6

THE APPLICABLE LAW

A. Introduction

6.01 No arbitration is conducted in a legal vacuum. The rights, duties, and obligations of the contracting parties are founded upon principles of law. This law is often referred to as 'the proper law of the contract', or the 'substantive law' or the 'applicable law'. The term 'applicable law' is hereafter used to refer to the law relevant to the substantive issues of the dispute. The applicable law will be relevant to questions relating to the validity of the contract, its breach, and the level of damages.

6.02 The applicable law does not need to be the same as the law which governs the arbitration.[1] International arbitrations have a peculiarity that is rarely found in domestic arbitrations. In most domestic arbitrations the parties will be concerned with only one law. The complex nature of international contracts means that there can be four or five different legal systems that are relevant to the

[1] This is the procedural law of the arbitration or *lex arbitri* which is discussed in Chapter 7.

arbitration.[2] Two parties from separate countries may contract to build a bridge in Malawi under the laws of Malawi. However, neither party may want a dispute heard in the country where one of them is resident; perhaps fearing bias or believing that the system of law governing the arbitration procedure is unsophisticated. The parties may therefore decide to have their disputes heard by an independent third party in a neutral country. If they choose England as the seat of the arbitration then the laws governing the conduct of the arbitration will be English, subject to any contrary agreement of the parties. Further, when a party obtains an award it will need to enforce it. The successful party will have to do this in the country where the unsuccessful party has assets. It will be the law of that place which will determine the question of whether the award is enforceable.[3]

6.03 The following sections look at how the applicable law is chosen and in particular how it is determined in the absence of an express choice by the parties. The sections also focus on whether the applicable law needs to be a national law.

B. The Choice of an Applicable Law

6.04 The applicable law relates only to the obligations arising within the underlying contract between the parties. The arbitration agreement is a separate contract within the contract and therefore it does not need to be governed by the applicable law.[4] In *Amin Rasheed Shipping Corp v Kuwait Insurance Co*[5] Lord Wilberforce defined the applicable law as meaning 'the law which governs the contract and the parties' obligations under it; the law which determines normally its validity and legality, its construction and effect, and the conditions of its discharge.[6] It is often the case that the applicable law will be evidenced by a 'choice of law' clause within the contract. The arbitral tribunal appointed will then give effect to this agreement by applying the parties' chosen law as the law to determine the substantive dispute.

6.05 The principle that the arbitral tribunal will apply the applicable law chosen by the parties is almost universally accepted. Both common law countries and civil law countries will recognize a choice of law clause. The principle that the parties are free to choose the law to govern their contractual relationships 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'.[7] The main exception to this is where the chosen applicable law conflicts with mandatory rules of law at the seat of the arbitration. These mandatory rules of law may override the contractual agreement of the parties. In such a case the arbitral tribunal will be constrained to apply the mandatory rules of law in preference to the law chosen by the parties.

6.06 Where, however, the parties have not chosen an applicable law then that law must be chosen by the arbitral tribunal. In considering what law to apply to the dispute the arbitral tribunal may need to have regard to three fundamental questions. First, whether the arbitral tribunal can look at the subsequent conduct of the parties in order to assist it in the ascertainment of the applicable law. Second, whether different laws can apply to different aspects of the dispute. Third, whether the law applicable to the substance of the dispute has to be a national law. In *CGU International Insurance plc v Szabo*[8] the High Court of England considered the first two of these issues. The court, referring to Court of Appeal authority,[9] held that contractual rights crystallized when the contract was made. Therefore, there had to be a proper or applicable law at the time the contract was made and the subsequent conduct of the parties was irrelevant except that the parties could by agreement vary the applicable law.[10] However, such a variation does not dispense with the need for a pre-existing applicable law.

6.07 The English position that a contract must have an applicable law at the time of its conclusion is not, however, universally accepted. Lagergren J in an

[2] Redfern and Hunter, *Law and Practice of International Commercial Arbitration*, (1999), at 77 lists the various potential laws as being: (i) the law governing the parties' capacity to enter into the arbitration agreement; (ii) the law governing the arbitration agreement and the performance of that agreement; (iii) the law governing the existence and proceedings of the arbitral tribunal—ie the *lex arbitri*; (iv) the applicable law which governs the substantive rights of the parties; and (v) the law governing recognition and enforcement of the award.

[3] The enforcement of the award is considered in Chapter 13.

