1986, c. 14.
[230] J. Blom, "Conflict of Laws Aspects of the International Commercial Arbitration Act" in *R.* Paterson and B. Thompson., (eds.) *UNCITRAL Arbitration Model in Canada* (Toronto: Carswell, 1987) 127 at 131.
[230] Article 3(2).
[231] See also the interim award *inJCC Case No. 5717 of1968,* interim award in *ICC Case No. 5660 of 1990* (1992) 17 Y. *Comrn. Arb.* 226. 150.

A similar approach was adopted in ICC *Case No. 3316.* This approach is somewhat similar to the general principles method in that its application presupposes the general application of a norm favoring the law of the place with which the contract is most closely connected. However, there is a significant difference between the direct application method and the application of general principles. Arbitrators using the direct methodology rely on connecting factors in locating applicable law not necessarily because the use of these connecting factors is generally accepted, but because they deem this method appropriate. Arbitrators using the direct approach need not demonstrate that the approach is commonly accepted; all they have to do is to demonstrate their preference for this method. It should be noted that the direct approach, which is essentially an indirect application of the proper law doctrine, is becoming the dominant conflict of law method in modern legislation and court decisions.[232] It was adopted by the European Convention on Contractual Obligations. Article 4(1) of the convention provides, *inter alia,* that in the event of a failure by the parties to make an express choice of law, "the contract shall be governed by the law of the country with which it is most closely connected."[233]

This writer believes that the direct approach is best suited for eradicating the confusion that this area of arbitration has become. If generally accepted, it would enable arbitrators to directly select the applicable law without the rigors of deciding which conflict rule to apply. An arbitrator faced with the problem of determining the governing law in the absence of the parties' agreement would directly apply the law most closely connected to the contract. It is to be hoped that the next international project on arbitration will adopt this straightforward approach to choice of law by arbitrators. Canadian legislations have led the way in this respect.

4.4.1. Conventions

Early Arbitration Conventions:

Historically, international arbitration has followed two streams; public law arbitrations between states and commercial arbitration. Both types of arbitration have been

[232] See O.Lando, supra note 3 at 142-143.

[233] Article 4(2) of the convention further contains a presumption that a contract "is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contact, his habitual residence, or in the case of a body corporate or unincorporated, its central administration."

known for many centuries. Arbitration between states was used by the ancient Greeks,[234] and commercial arbitration was well known to the Romans during the era of their domination of Europe. In some ways the modern international arbitrator acts in the ancient Roman tradition of the *preator Peregrinus,* an official appointed to deal speedily with disputes involving foreigners and traveling merchants, who helped to establish the *lex mercatoria.*

However, regulation of international arbitration in the form of multilateral conventions did not appear until the end of the nineteenth century.[235] The Hague Convention of 1899 was one of the practical achievements of the Hague Peace Conference of that year. That Convention established the Permanent Court of Arbitration and although little used, the Convention itself was, in modern times, the first positive action taken by a group of states to provide a general method for the peaceful resolution of disputes between them. The Convention lays down rules of procedure to apply where the parties fail to agree, and provides for a method of establishing the arbitral tribunal, which is composed of five members. Another arbitration in which one party is a state are more commonly held under the auspices of ICSID, a much newer creation.

The Permanent Court of International Justice was established by the League of Nations after the First World War for the resolution of disputes between states; it was indeed to be an additional method of resolving disputes to that provided by the PCA.

In parallel with this development came the first major step at an international level for the recognition and support of international commercial arbitration. This was the Geneva Protocol of 1923.[236] The Protocol which was promoted by the ICC, was directed at the lack of international enforceability of arbitration clauses referring future disputes to arbitration. It expressly declared that arbitration agreements were valid, whether they related to existing or to future disputes, and it obliged courts of states which became parties to the Protocol to say an action brought by a claimant where an arbitration clause existed, so that the dispute might be referred to

[234] See, Hammond, "Arbitration in Ancient Greece" (1985) Arbitration International, p. 188.
[235] Although there were earlier bilateral treaties in the field of public law; e.g. the Jay Treaty entered into between the United Kingdom and United States in 1794 which referred to arbitration various outstanding disputes following the Declaration of Independence 1776.
[236] League of Nations Treaties Series (1924), Vol. XXVII, 158, No.678; for further discussion of the Geneva Protocol of 1923, see Chap. 8, pp. 455 *et seq.*

arbitration. The League of Nations quickly followed this step with the first major international convention relating to the enforcement of arbitration awards, the Geneva Convention of 1927.[237] The Geneva Treaties represent the first stage of what has become a long and continuing process for the regulation and harmonization of arbitration as a means of resolving disputes in international trade.

International conventions and rules of arbitration

The Washington Convention states that in the absence of any choice of the applicable law by the parties the arbitral tribunal must apply the law of the contracting state which is a party to the dispute, together with such rules of international law as may be applicable.[238] The Washington Convention, however, is necessarily concerned with the states or state entities. Accordingly, it follows the traditional practice of giving considerable weight to the law of the state party to a contract, in the absence of any choice of law.

Other conventions are content to leave the choice to the arbitral tribunal. The European Convention of 1961, for instance, stipulates that: "Failing any indication by the parties as to the applicable law, the arbitrators shall apply the proper law under the rules of conflict that the arbitrators deem applicable."[239]

Although the European Convention of 1961 refers to "rules of conflict," these are not necessarily the rules of conflict of the country in which the arbitration has its seat. On the contrary, the reference is to the conflict rules that the arbitrators deem applicable. A similar approach is adopted in the UNCITRAL Arbitration Rules, which state that failing any designation of the applicable law by the parties, the arbitral tribunal shall apply "the law determined by the conflict of laws rules which it considers applicable."[240]

The Model Law adopts the same terminology.[241] The intention is that the arbitral tribunal should be given almost complete freedom to choose the applicable law in the absence of any choice of law by the parties. But should the arbitral tribunal still be

[237] The Geneva Convention for the Execution of Foreign Arbitral Awards 1927, League of Nations Treaty Series (1929-1930), Vol. XCII, p. 302 for further discussion of the Geneva Convention of 1927.
[238] Washington Convention, Art. 42(1).
[239] European Convention of 1961, Art. VII.
[240] UNCITRAL Arbitration Rules Art. 33.
[241] Model Law, Art. 28(2).

obliged to proceed to its choice by way of conflict rules? The French law on this point is both sensible and more logical:

> "*The arbitrator shall settle the dispute in accordance with the rules which the parties have chosen, and in the absence of such a choice, in accordance with those rules which he considers to be appropriate*."[242]

It will be seen that this provision contains two stipulations. First, that an international arbitral tribunal is not obliged to proceed to its choice of law by the adoption of any national conflict of laws rules. Secondly, that it is not obliged to choose a *system* of law as the proper law of the contract; it may, instead, choose such *rules* of law as it considers appropriate for the resolution of the dispute. The trail blazed by French law has now been followed by other countries, including Switzerland and the Netherlands.[243]

Another category of arbitral applications of the UNIDROIT Principles consists of using them in order to resolve matters of interpretation or, eventually, to fill gaps in international conventions such as CISG.[244] Without entering into the continuing debate over national versus autonomous means of interpreting and supplementing international uniform law conventions,[245] we here simply focus on the position of the arbitrator. From this standpoint, transnational rules may become applicable at least through the *renvoi* contained in the convention towards general principles. The theorem is simple in its basic assumption: if and only if the convention is applicable, it follows, *coeteris paribus,* that transnational rules may be applied on the ground of a specific rule contained in the particular convention at issue.

Then again, in case of doubts on the precise meaning of rules of an international uniform law convention, the solution may be found in transnational rules, such as the *lex mercatoria* or the UNIDROIT Principles. After considering the state of the

---

[242] Art. 1496 of the Code of Civil Procedure—Decree Law No. 81-500 of May 12, 1981.

[243] See the Swiss PİL Act, Chap. 12, Art. 187 and The Netherlands Arbitration Act 1986, Art. 1054.

[244] UNIDROIT Principles, supra note 2, art. 7.