[4] See Chapter 7 for an analysis of the law applicable to the arbitration and the arbitration agreement

[5] [1984] AC 50.

[6] Under English law the applicable law is more usually known as the 'proper law of the contract'. However, that phrase appears to denote a legal system whereas the more neutral phrase 'applicable law' is generally construed as being broader. In international commercial arbitrations it is not unusual to find that the applicable law is a system of principles, such as fairness and equity or that the parties chose *lex mercatoria* as the law to govern their contractual relationship.

[7] J Lew, *Applicable Law in International Commercial Arbitration* (1978), 75.

[8] [2002] 1 All ER (Comm) 83.

[9] *E I Du Pont de Nemours and Co v Agnew* [1987] 2 Lloyd's Rep 585, 592 CA, per Bingham LJ.

[10] *Amin Rashid Shipping Corp v Kuwait Insurance Co* [1984] AC 50, 65, HL; *Dubai Islamic Bank PJSC v Paymentech Merchant Services Inc* [2001] 1 Lloyd's Rep 65; *American Independent Oil Co Inc v Government of the State of Kuwait* [1982] 21 ILM 976; and *Armar Shipping Co Ltd v Caisse Algerienne d'Assurance et de Reassurance* [1980] 2 Lloyd's Rep 450.

International Chamber of Commerce (ICC) arbitration stated that:[11] '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 itself made during the course of the arbitration proceedings*, not be itself binding on me, I have no doubts about the correctness of their conclusion in that respect.' However, having regard to the fact that under English law the parties would be a liberty to vary the choice of law during the course of the arbitration the conclusion reached by Lagergren J is likely to be the same as that of any English court or arbitrator applying English law.

6.08 The second issue addressed by the High Court in *CGU International Insurance plc v Szabo*[12] was whether the principle of party autonomy permitted the parties to choose different laws to govern different aspects of their relationship. The court stated that both English conflict of law rules and Article 3 of the Rome Convention on the law Applicable to Contractual Obligations 1980 (Rome Convention) permitted the parties to choose different laws to apply to different parts of the contract.[13]

6.09 In relation to the third question, the English Arbitration Act 1996 now permits the parties to choose something other than a national law in order to determine the dispute.[14] Similarly, Article 28 of the United Nations Commission on International Trade Law (UNCITRAL) Model Law permits the parties to agree that the arbitral tribunal shall decide the dispute *ex aequo et bono* or as *amiable compositeur*. Equally under French legislation there is reference to 'rules of law' rather than 'law'. This reference to 'rules of law' was 'intended to signal that the parties may choose not only a national law, with the different nuances that might entail, but also, if they see fit, transnational rules, often referred to as *lex mercatoria*. The parties can also empower the arbitrators to act as *amiable compositeurs*'.[15]

C. The Application of National Laws

6.10 It is commonplace for the parties to select a system of law to determine the merits of the dispute. However, it is usual to find that a country's arbitration legislation will exclude its conflict of law rules from consideration.[16] The

[11] Referred to by J Lew, *Applicable Law in International Commercial Arbitration* (1978), 98.
[12] [2002] 1 All ER (Comm) 83.
[13] See also *Dicey and Morris on the Conflict of Laws* (2000) para 32–085.
[14] Arbitration Act 1996, s 46(1)(G).
[15] Fouchard, Gaillard and Goldman, *International Commercial Arbitration* para 1431.
[16] UNCITRAL Model Law, art 28.1; and the English Arbitration Act 1996, s 46(2).

reasoning for this is that where a party expressly chooses the law of a particular country to determine the merits of the dispute then it would frustrate the agreement if that country's conflict of law rules provided that the dispute should be resolved under the law of another country. Where the legislation of a country does not exclude its conflict of law rules from consideration then the parties in their arbitration agreement should address this issue.

The choice of a neutral applicable law

6.11 The applicable law chosen may have a connection to the transaction or be neutral. Historically, there were difficulties with a choice of law clause that required resolution of the substantive issues by a neutral law. In the United States the Restatement (Second) of Conflicts of Laws still requires a relationship between the law chosen and the transaction, unless there is another reasonable basis for the parties' choice. However, most countries will now recognize and enforce a choice law clause which refers to a neutral law. In *ICC Award in case no 4629 of 1989* the arbitral tribunal stated:[17]

> The parties have agreed on submitting their contractual relations to the Swiss Code of Obligations in any case for which the contract does not provide a specific solution. In an international contract like the present one, involving parties of different nationalities, the choice of law is entirely free, and the parties could freely decide that their relations were to be governed by Swiss law, even though the case has no connection whatsoever with Switzerland.