[245] *See, e.g.,* COMMENTARY ON THE UNITED NATIONS CONVENTION ON THE INTERNATIONAL SALE OP GOODS (CISG) (Pater Sehlechtriem ed., 2d. ed. 199B); M.Gebauer, *Uniform Law, General Principles and Autonomous Interpretation,* 5 UNIFORM L. REV. 6S3, 683-705 (2000).

art of ICC arbitral practice on this specific point, including a practical example, I shall illustrate further applications of the interpretation and gap filling method.

1. Arbitral Practice

In ICC arbitral practice, UNIDROIT Principles have been used as a means of interpretation and supplementation of international conventions in at least five cases which, in perspective, allow us to estimate this group at approximately 13 percent of all UNIDROIT awards.[246] In this line of arbitral jurisprudence, arbitrators have employed the Principles mainly in the context of interpreting the 1980 Vienna Convention on the International Sale of Goods (CISG). The nexus between the CISG and the Principles may be found in Article 7 of the Vienna Convention where it is stated that:

> (1) In the interpretation of this Convention, regard is to bis had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.
>
> (2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.[247]

Therefore, the need of "international interpretation" of the CISG is satisfied by UNIDROIT Principles as it will be seen in the following example.

2. One Practical Example: ICC Award Number 8769

A practical example of this line of cases may be found in ICC Award Number 8769.[248] The parties entered into a manufacturing contract, plus a tooling agreement relate'd to it. The claimant alleged a breach of contract by the respondent, referring to misleading conduct in negotiations, failure to meet technical specifications, misuse of tooling, and non-registration of patent. The respondent objected and filed a

---

[246] See Award Nos. 8128, 87G9, 8817, *discussed in* Marrella & Gelinas, *supra* note 2.

[247] Vienna Sales Convention, *supra* note 29, art. 7.

[248] Id. at 75.

counterclaim to cover balance of tooling costs, unused packaging and materials, warehouse costs, settlement payment for termination of licensing agreement, additional machinery costs, outstanding invoices, and lost profits. The sole arbitrator applied French law and the 1980 Vienna Convention on contracts for the international sale of goods (CISG), in accordance with the agreement reached by the parties in the arbitration clause. He rejected the claimant's demands and granted the respondent's counterclaims. In awarding interests, he referred to Article 7.4.9(2) of the UNIDROIT Principles relating to the rate of interest.

Thus, Article 7.4.9 of the UNIDROIT Principles has been allowed to fill gaps in Article 78 of the CISG by determining the legal autonomy of the right to interests for failure to pay money whether or not the non-payment is excused.[249] The same approach has also been used when arbitrators have been confronted with the problem of determining the interest rate to use as a base for determining the total amount of the sum due for the lacking payment.

3. Future Applications

Future applications in this category of cases may concern other international uniform law conventions containing rules of interpretation referring to needs of uniformity in the application of the convention or even a reference to concepts of "good faith in international trade." Actually, these formulas seem recurrent in a certain number of conventions regulating international business law.

We may thus refer to the UNIDEOIT Convention on International Factoring of May 28, 1988, where Article 4 states:

1. In the interpretation of this Convention, regard is to be had ID its object and purpose as set forth in the preamble, to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.

[249] For more information see, UNIDROIT Principles, at Art. 7.4.9; The UNIDROIT commentary to Article 7.4.9.

[249] The same approach may be found in Article 6 of the UNIDROIT Convention on International Financial Leasing, May 20, 198S, *available* at http://www.unidroit.org/english/conventjonsfc-leBs.htm (last visited Oct. 2, 2003):

[249] The same approach may be found in Article 6 of the UNIDROIT Convention on International Financial Leasing, May 20, 198S, *available* at http://www.unidroit.org/english/conventjonsfc-leBs.htm (last visited Oct. 2, 2003):

2. Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.

Again, in Article 14 of the 1991 U.N. Convention on the Liability of Operators of Transport Terminals in International Trade, it is stated that: "In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application."[250]

Finally, another example may be found at Article 3 of the United Nations Convention on the Carriage of Goods by Sea of 30 March 1978 (The Hamburg Rules) where, it is expressly stated that: "In the interpretation and application of the provisions of this Convention regard shall be had to its international character and to the need to promote uniformity." Moreover, the Hamburg Rules are inspired on the base of the *favor arbitri* as it is revealed at Article 22 of such rules.[251]

---

[250]U.N. Convention on the Liberty of Operators of Transport Terminals in International Trade, U.N. Doc, A/CONF. 152/13 (1991), *reprinted in* 30 I.L.M. 1503 (1991).

[251] U.N. Convention on the Carriage of Goods by Sea, art. 22, Mar. 30, 1978.

Article 22- Arbitration

1. Subject to the provisions of this Article, parties may provide by agreement evidenced in writing that any dispute that may arise relating to carriage of goads under this Convention shall be referred to arbitration.

2. Where a charter-party contains *a* provision that disputes arising thereunder shall be referred to arbitration and a bill of lading issued pursuant to the charterparty does not contain a special annotation providing that such provision shall be binding upon the holder of the bill of lading, the carrier may not invoke such provision as against a holder having acquired the bill of lading in good faith.

3. The arbitration proceedings shall, at the option of the Claimant, be instituted at one of the following places:

(a) A place in a State within whose territory is situated:

(i) The principal place of business of the Defendant or, in tho absence thereof, tho habitual residence of the Defendant; or

(ii) The place where the contract was made, provided that the Defendant has there a place of business, branch or agency through which the contract was made; or (iii) The port of loading or the port of discharge; or

(b) Any place designated for that purpose in the arbitration clause or agreement.

4. The arbitrator or arbitration tribunal shall apply the rules of this Convention.

5. The provisions of paragraph 3 and 4 of this Article are deemed to be part of every arbitration clause or agreement, and any term of such clause or agreement which is inconsistent therewith *is* null and void.

6. Nothing in this Article affects the validity of an agrooment relating to arbitration made by the parties after the claim uutior the contract of carriage by sea has arisen.

In conclusion, as long as international uniform law conventions provide for such rules of interpretation referring to general principles and the need for a uniform application, it seems that transnational rules such as the UNIDROIT Principles and the *lex mercatoria* may supply the necessary rules to fill gaps and avoid ambiguities.[252] Arbitrators are specialists in international trade and business law and they will select with care those transnational rules which are useful to resolve the dispute. In the right hands, the method of transnational rules is a plus and never a minus for international arbitrators.

4.4.2. Code of Practice

Numerous international arbitration institutions require in their rules that arbitrators consider usages of trade in deciding contract disputes.[253] For example, Article 17(2) of the 1998 Rules of Arbitration of the International Chamber of Commerce requires that "[I]n all cases, the arbitrator shall take account of the provisions of the contract and the relevant trade usages."[254]

---

[252] In the matters of international bills of exchange, a domain which has represented a sort of laboratory of uniform law, the recent UNCITRAL Convention on International Bills of Exchange and International Promissory Notes, 1988, provides in Article 4, that: "In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international transaction."

[253] Domestic arbitration rules generally are silent on the question of trade usages. See, *e.g.,* COMMERCIAL ARBITRATION. RULES OF THE AMERICAN ARBITRATION ASSOCIATION (1999).

[254] RULES OF ARBITRATION OF THE; INTERNATIONAL CHAMBER OF COMMERCE, *supra* note 8, art. 17(2). The ICC apparently drew the rule from Article VII(l) of the European Convention on International Commercial Arbitration, April 21, 1961, 484 U.N.T.S. 349 ("European Convention"), which provides as follows:

The parties shall be free to determine, by agreement, the law to be applied by the arbitrators to the substance of the dispute. Failing any indication by the parties as to the applicable law, the arbitrators shall apply the proper law under the rule of conflict that the arbitrators deem applicable. *In bath cases the arbitrators shall take account of the terms of the contract and trade usages. Id.* art. 7(1) (emphasis added). The ICC amended its rules to add the rule on trade usages in 1975. See Giorgio Sacerdoti, *The New Arbitration Rides of ICC and UNCTTRAL,* 11 J. WORLD TRADE L. 248, 262 (1977).

[254] RULES OF ARBITRATION OF THE; INTERNATIONAL CHAMBER OF COMMERCE, *supra* note 8, art. 17(2). The ICC apparently drew the rule from Article VII(l) of the European Convention on International Commercial Arbitration, April 21, 1961, 484 U.N.T.S. 349 ("European Convention"), which provides as follows:

The parties shall be free to determine, by agreement, the law to be applied by the arbitrators to the substance of the dispute. Failing any indication by the parties as to the applicable law, the arbitrators shall apply the proper law under the rule of conflict that the arbitrators deem applicable. *In bath cases the arbitrators shall take account of the terms of the contract and trade usages. Id.* art. 7(1) (emphasis added). The ICC amended its rules to add the rule on trade usages in 1975. See Giorgio Sacerdoti, *The New Arbitration Rides of ICC and UNCTTRAL,* 11 J. WORLD TRADE L. 248, 262 (1977).

The International Arbitration Rules of the American Arbitration Association provide that "[i]n arbitrations involving the application of contracts, the tribunal shall decide in accordance with the terms of the contract and shall take into account usages of the trade applicable to the contract." A third large international arbitration institution, the China International Economic and Trade Arbitration Commission (CIETAC), has a similar rule, which provides: "The arbitration tribunal shall independently and impartially make its award on the basis of the facts, in accordance with the law and the terms of the contracts, with reference to international practices and in compliance with the principle of fairness and reasonableness." By comparison, none of the institutional rules studied address prior dealings between the parties as a basis for decision.

Practical applications

The United Nations Commission on International Trade Law (UNCITRAL) was established by the General Assembly in 1966 on December 17. In establishing the Commission, the General Assembly recognized that disparities in national laws governing international trade created obstacles to the flow of trade, and it regarded the Commission as the vehicle by which the United Nations could play a more active role in reducing or removing these obstacles.[255] Thousands of files were submitted for resolution by arbitration by the closing date for the filing of claims.

On the other hand, ICC was established in 1923 and Arbitration under the rules of the ICC International Court of Arbitration is on the increase. Since 1999, the Court has received new cases at a rate of more than 500 files a year.[256] The application of the UNCITRAL Arbitration Rules to practical situations in literally thousands of cases has now been tried and tested, and has in general, proved successful-certainly as successful as any other existing set of rules is likely to have proved in the circumstances.

UNCITRAL Arbitration Rules have been adopted as the sole rules for arbitration to be used by a number of centers and arbitral institutions or organizations. Examples of adoption of the Rules by arbitration centers (with minor modifications covering administrative matters) :

[255] http://www.uncitral.org/uncitral/en/about/origin.html, on Nov 5, 2006
[256] http://www.iccwbo.org/id93/index.html on Nov, 5th, 2006

- -Australian Centre for International Arbitration
- -British Columbia International Commercial Arbitration Centre
- -Cairo Regional Centre for International Commercial Arbitration
- -Chamber of Commerce and industry of the Russian Federation
- -Chamber of Commerce, Industry and Agriculture of Panama
- -Chicago International Dispute Resolution Association
- -Croatian Chamber of Economy
- -German Institution of Arbitration
- -Hong Kong International Arbitration Center
- -Institute of Arbitrators & Mediators Australia
- -Inter-American Commercial Arbitration Commission
- -Kuala Lumpur Regional Centre for Arbitration
- -Latvian Chamber of Commerce and Industry
- -Spanish Court of Arbitration

These institutions use UNCITRAL Rules.[257]

Because of the private nature of arbitration, it is difficult to ascertain how many international arbitrations have been held up to the present time. By comparison with the number of current ICC Arbitrations, the number is probably small. However, there is no doubt that a large number of contracts for international trading transactions now incorporate UNCITRAL arbitration clauses, particularly where governmental agencies are concerned. It was to be accepted that it would be some time before arbitrations using the UNCITRAL Arbitration Rules became commonplace, since disputes do not normally arise until a considerable time after a contract is entered into. However, UNCITRAL arbitration has taken its place alongside the existing arbitration systems of the World's major arbitral institutions.

Also the literature suggests that the ICC is still the predominant institution in the field.[258] Various Asian arbitration centers, particularly CIETAC,[259] are growing rapidly,

[257] Vanderbilt Journal of Transnational Law, Vol. 33:79, p. 113

[258] The number of new requests for arbitration with the ICC has grown steadily since 1992, to 352 in 1993, 384 in 1995, and 433 in 1996. ICC INT'L CT. OFARB. BULL, May 1997, at 6.

although CIETAC arbitration is not as well accepted internationally.[260] The American Arbitration Association has a relatively large internationally caseload[261] and is followed by the London Court of International Arbitration (LCIA), THE Federal Economic Chamber in Vienna, and the Stockholm Chamber of Commerce.[262]

The precise formulations of the rules on trade usages vary in important ways. The UNCITRAL Rules and those rules following the UNCITRAL Rules, although requiring arbitrators to consider trade usages, make the terms of the contract controlling. UNCITRAL Rule 33(3) provides that the arbitrators "shall decide in accordance with the terms of the contract," and merely "take into account" the applicable trade usages.[263] The ICC Rules, by contrast, apparently treat contract provisions and trade usages as coequal by stating that the tribunal "shall take account" of both. Among other arbitration institutions with similar rules are the Italian Association for Arbitration, the Milan Chamber of National and International Arbitration, and the Netherlands Arbitration Institute.[264]

In addition, the phrase "usage of trade" as used in these institutional rules is ambiguous. The phrase certainly includes codified or uncodified commercial practices in various trades and industries. Some have suggested, however, that the phrase "usage of trade" also includes the *lex mercatoria,* which includes both international trade customs and general principles of law applicable to international trade.[265] For the purposes of this article, the ambiguity is largely immaterial, because under either reading the arbitrator is directed to consider commercial norms. It may explain, however, the reluctance of some arbitral institutions to include a provision addressing trade usages.

---

[259] *See* William K. Slate II, *International Arbitration: Do Institutions Make a Difference?,* 31 WAKE FOREST L. REV, 41, 50 (1996);

[260] CIETAC reports an even larger international case load than the AAA, but many of these apparently are disputes between Chinese and Hong Kong parties. CIETAC arbitration is not in general use among non-Chinese parties.

[261] The American Arbitration Association's case load is declared at the page <http://www.adr.org.

[262] See, Arbitration Institute of the Stockholm Chamber of Commerce, *Statistics* (visited Sep 09, 2006) <http://www.sccinstitute.com/uk/About/Statistics/>. Of the cases filed in 1998, 12 were under the UNCITRAL Rules, and 11 were ad hoc arbitrations.

[263] UNCITRAL ARBITRATION RULES, Art, 33(3),

[264] See *Italian Association for Arbitration, Rules for International Arbitration* art. 22(3) (1988).

[265] See Emmanuel Gaillard, *The UNCITRAL Model Law and Recent Statutes on International Arbitration in Europe and North America, 2* ICSID REV. 424, 434 (1987).

These arbitration rules are merely standard contract terms that the parties can and do incorporate by reference into their contracts. As such, the parties by agreement can change the rules, including, if they so desire, any rule requiring arbitrators to consider trade usages. The available evidence, however, indicates that they do not do so. In a study of arbitration agreements in cases administered by the ICC in 1987 and 1989, no parties modifying in their arbitration agreements the ICC rule on trade usages.[266]

4.4.3. Lex Mercatoria

Some commentators find a "discernable trend in arbitral practice that supports the proposition that arbitrators, in the absence of a choice of law by the parties, may apply the so-called *lex mercatoria,* without the need to justify this measure by reference to any national conflict rule."[267] As discussed above, the *lex mercatoria*—or law merchant—incorporates trade usages as well as general principles of international trade law, depending on how the phrase is defined.[268] A number of published awards have applied the *lex mercatoria* as applicable law, even when parties have not so agreed.[269] Some arbitrators find their authority to do so in the trade usage provision of the ICC Rules.[270] The number of reported arbitral awards that address the *lex mercatoria* may be misleading, however, in light of the much larger number of unreported arbitral awards that evidently do not.