Dépeçage

6.12 It is an accepted principle in many countries that the parties to a dispute can choose different laws to cover different aspects of the relationship between them. This principle is known as dépeçage or 'split proper law'. The principle is now enshrined in Rome Convention on the Law Applicable to Contractual Obligations[18] and has been accepted in English case law.[19] However, although the parties may choose different laws to apply to their contract it may not always be appropriate. The application of different laws to different aspects of the dispute can sometimes lead to inconsistencies and conflicts regarding the scope of each particular law.

6.13 Where the parties have not expressly made any provision for the choice of a particular law then the dépeçage doctrine may be attractive to the arbitral

[17] (1993) Ybk Comm Arbn 11, 15. Similarly in ICC *Award in case no 7047 of 1994* (1996) Ybk Comm Arbn 79, 83, the arbitral tribunal stated: 'It is standing practice in arbitration to recognize the choice of law made by the parties of their own free will even if the contract has no other connection with the law chosen.'
[18] Article 3.1.
[19] *CGU International Insurance plc v Szabo* [2002] 1 All ER (Comm) 83.

tribunal. The arbitral tribunal must consider the merits of the dispute and it may appear to them that there are certain issues that can be best addressed by applying one law and other issues that are best addressed by applying another law. This will be more obvious where the dispute is made up of a number of different heads of claim or where there is a counterclaim.[20]

6.14 Issues of dépeçage may also arise where there is an express choice of law but the mandatory laws of a country in which the contract is being performed override that selection. The conflict between mandatory laws and the law chosen by the parties has been frequently discussed and the potential problems illustrated. Where this occurs the mandatory laws will usually override the law chosen by the parties. The rationale for this is illustrated by Andreas Lowerfeld by reference to anti-trust laws in the United States:[21]

> Suppose . . . that the contract contains a clause choosing English or Swiss or Japanese law; the characteristic performance, however, involves selling into the United States market, and the antitrust claim is based on an allegation that trade in that market is unlawfully restrained. It seems to me that here, as in the second case, dépeçage is called for, on the ground that antitrust law is 'mandatory law', on the same level as export controls, criminal law, or tax law, i.e., law that cannot ordinarily be avoided by party choice of law in the same way that, for instance, otherwise applicable statutes of limitations, or law governing the extent of implied warranties, or the measure of damages for breach of contract, can be avoided by the parties through a choice of law clause. The antitrust claim accordingly should, and I believe would, be decided under United States law, notwithstanding a contractual choice of the law of another country.

The application of the dépeçage principle should therefore be considered by an arbitral tribunal where either more than one law could and should be applied to the dispute or where the law chosen by the parties conflicts with mandatory laws which are applicable to the dispute.

The tronc commun doctrine

6.15 Where the parties do not state within their contract, either expressly or by implication, a choice of law then the arbitral tribunal must elect what law to apply. A theory that has been occasionally used is to apply the tronc commun doctrine. This doctrine states that if given the choice the parties would no doubt elect to choose their own national law to govern the contract. Where the parties

[20] As Cheshire, *Private International Law* (1987) 448 points out: 'It is essential to appreciate at the outset that not all the matters affecting a contract are necessarily governed by one law. The correct inquiry is not—what law governs the contract? It is—what governs the particular question raised in the instant proceedings? Different questions may well be determinable by different laws.'

[21] Andreas Lowenfeld, 'The Mitsubishi case: another view', (1986) 2 Arbitration International, (No 3), 178–190.

are from different jurisdictions then the approach should be to ascertain what areas of law are common to the national law of both parties and apply these common parts to the issues in dispute.[22] Equally, the parties are at liberty to agree a combined law clause.

A combined law clause was a feature of the Channel Tunnel contract. The combined law clause stated:[23] 6.16

> The construction, validity and performance of the contract shall in all respects be governed by and interpreted in accordance with the principles common to both English law and French law, and in the absence of such common principles by such general principles of international trade law as have been applied by national and international tribunals. Subject in all cases, with respect to the works to be respectively performed in the French and in the English part of the site, to the respective French or English public policy (ordre public) provisions.