Other awards refuse to apply the *lex mercatoria* absent agreement of the parties.[271] Such agreement is extremely rare. Stephen Bond's study of the arbitration agreements of parties involved in ICC arbitrations in 1987 and 1989 found that only a handful selected "general principles" of law to govern the parties' dispute and none specified the *lex mercatoria* to be the basis for the arbitrators'

---

[266] See Stephen R. Bond, *How to Draft an Arbitration Clause (Revisited),* ICC Int. CT. OF ARB. Bull., Dec, 1990, at 14, 19, 21.
[267] QKEZIE CHUKWUMERIJE, CHOICE OF LAW IN INTERNATIONAL COMMERCIAL ARBITRATION 130 (1994).
[268] See CRAIG BT AL., supra note 109, at 603, 607-19; see supra note 183 and accompanying text.
[269] See Paris Chamber of Arbitration Award in Case No. 9246 of 8 Mar. 1996, 22 Y.B. COMMERCIAL ARB. 28, 31 (1997) ("the arbitral tribunal deems it more proper to refer to the body of rules of international commerce which have been developed by practice and affirmed by the national courts (lex mercatoria)").
[270] See ICC Interim Award in Case No. 5314 of 19B8, 20 Y.B. COMMERCIAL ARB. 35, 39 (I995)
[271] See CRAIG ET AL., supra note 109, at 300.

decision.[272] Only three percent of the clauses in 1987 and four percent in 1989 authorized the arbitrators to decide in equity *[ex aequo et bono* or as *amiable compositeur).*[273] Instead, a substantial majority of clauses (seventy-five percent in 1987 and sixty-six percent in 1989) identified a particular national law as governing the contract.[274]

When arbitrators rely on the *lex mercatoria,* they readily consider good faith and similar considerations in making their decisions. A leading example is the *Norsalor* award of 1979.[275] In *Norsolor,* the Turkish claimant sought damages for breach of an agency agreement by the French respondent. The contract did not provide for a particular national law to govern; accordingly, the arbitrators "considered that it was appropriate, given the international nature of the agreement, to leave aside any compelling reference to a specific legislation, be it Turkish or French, and to apply the international *lex mercatoria."*[276] One principle that "inspires" the *lex mercatoria,* according to the arbitrators, "is that of the good faith which must preside the formation and the performance of contracts."[277] Because respondent's conduct "was scarcely compatible with the maintaining of good commercial relations," the tribunal found it liable for breach of contract.

There is a discernible trend in arbitral practice that supports the proposition that arbitrators, in the absence of a choice of law by the parties, may apply the so-called *lex mercatoria,* without the need to justify this measure by reference to any national conflict rule. Some advocates of this view go as far as suggesting that the parties' consent to arbitration is indicative of their submission to *the lex mercatoria.* Arguing this position, T. Carbonneau states that the parties' "engagement in a transnational commercial venture and invocation of the international arbitral process constitutes an

---

[272] See Bond, *supra* note 184, at 19; see *also* Barton S. Selden, Lex Mercatoria *in European and U.S. Trade Practice; Time* to *Take a Closer Look.*

[273] See Bond, supra note 184, at 19.

[274] See id.

[275] Pabalk Ticaret Limited Sirketi v. Norsotor S.A., ICC Award of Oct. 26, 1979, No. 3131, 9 Y.B. COMMERCIAL ARfl. 109 (1984) [hereinafter *Norsolot*\. The award ultimately was upheld by the Supreme Court of Austria. See Norsolor S.A. V. Pabalk Ticaret Ltd. (Oberster Gerichtshof, Nov. 18, 1982), 9 Y.B. COMMERCIAL ARB. 159 (1984). For another example, see ICC Case No. 2291 (1976), *described in* DE Ly, *supra* note 16, at 263 (according to De Ly, the "tribunal revised freight tariffs on the basis of the principle of the *lex mercatoria* or *rebus sic stantibus* and according to which in international commercial transactions a certain contractual balance should exist between the mutual obligations of the parties").

[276] Norsolor, supra note, supra note 236, at 110.

[277] Id.

implied submission to the law which governs all transnational commercial venture."[278] This proposition flies in the face of the fact that many parties to international commercial ventures actually choose national law as their governing law, thereby negating any implied submission to the *lex mercatoria.* Moreover, even when parties do not make an express choice of law, the preponderance of arbitral awards apply national laws, a fact that indicates that there is no one law governing transnational commercial relations, as Carbonneau would have us believe.

Lando, speaking along the same line as Carbonneau, argues that the *"lex-mercatoria* has the advantage that it does away with the choice-of-law process which many lawyers abhor."[279] This view implies that arbitrators may dispense with conflict rules and directly apply the *lex mercatoria.* More combative advocates of this view go as far as to suggest that arbitrators may apply the *lex mercatoria* if the State to which the applicable conflict rules point does not have a clear answer to the issue in dispute. They further suggest that arbitrators may apply the *lex mercatoria* where the answer suggested by the relevant national law is "dearly out of line with the reasonable expectations of the parties and the business community as a whole" or where "the rule is not fit for international trade".[280] Acceptance of this latter view would make arbitrators judges of the fitness of national laws for international trade and the needs of the business community. This theory would grant arbitrators the power to dictate which rules of national laws would be applied in the international arena, a rather strange prospect.

The so-called *lex mercatoria,* as we have seen, lacks a comprehensive body of rules sufficient to regulate complex commercial transactions. Worse, its legality is disputed in some jurisdictions and arbitrators run the risk of compromising the enforceability of their awards by applying the *lex mercatoria.*[281]

---

[278] T. Carbonneau, supra note 29, at 597. In one award, the tribunal in applying the *lex mercatoria* noted that "this practice [common practice in international arbitration particularly in the field of oil drilling], which must have been known to the parties, should be regarded as representing their implicit will." See *ICC Case No.3572 of 1982* (1989) 14 Y. *Comm. Arb.* Ill at 117.

[279] O. Lando, supra note 13 at 754.

[280] A. Lowenfeld, "Lex Mercatoria: An Arbitrator's View" in T. Carbonneau, supra note 35 at 37,51.

[281] As W. Craig et al. note, "it would seem futile and imprudent to make abstract declarations to the effect that they [arbitrators] have rendered an award on a legal foundation whose legitimacy may still not be apparent to many national
courts." Supra note 5 at 300.

If the argument of the advocates of the *lex mercatoria* had been that arbitrators should take into account trade usages irrespective of the applicable national law, very few people would dispute that. Indeed arbitrators--and national courts have always adopted this position. For example, under ICC Rules arbitrators are enjoined to use trade usages and customs as complementary sources of rules that must be considered together with national law.[282] Regrettably, this is not the view adopted by the advocates of the *lex mercatoria;* they rather suggest that an arbitrator could choose the *lex mercatoria* as the governing legal standard independent of the provisions of relevant national laws. This approach has been uncritically adopted in a number of awards, and in some instances sanctioned by some national courts.

In *Pabalk Ticaret v. Norsolor*[283] ICC arbitrators sitting in Vienna held a French part)' liable for breach of a contract with a Turkish party. In deciding the applicable substantive law the arbitrators declined to apply any national law:

Faced with the difficulty of choosing a national law the application of which is sufficiently compelling, the Tribunal considered that it was appropriate, given the international nature of the agreement, to leave aside any compelling reference to a specific legislation and apply the international *lex mercatoria.*[284]

On appeal, the Court of Appeal of Vienna set aside a portion of the award (dealing with the amount of damages) on the ground that the arbitrators failed to conform with Article 13(3) of the ICC Rules, which, in the court's view, required them to base their decision on a national law determined by conflict of law analysis. On further appeal to the Austrian Supreme Court, the Court of Appeal's decision was reversed on the ground that the arbitrators' application *of the lex mercatoria* did not infringe any mandatory rule of law.[285] In that case the ICC arbitrator, in the absence of a choice of law by the parties, chose the *lex mercatoria* as the governing law. Portland sought to set aside the award in France, the seat of arbitration, on the ground that

[282] See Article 13(5) of the ICC Rules. See also W. Craig, "International Ambition and National Restraints in ICC Arbitration" (1985) 1 *Arb. Int'l* 49 at 67.
[283] (1984) 9 Y. *Comm. Arb.* 109.
[284] As W. Craig et al. note, "it would seem futile and imprudent to make abstract declarations to the effect that they [arbitrators] have rendered an award on a legal foundation whose legitimacy may still not be apparent to many national
courts." Supra note 5 at 300.
[285] A similar decision was reached in *Campania Portland v. Primary Coal'Inc.*

the arbitrator decided in a manner incompatible with his mandate. According to Portland, the arbitrator erred in not selecting the governing law through the conflict of law methodology as, it claimed, the arbitrator was required to do under the ICC Rules. The Cour d'appel of Paris refused to set aside the award because the arbitrator was not required to make use of a conflict rule belonging to any given system in order to determine the applicable law. According to the court, the arbitrator "was free to refer to the principles governing the matter"[135] The court went on:

The arbitrator applied these principles and determined the most characteristic factor connecting the dispute to a body of rules of substantive law, taking into account the nature of the dispute. He examined the connecting factors invoked, rendered a final decision that none of them justified the application of a [national] law, and decided to apply the body of principles and trade usages called *lex mercatoria,* i.e. international norms which can apply to the solution of such a dispute in the absence of a determined [national] jurisdiction.

It is noteworthy that these decisions were made in civil Jaw jurisdictions that have been traditionally liberal in their treatment of the *lex mercatoria.* Regrettably, the courts did not express any opinion on the question whether the *lex mercatoria* is indeed a comprehensive body of law. In view of the dispute about the legal foundation of the *lex mercatoria* (particularly in some common law jurisdictions), and in view of its incomplete nature, it would seem that arbitrators should not apply the *lex mercatoria* unless the parties themselves indicate a preference for it. As one tribunal correctly notes, the choice of the *lex mercatoria* "would require an agreement between the parties.[286]

5. Consideration of International Mandatory Rules

Despite the fact that the authority of arbitrators finds its origin in the will of the parties, and as a result Arbitral Tribunals should conform to the parties' stipulations as to the applicable law, since any deviation would imply acting beyond the scope of their authority, the fact remains that in a number of cases international commercial arbitrators have not hesitated to consider the possibility of fashioning their decisions by applying or taking into account international mandatory rules *(lois de police)* or public policy principles not belonging to the proper law of the contract even in hypotheses where the parties had expressly stipulated on the law

[286] *ICC Case No. 4650* (1987) 12 *Y. Comm. Arb.* 111.

governing the transaction giving rise to the dispute, although international commercial arbitrators do not always finally conclude that such rules or principles govern the resolution of the dispute.

It thus seems that the increasing acceptance of international arbitration as a legitimate alternative to litigation implies an expectation on the part of States that arbitrators will, like judges, respect the basic notions of justice and in appropriate cases apply the mandatory provisions of relevant laws. It is one thing to grant parties the power to organize their dispute resolution process in a manner compatible with their objectives; it is a different matter to suggest that parties to an international arbitration are entirely free from the demands of public policy and fundamental provisions of relevant laws.[287] The integrity of international arbitration and its endurance as a viable alternative to litigation would seem to rest on arbitrators' continual respect for public policy of States whose legitimate interests are implicated in arbitration disputes. Arbitrators therefore have to balance their respect for the autonomy of the parries' will with the need to apply mandatory provisions of laws that are relevant to the dispute.

In this section, I will examine the impact of mandatory rules in resolving the merits of a dispute before international arbitrators. The problem posed by mandatory rules in international arbitration will be put in perspective by contrasting the position of international arbitrators with those of national judges called upon to enforce imperative laws.

Traditional conflict theory postulates that a statute is inapplicable to a contract unless the statute forms a part of the proper law of the contract or is otherwise applicable as part of the procedural laws of a forum court. However, it has long been accepted that this proposition is subject to the qualification that imperative laws of the forum may apply to a contract irrespective of the proper law of the contract. Thus, one of

---

[287] A. Bucher and P. Tschanz remind us that

States that favour international arbitration as a means of resolving international commercial disputes do not by the same token forego compliance with principles and rules which are fundamental for the economic and social system. The fact that arbitral tribunals are allowed to adjudicate disputes instead of courts does not mean that arbitration can enerve the legislative power of States.
International Arbitration in Switzerland (Basel: Helbing and Lichtenhahn, 19S9) at 103.

the limitations on party autonomy within a national legal system is that overriding laws of the forum may override the law chosen by the parties.[288]
It is these rules of law that are capable of overriding the will of parties that are labeled "mandatory rules."[289] Mandatory rules denote those rules of law from which the parties cannot derogate, rules that in appropriate cases supersede the proper law, thereby substituting their provisions for the will of the parties:

[A] mandatory rule is a rule which overrides the normally applicable law (or … the proper law of the contract) whether that applicable (proper) law is ascertained by reference to an express stipulation or by reference to the closest connection. In short it is a law which applies irrespective of or despite the proper law of a contract.[290]

These rules embody the fundamental polity of a given State and are therefore applicable by virtue of their imperative nature. They typically regulate matters in which the "interest of the State is too important for them to be in competition with foreign laws"[291] or the will of the parties. Thus, there is a close relationship between the concept of public policy and that of mandatory rules. Mandatory rules would include those aspects of public policy and rules of national law that are couched in an imperative manner because they embody the vital socioeconomic policies of the State involved. These include currency and exchange regulations, boycotts and blockades, embargoes, and environmental protection laws.[292] Examples of mandatory rules abound in national laws. In Australia, for example, the Consumer Transaction Act

---

[288] As A. Maniruzzaman puts it: "Although the parties' freedom of choice (autonomy of will) is a general principle of private international law and is to be respected in principle, ii should operate within the limits imposed by such other
equally important, general principles of law or subject to any restraints of public policy." "International Arbitrator and Mandatory Public Law Rules in the Context of State Contracts: An Overview" (1990) 7:3 /. *M'l Arb.* 53 at 63.
[289] See *Award of 27 May 7991,* reported in (1992) 17 *Y. Comm. Arb.* 11 at 27-29.
[290] See M. Pryies, "Reflection on the JE.E.C. Contractual Obligations Convention—An Australian Perspective" in P. North (ed.) *Contract Conflicts: The E.E.C. Convention on the Law Applicable to Contractual Obligations—A Comparative Study*
(Amsterdam: North-Holland Publishing Company, 1982) 323 at 331.
[291] Y. Derains, "Possible Conflict of Law Rules and the Rules Applicable to the Substance of the Dispute" in P. Sanders (ed.) *UNCTTRAL's Project for a Model Law on International Commercial Arbitration* (Deventer, The Netherlands: Kluwer Law
and Taxation Publishers, 1984) 169 at 179.
[292] Speaking about the European Community Regulation No. 2340 of August 8, 1990, which imposed embargo against Iraq, an arbitral tribunal noted: 'These provisions not only cannot be derogated from, they must be necessarily applied; that is, they are provisions which must be necessarily applied in the EC, whichever law applies to the contract, as it appears from their purpose and public law character." *Final Award of 20 July 1992, No. 1491,* reported in (1993) 18 *Y. Comm. Arb.* 80 at 85.

applies to a consumer contract involving the delivery of goods in South Australia irrespective of the proper law of the contract.[293] Similar provisions are to be found in the English Employment Protection (Consolidation) Act,[294] the English Uniform Contract Terms Act," and the German Regulation of Standard Contract Terms Act." Occasionally statutory provisions that do not appear mandatory on their face are construed as mandatory by virtue of judicial interpretation.

A national court is obliged to apply the relevant fundamental public policy of its legal system to disputes before it because its adjudicatory competence is founded on the law of that particular system. Thus, a national court would, in appropriate cases, apply the public policy and mandatory rules of its *situs* regardless of the proper law of the contract involved. The court system is one of the vehicles through which a society expresses and protects those fundamental values that underlie its social fabric; thus national courts generally apply imperative rules that invariably represent the essential values of their societies, even in cases where the forum's law does not govern the contract.

Fundamental public policy has a dual aspect in its impact on judicial proceedings. The first, and perhaps the more common, aspect is that it compels a national court to deny recognition to an applicable foreign law that contravenes the stringent public policy of the forum.[295] Second, it mandates the national court to give effect to those national legislations that, by their provisions, govern all contacts regardless of the proper law of the contract.