The English House of Lords upheld this clause as being valid.

However, while it would be usual for most national courts to uphold a combined law clause it is not common for national courts to apply the tronc commun doctrine in the absence of a combined law clause. In *Islamic Republic of Iran v Westinghouse Electric Corp*,[24] for example, the arbitral tribunal refused to apply the tronc commun doctrine. The dispute related to the supply of goods between a United States seller and a Middle Eastern purchaser. The Middle Eastern purchaser claimed damages for delayed delivery of the goods. There was no choice-of-law clause. The United States seller claimed that the law of Maryland was applicable as this was the place where the significant contractual obligations had been performed, and that the claim was time-barred as a consequence. The Middle Eastern purchaser relied on its own domestic law under which the action would not be time-barred. The arbitral tribunal concluded that the absence of a choice-of-law clause showed that neither party was prepared to accept the other's domestic law. The arbitral tribunal decided that it could make one of three choices: first, to apply a neutral law; second, to adopt the tronc commun doctrine; or third, to choose a de-nationalized solution and apply generally accepted principles of law. 6.17

The arbitral tribunal rejected the first two alternatives on the basis that: (a) applying a neutral law would be artificial and arbitrary; and (b) applying the tronc commun doctrine would require lengthy comparative law research and 6.18

[22] *Deutsche Schachtbau-Und Tiefbohrgesellschaft MBH v R'as Al Khaimah National Oil Co (UAE) and Shell International Petroleum Co Ltd* [1987] 3 WLR 1023; and Rubino-Sammartano, *International Arbitration Law* (1990).

[23] See *Channel Tunnel Group Ltd v Balfour Beatty Construction Ltd* [1993] AC 334, HL.

[24] *ICC Award No 7375 of 5 June 1996* (1996) 11 Mealey's International Arbitration Report, A-1 et seq; Uniform Law Review 1997, 598.

might not lead to any conclusion. The arbitral tribunal therefore applied what it considered were general principles and rules of law applicable to international contractual obligations.[25] The tribunal found that these qualified as rules of law which had earned a wide acceptance and international consensus in the international business community. This included principles which were held to be part of the *lex mercatoria*. The tribunal also took into account trade usages as well as the UNIDROIT Principles, as far as they can be considered to reflect generally accepted principles and rules.

Stabilization clauses

6.19 It is a generally accepted principle that when the parties choose an applicable law then the law which is applied is that law as it stands at the time when the dispute is referred to arbitration and not when the contract is made. This may cause difficulties for the parties where they wish for their arrangements to be conducted under specific legal provisions. For example, in contracts between an individual and a State the individual may require that the State does not change relevant legislation.

6.20 There are a number of ways that the parties can avoid changes in national law. First, the parties can include a term that the law to be applied to the contract is 'the law of X country as at [date]'. In such cases the arbitral tribunal will apply the law at a set date unless such a clause is contrary to the law of that country. An alternative is to include, as express terms of the contract, the relevant provisions of the law that the parties wish to have included. A further alternative can occur where the State entity agrees not to change relevant legislation. This occurred in the case of *Alcoa Minerals of Jamaica v Jamaica*.[26] Alcoa signed a twenty-five-year contract with the government of Jamaica giving Alcoa bauxite mining rights as well as tax concessions. The contract contained a stabilization clause. The government of Jamaica raised taxes on bauxite, resulting in a huge increase in Alcoa's taxes. Arbitration was commenced by Alcoa under the arbitration provisions within the contract. Alcoa argued that the government of Jamaica's change in legislation had resulted in the imposition of additional taxes and that this amounted to a breach of contract. The arbitral tribunal concluded that the government of Jamaica had breached the contract because a State party to the International Centre for Settlement of Investment Disputes (ICSID) Convention cannot, by its national laws, unilaterally alter the conditions of an

[25] In making this decision the arbitral tribunal specifically referred to ICC Award No 7110 in support of its decision.