Under the first aspect, the applicability of foreign governing laws is determined by their conformity with the stringent public policy of the forum. This rule was stated by Lord Justice-Clerk Patton in *Cotvml & Co.* v. *Loder.*[296]

Everybody knows that the fundamental principle upon which we introduce foreign law as law affecting the rights of contracts or otherwise, is only to the effect of

[293] M. Pryies, supra note 6 at 331.
[294] See A. Anton and P. Beaumont, *Private International Law,* 2d ed. (Edinburgh: W. Green, 1990) at 343.
[295] See F. Juenger, *Choice of Law and Multistate Justice* (Dordrecht, The Netherlands: Martinus Nijhoff, 1993) at *79;* P. Carter, 'The Role of Public Policy in English Private International Law" (1993) 42 *I.C.I. Q.* 1.
[296] See *Ross* v. *McMillien* (1971) 21 D.L.R. (3d) 228; *Oppenheimer* v. *Caltermole*

introducing such law when it is not in direct contradiction to the principle upon which our law is governed, and according to which the rights of the subjects in this country must be determined.

Under the second aspect of public policy, in dealing with a contract containing a foreign choice, of law, a national court will apply those laws of the forum that by their provisions are designed to apply "to all disputes litigated in the forum that fall within their scope. Here the court has no discretion whether or not to apply the mandatory rule because, as a creature of the national legal system, its jurisdiction and powers are regulated by national law: it is constrained to apply imperative laws of its forum. To illustrate, a court in South Australia dealing with a contract for delivery of goods in South Australia must apply the Consumer Transaction Act, whatever the contractual stipulations of the parties or the provision of the proper law chosen by them.

The particular positions of arbitrators

Unlike national courts, international arbitral tribunals do not owe strict allegiance to the laws of the place of arbitration, neither are they constituted by the laws of the arbitral seat. Indeed, they do not have a forum in the same way as national courts do. An arbitral tribunal could decide to conduct the arbitration proceedings in different countries, in which case it is unrealistic to categorize the stringent public policy of any of the fora as applicable to the merits of the dispute. Even in cases where the proceedings are held in one country, international arbitrators still do not, as a theoretical matter, owe strict allegiance to the laws of that *situs*[297] in the sense that they are not constrained to apply all the imperative rules of the forum in the same way that national courts are.

It is said that an arbitrator's responsibility is to the arbitrating parties in particular and the international business community in general.[298]

---

[297] See M. Bogdan, "Some Arbitration Related Problems of Swedish Private International Law" [1990] Swedish Int'l Arb. 70 at 76.

[298] See J. Lew, *Applicable Law in International Commercial Arbitration: A Study on Commercial Arbitration Awards* (Dobbs Ferry, NY: Oceana Publications, 1978) at 536. This principle may well be overstated in that an arbitral tribunal still owes a duty
to the various national legal systems: a duty to ensure that arbitration proceedings conform with basic notions of justice and fairness.

[international commercial arbitrators]-are the guardians of the international commercial order: they must protect the rights of participants in international trade, give effect to the parties' respective obligations under the contract; imply the presence of commercial *boitn fides* in every transaction; respect the customs followed in international trade practice and the rules developed in relevant international treaties; uphold the commonly accepted views of the international commercial community and the policies expressed and adopted by appropriate international organizations; and enforce the fundamental moral and ethical values which underlie every level of commercial activity.[299]

While it is true that the jurisdiction of international arbitrators depends on the agreement of the parties, it is also true that arbitration would lose its respect and legitimacy as a dispute resolution system if arbitrators continually ignore the mandatory national laws that are connected with arbitral disputes.

Every arbitrator has to consider the importance of preserving commercial arbitration as an instrument for settling international disputes. Today commercial arbitration is highly regarded in most countries. Governments have not interfered with its operation and, indeed have encouraged its establishment in their countries. If, however, arbitration is used as a means of evading the relevant policies of countries which have an- interest in the subject matter of the dispute, the reputation of arbitration will suffer.[300]

Thus, while arbitrators should respect the will of the parties, they should also ensure that recourse to arbitration does not become a means of avoiding fundamental principles of public policy. Consequently, arbitrators have a responsibility to apply the mandatory rules of those jurisdictions whose national interests are substantially involved in the matter under arbitration.
Two kinds of mandatory rules are potentially involved in arbitration proceedings: those of the *lex contractus,* and those external to the *lex coniractus.* Let us examine these two strands of mandatory rules.

---

[299] Id. at 340.
[300] O. Lando, "The Law Applicable to the Merits of the Dispute" in P. Sarcevic (ed.) Essays *on International Commercial Arbitration* (London: Martinus Nijhoff, 1989) 129 at 158.

Mandatory Rules of the *Lex Contractus*

Arbitrators generally apply the law chosen by the arbitrating parties; when the parties have made an express choice of law, arbitrators apply that law, together with its mandatory rules. In most awards in which the applicability of the mandatory rules of the la w chosen by the parties arose, arbitrators applied those rules as a matter of fact.[301]

However, it is possible to conceive of a situation where an arbitrator need not apply the mandatory rules of the law chosen by the parties. An example would be cases where the underlying purpose and objective of the rule indicate that it is aimed at purely domestic situations as opposed to cases involving international disputes. Additionally, an arbitrator may decline to apply a mandatory rule of a law chosen by the parties in the unlikely event that the rule is contrary to "transnational public policy."[302]

Since the conflict rules used in determining the applicable law in the absence of the parties' express choice usually focuses on the law of the country with which the contract is most closely connected, there are grounds for an arbitral tribunal to apply the mandatory rules of the law of such a country. This is because the transaction would invariably have a notable impact on that country. Even then, the tribunal might have to balance the interests of this country with those of other countries that are equally connected with the transaction. The tribunal's objective should be to determine which of them has a greater claim to the application of its mandatory rules by virtue of its connection with the dispute.

Conclusion

Mandatory rules are one of the ways in which the doctrine of party autonomy is adapted to the legitimate interests of States in ensuring that the arbitral process affirms the basic elements of contractual morality. Of course, arbitrators are not expected to apply each and every mandatory rule that is pleaded as relevant to the case. Their mission in this regard is to examine the nature and purpose of relevant

[301] See, for example, *ICC Case No. 1397* (1966) *Outlet* 878. See also *Final Award of 20 July 1992, No. 1491.*

[302] The concept of "transnational international public policy" and its effect on the application of mandatory rules of national law is discussed in the section of this chapter entitled "The Role of Transnational Public Policy."

mandatory rules and ascertain whether the enacting State's connection with the parties' transaction warrants the application of such rules. Where the connection is limited or merely speculative, the arbitrator should decline to apply such rules.[303] Arbitrators should also ensure that disputes before them conform to the requirements of truly transnational public policy.

The enforcement of appropriate mandatory rules by arbitrators would send a signal to prospective arbitrating parties that the arbitral process is certainly not a device for circumventing imperative laws of States with which their transaction is substantially connected. This attitude will justify the confidence of those States that believe arbitrators are well suited to adjudicate claims involving sensitive matters of State policy.

6. Consideration of International Public Policy

The preceding discussion has focused on the restriction that mandatory rules of national law (rules that are reflective of the public policy of the enacting States) place on the application of the governing substantive law. However, while mandatory national rules may operate to dislodge the applicable substantive law, there is in international-commercial practice a public policy superior to national public policy.

This preeminent public policy is sometimes labeled transnational public policy or truly international public policy.[304] Like the concept of public policy in national law, the concept of transnational public policy presupposes the existence of "a certain community and of certain fundamental values."[305] Unlike national public policy, the relevant community here is not a national community but the international community.

While the public policy of a State embodies the moral and ethical philosophy of the State, transnational public policy performs the same role for the international business community. There is a certain similarity between the two: principles that embody the fundamental and ethical values of a national community would in most

[303] J. Enternia, "The Role of Public Policy in International Commercial Arbitration" (1990) 21 Law*&Policy Int'l Bus.* 389 at 438.
[304] For a very helpful discussion of the role of transnational public policy in international commercial arbitration, see P. Lalive, 'Transnational (or Truly Inter national) Public Policy and International Arbitration" in P. Sanders, supra note 47 at 257.
[305] Id. at 315.

cases be equally fundamental in the international community. For example, the requirement of fair hearing and due process is considered a basic element of justice in both national and international communities. However, so long as national public policy represents particular and narrow national interests, while transnational public policy represents the values of the world community, the two strands of public policy can not be identical. Thus, while the act of gambling is against public morals in some societies, it can hardly be said that the abhorrence of gambling is part of the fundamental values of the world community

Transnational public policy represents the fundamental values, the basic ethical standards, and the enduring moral consensus of the international community. Its principles are derived from "the fundamental rules of natural law, the principles of universal justice, *jus cogens* in public international law" and the public policy accepted in a generality of nations. These principles, which include the abhorrence of racial, religious, and sexual discrimination and the repudiation of corrupt practices, are in a sense the mandatory rules of international commercial relations that must be respected in all arbitrations.

The application of transnational public policy is seen as crucial to the maintenance of minimum standards of conduct and behavior in international commercial relations. As the Cour d'Appel of Paris points out, "The security of international commercial and financial relations requires the recognition of a public policy that is, if not universal, at least common to the various legal systems."[306]

Arbitrators are particularly suited to apply the principles of transnational public policy because they have a responsibility to maintain a certain element of equity and fair play in the international commercial arena, and they are not guardians of the public policy of any particular State. This responsibility is partly discharged by their balancing the will of the parties with the legitimate interests of the international community in preserving the basic notions of contractual morality and justice.

[306] Lew, supra note 23 at 534.

Arbitrators, as guardians of the international commercial order, refuse to enforce a contact if it contravenes transnational public policy. This was the result in *ICC Case No.* 1110.[307] In that case, the claimant claimed some money as commission for his efforts in helping the respondent procure an Argentinian government contract. Having determined that the commission amounted in effect to a bribe, the sole arbitrator held the contract in violation of transnational public policy:

[I]t cannot be contested that there exists a general principle of law recognized by civilized nations that contracts which seriously violate *bonos mores* or international public policy are invalid or at least unenforceable and that they cannot be sanctioned by courts or arbitrators. This principle is especially apt for use before international arbitration tribunals that lack a "law of the forum" in the ordinary sense of the term.[308]

The arbitrator declined to proceed with the arbitration, holding that the corruption involved in the transaction was "an international evil; it is contrary to good morals and to an international public policy common to the community of nations."[309] Also in *ICC Case No. 2730*[310] the tribunal held that an agreement designed to contravene Yugoslav exchange control law was void because the contract was contrary "not only to Yugoslav law but also to morality and *bonos mores."*

Transnational public policy could also be a ground for an arbitrator's refusal to apply the mandatory rule of a relevant national law. Transnational public policy represents values that are superior to those of particular national systems. Therefore, when a mandatory national rule is in conflict with a transnational policy, the latter prevails, at least in an international arbitral forum.[311] This is because arbitrators owe a paramount duty to the international community. Illustrating this principle, P. Mayer gives as an example certain boycott laws that establish restrictions on the grounds of race and religion. He rightly argues that an arbitrator should in the name of transnational public policy refuse to enforce such mandatory laws because they seek to institute racial or religious discrimination which contravenes transnational public policy.

---

[307] Reported by J. Lew, supra note 23 at 553.
[308] Id. at 554.
[309] Id. at 555.
[310] (1984) Clunet, 914.
[311] See P. Mayer, supra note 25 at 291; J. Lew, supra note 23 at 104.

It is useful to enter a caveat regarding the use of transnational public policy in refusing to apply national mandatory rules. If the use of this doctrine is not placed under careful and continual scrutiny, it may become a ready tool at the hands of some jurists who wish to utilize this theory in refusing to recognize or apply those national laws that they deem unsuitable to their regional interests. Now and again one hears all sorts of rules being pleaded as part of transnational public policy, rules that often do not embody generally accepted principles. For example, the doctrine of *pacta sunt servanda* and the principle of good faith are often pleaded in support of an alleged principle of transnational policy that ordains the immutability of State contracts in the absence of a common agreement of the parties to alter the contractual provisions. This argument is made despite clear and readily accessible evidence that State practices in many jurisdictions (for example, State practices in France and those jurisdictions whose legal systems are modeled on the French) adopt the theory of administrative contracts whereby the State in municipal relations has, under certain conditions, extracontractual powers to alter the provisions of a government contract.[312] The type of transnational public policy that could exclude the application of mandatory rules of national law should be interpreted as including only those policies, standards, and principles that truly represent a consensus of the world community and that are necessary for securing contractual morality in international commercial relations.

In sum, the theory of transnational public policy originates from an attempt by arbitrators to enforce those fundamental ethical and moral values that are necessary for the security of international commercial relations. It is the case that the concept of transnational public policy is rarely raised before arbitrators as a ground for invalidating a contractual obligation. Nevertheless, its presence in arbitral practice is a constant reminder to potential arbitrating parties that the relative independence of the arbitral process does not imply that the process could be used to circumvent the application of basic concepts of morality and justice.

[312] See C. Turpin, "Public Contract" in *International Encyclopedia of Comparative Law,* vol. 7 *Contracts in General,* chapter 4 (Tubingen: J.C.B. Mohr, 19S2). See also J. Mitchell, *The Contracts of Public Authorities: A Comperative Study* (London: G. Belland Sons, 1954).

CONCLUSION

As the applicable law is chosen, the tribunal applies it as being a municipal court. However, in arbitral procedure, it may be more flexible than that of courts; but the tribunal cannot ignore or modify rules of law that it has held to be applicable to the dispute before it.

By an inference from this study it seems to be that parties to international contracts should endeavor to make an express choice of law to govern their contract, preferably national law. Such a choice simplifies matters a great deal: the principle of party autonomy makes such choice binding on arbitrators, subject of course to mandatory provisions of relevant laws.

As we have seen, arbitral practice regarding the determination of an applicable law in the absence of the parties' choice can cover the dispute with an uncertainty, when we consider that different arbitrators adopting different approaches. While the method of applying the law most closely connected to the transaction seems to be the emerging common practice in this regard, parties are better advised to put this matter beyond doubt by stipulating their own choice of law.

For the foregoing reasons, in case of an absence of an applicable law, in this vast subject no universal rule can strictly be laid down. Some systems of law insist that, in making its choice, an arbitral tribunal should follow the rules of conflict of the seat of arbitration. Today, there are contemporary conventions and rules of arbitration for giving considerable latitude to arbitral tribunals in making their choice of law, instead.

If the parties do not wish the arbitral tribunal to have an area of action, the remedial chance is in their hands. Otherwise the parties may incur substantial time and money while the subject is being debated, once a dispute arises. Thus, today every national contract should include a functional clause that selects the governing substantive law with the purposes to govern both for the performance of the contract, and the merits of the substance in the event of a dispute. For avoiding *stomach ulcers,* this clause can be drafted as follows: *This Agreement is governed by, and all disputes arising under or in connection with this Agreement shall be resolved in accordance with, the laws of _____ (to exclusion of its conflict of laws rules)*.

BIBLIOGRAPHY

BOOKS :

Begic, Taida, (2005). Applicable Law in International Investment Diputes, Eleven International Publishing,

Blessing, Marc, (1999). Introduction to Arbitration — Swiss and International Perspectives: Swiss Commercial Law Series, Basel.

Broches, Aaron, (1983). “Settlement of Disputes arising out of investment in Developing Countries” 11 International Business Lawyer.

Carbonneau, Thomas E. (2003) “The Exercise of Contract Freedom in the Making of Arbitration Agreements”: Vanderbilt Journal of Trasnational Law.

Collier, John; Lowe Vaughan, “The Settlement of Disputes in International Law”, (2000), Cambridge University Pres.

Collins, Lawrence, (1994) “Essays in International Litigation and the Conflict of Laws”: Oxford University Pres.

Chukwumerije, Okezie, (1994). “Choice of Law in International Commercial Arbitration”: Quorum Books, Westport, Connecticut, London,.

Contra, J. Robert; Cwbonneau, T. (1983). Trie French Law of Arbitration (New York: Matthew Bender)

Craig, W. Lawrence; Park, William; Paulsson, Jan (1990) International Chamber of Commerce Arbitration, 2d ed. : Dobbs Ferry, NY: Oceana Publications.

Derains, Yves. (1987). "Public Policy and the Law Applicable to the Dispute in International Arbitration", Comparative Arbitration Practice and Public Policy in Arbitration: ICCA Congress Series 3.

Dezalay, Yves; Garth, Bryant G., (1996) “Dealing in Virtue: international commercial arbitration and the constitution of a transnational”: University of Chicago Pres.

Elkouri, Frank, (2003) “How Arbitration Works?”: BNA Books.

Emmanuel Gaillard, (1987). The UNCITRAL Model Law and Recent Statutes on International Arbitration in Europe and North America: 2 ICSID REV.

Enterria, Garcia, D., (1990) "The Role of Public Policy in International Commercial Arbitration": 21 Law&Policy International Business.

Fouchard/Gaillard/Goldman (1999). International Commercial Arbitration, the Netherlands: Kluwer Law International

Friedland, Paul D., (2001). “Arbitration clauses for International Contracts” – “Choosing between Arbitration and Litigation”: New York: Juris Publishing, Inc.,

Goldman, Berthold, (1986) 'The Applicable Law: General Principles of Law—The Lex mercatoria" in J. Lew (ed.) Contemporary Problems of International Arbitration (London): Centre for Commercial Law Studies.

Greenwood, C. J.; Lauterpacht, Elihu (1984) “International Law Reports” vol.65: Cambridge University Pres.

Kellor, Frances, (1948) “American Arbitration: Its History, Functions and Achievements”: New York: Harper and Brothers.

Lando, Ole, (1989) 'The Law Applicable to the Merits of the Dispute" in P. Sarcevic (ed.) Essays on International Commercial Arbitration (London): Graham and Trotman,.

Laurence R. Helfer; Graeme B. Dinwoodie, (2001) “Designing Non-National Systems: The Case Of The Uniform Domain Name Dispute Resolution Policy”, William And Mary Law Review, Vol.43.

Lauterpacht, Elihu; Lauterpacht, C. J., Greenwood, [1984] “International Law Reports”: Published Cambridge University Pres.

Lew QC, Julian D M /Mistelis, Loukas (2004-2005). Primary Materials Arbitration Laws, Conventions, Rules and Other Materials, London: Queen Mary University of London

Lew QC, Julian DM/ Mistelis, Loukas A/ Kröll, Stefan M (2003). Comparative International Commercial Arbitration, the Netherlands: Kluwer Law International

Mayer, Pierre, (1986) "Mandatory Rules of Law in International Commercial Arbitration", 2Arbitration International No:1.

Maniruzzaman, A., (1990). "International Arbitrator and Mandatory Public Law Rules in the Context of State Contracts: An Overview" 7:3 /. M'l Arb..

Mitchell, J. (1954) The Contracts of Public Authorities: A Comperative Study, London: G. Belland Sons.

North, P. and Fawcett, J., (1987), Cheshire and North Private International Law, 11th ed. London: Butterworths,.

Naon, Horacio A. Grigera, (2001) Choice-of-Law Problems in International Commercial Arbitration: Collected Courses of the Hague Academy of International Law.

Park, William, (1983) .The Lex Loci Arbitri and International Commercial Arbitration: Arbitration International.

Redfern, Alan/ Hunter, Martin/ Blackaby, Nigel / Partasides, Constantine (2004). Law and Practice of International Commercial Arbitration, London: Sweet & Maxwell

Tetley, William, (1994) "International Conflict of Laws: Common, Civil, and Maritime", Montreal. QC,

Stephen R. Bond, (1990). How to Draft an Arbitration Clause (Revisited), ICC Int. CT. OF ARB. Bull.

Szasz, Ivan (1984). “Introduction to the Model Law of UNCITRAL on International Commercial Arbitration”: Deventer, The Netherlands: Kluwer Law and Taxation Publishers,

Vanderbilt Journal of Transnational Law, (2003) Vol. 36,

Vanderbilt Journal of Transnational Law, (2000). Vol. 33:79

The United Nations Convention on Contracts fort he International Sale of Goods (CISG), [1980], U.N. Doc A/Conf. 97/18.

Von Mehren, A.T.,[1974]. “Substantive Rules for Multistate Problems – Their Role and Significance in Contemporary Choice of Law Metodology”,: 88 Harvard Law Review

William K. Slate, (1996). II, International Arbitration: Do Institutions Make a Difference?, 31 WAKE FOREST L. REV, 41, 50

William, F. Baxter, Choice of Law and the Federal System, (1963). 16 STAN. L. REV. 1, 17.

Zekos, I.Georgios, (1999). “Dispute Resolution Journal”;, 54, 2, ABI/INFORM Global.

CASES :

Mc Amis v. Panhandle Pipe Line Co., 23 LA 570, 574 (1954).

Compagnie d’Armement Maritime S.A. v. Compagnie Tunisienne de Navigation S.A., (1971)

Dow Chemical France et al. v ISOVER Saint Gobain, ICC Award No. 4131, in: Journal du Droit International (Clunet) 1983 (Volume 110).

Compagnie d’Armement Maritime S.A. v. Compagnie Tunisienne de Navigation S.A. (1971). A.C. 572

China Time Ltd. v. Benetton International NV before the European Court of Justice, Case C-126/197.

American Independent Oil Company Inc. (Aminoil) v. The Government of the State of Kuwait (1982) 21 I.L.M.

Sapphire International Petroleum Limited v. The National Iranian Oil Company (1964) 13 I.C.L.Q. 1011, 1012.

Lord Wright in Vita Food Products v. Unus Shipping Co. (1939) A.C. 277.

Petroleum Development (Trucial Coast) Ltd. v. The Sheikh of Abu Dhabi (1952) 11.C.L.Q. 247.

Campania Portland v. Primary Coal'Inc. ICC Case No. 4650 (1987) 12 Y. Comm. Arb.

Ross v. McMillien (1971) 21 D.L.R. (3d) 228; Oppenheimer v. Caltermole

Mc Amis v. Panhandle Pipe Line Co., 23 LA 570, 574 (1954).

Compagnie d'Armement Maritime S.A. v. Compagnie Tunisienne de Navigation S.A., [1971]

Dow Chemical France et al. v ISOVER Saint Gobain, ICC Award No. 4131, in: Journal du Droit International (Clunet) 1983 (Volume 110).

Compagnie d'Armement Maritime S.A. v. Compagnie Tunisienne de Navigation S.A. (1971) A.C. 572

China Time Ltd. v. Benetton International NV before the European Court of Justice, Case C-126/197.
American Independent Oil Company Inc. (Aminoil) v. The Government of the State of Kuwait (1982) 21 I.L.M.

Sapphire International Petroleum Limited v. The National Iranian Oil Company (1964) 13 I.C.L.Q. 1011, 1012.

Lord Wright in Vita Food Products v. Unus Shipping Co. [1939] A.C. 277.
Petroleum Development (Trucial Coast) Ltd. v. The Sheikh of Abu Dhabi (1952) 11.C.L.Q. 247.

Campania Portland v. Primary Coal'Inc. ICC Case No. 4650 (1987) 12 Y. Comm. Arb.

Ross v. McMillien (1971) 21 D.L.R. (3d) 228; Oppenheimer v. Caltermole

WEB SITES

http://www.iccwbo.org/id93/index.html

www.internationaladr.org/e.htm

www.kentlaw.edu/depts/ipp/intl-courts/docs/

http://www.mcgill.ca/maritimelaw/glossaries/conflictlaws

http://www.nationmaster.com/encyclopedia/Lex-loci-arbitri

http://www.publications.parliament.uk/pa/ld199900/ldjudgmt/jd000727/alp-2.htm

http://www.unidroit.org/english/conventjonsfc-leBs.htm

http://www.uncitral.org/uncitral/en/about/origin.html