[26] (1979) IV Ybk Comm Arbn 206; and see also *AGIP SpA v Government of the People's Republic of the Congo* Award of 30 November 1979, (1979) 1 ICSID Reports 306, (1983) VIII Ybk Comm Arbn 133, 139–40.

existing contract. In another case it was stated that such clauses give rise to an expectation in damages.[27] Such clauses have, however, been criticized as attempting 'unrealistically, to create the cobwebbed palace of the sleeping beauty—"La Belle au Bois Dormant"—in which time has come to a stop'.[28]

Lois de police (mandatory rules of law) [29]

6.21 The theory of mandatory rules of law is sometimes used to justify the arbitral tribunal considering principles of other legal systems other than that chosen by the parties. The parties may choose a national law, transnational rules, or public international law to govern their contract; however, the mandatory public rules of a country may also be relevant. Professor Pierre Mayer has stated:[30]

> A mandatory rule (*loi de police* in France) is an imperative provision of law which must be applied to an international relationship irrespective of the law that governs that relationship. To put it another way: mandatory rules of law are a matter of public policy (ordre public) and moreover reflect a public policy so commanding that they must be applied even if the general body of law to which they belong is not competent by application of the relevant rule of conflict of laws. It is the imperative nature per se of such rules that make them applicable. One is thus led to conclude that there is an 'approach to mandatory rules of law' different to the classical method of conflict of laws. In matters of contract, the effect of a mandatory rule of the law of a given country is to create an obligation to apply such a rule, or indeed simply a possibility of so doing, despite the fact that the parties have expressly or implicitly subjected their contract to the law of a different country.

6.22 The principle of *loi de police* has been given express acknowledgement by the legislature of certain countries[31] and by certain Conventions.[32] It has also been

[27] *Government of the State of Kuwait v American Independent Oil Co (AMINOIL)* (1982) 21 ILM 71 976.

[28] Redfern and Hunter, *The Law and Practice of International Commercial Arbitration* (1999) 103.

[29] The use and application of public policy as a bar to enforcement has recently been considered in a number of reports: P Mayer and A Sheppard, 'Final ILA Report on Public Policy as a Bar to Enforcement of International Arbitral Awards', (2003) 19 Arbitration International (No 2), 249–63; see also the interim report by A Sheppard, 'Interim ILA Report on Public Policy as a Bar to Enforcement of International Arbitral Awards', (2003) 19 Arbitration International (No 2), 217–48; and see paras 13.56–13.60.

[30] P Mayer, 'Mandatory Rules of Law in International Arbitration', (1986) 2 Arbitration International (No 4), 274–93; see also Yves Derains 'Public Policy and the Law Applicable to the Dispute in International Arbitration', report to the 8th Congress of the International Council for Commercial Arbitration (New York, 1986); and Lew, *Applicable Law in International Commercial Arbitration* (1978), 541.

[31] For instance, the American Restatement Second Conflict of Laws, s 187(2)(b) of the United States considers that the mandatory rules of a State will be applicable where the law of that State has 'a materially greater interest than the chosen State in the determination of a particular issue and which . . . would be the State of the applicable law in the absence of an effective choice of law by the parties'.

[32] European Convention on the Law Applicable to Contractual Obligations of 19 June 1980,

accepted in some international arbitrations as a principle to which the arbitral tribunal should have regard.[33] In considering whether to apply a particular principle of mandatory law the arbitral tribunal will have to consider the relationship of that law to the dispute in question. There are a number of different criteria relevant to the question of whether a rule of mandatory law should be applied. Quite often mandatory laws, other than those applicable at the seat of the arbitration or relevant under the applicable law, will be ignored.[34]

D. *Contrat Sans Loi*

6.23 It is recognized by almost all modern arbitration legislation that an international commercial arbitration does not need to be decided in accordance with a national law. However, international commercial arbitrations cannot be totally free from the constraints of national laws. International commercial arbitrations must still be decided in accordance with a set of rules, norms or principles. Therefore, when jurists speak about arbitrations *sans loi* they do not mean that these arbitrations are 'lawless'; ie that they are without rules or any legal principles.[35]

6.24 Disputes that are to be resolved by arbitration should have regard to some overriding principles. If a dispute was to be resolved by the roll of a dice then the process could not properly be called arbitration. An arbitration involves a judicial decision.[36] However, there has been much academic debate as to what principles may apply and the extent of them. The principles may be discoverable from equity or law merchant. In some cases the principles that are to apply may be clearly defined, for example the United National Nations International

art 7(1); see also the Draft Recommendations on the Law Applicable to International Contracts by the Working Group of the Commission on Law and Commercial Practices of the International Chamber of Commerce.

[33] *Austrian Company (Seller) v Dutch Company (Buyer)*, Award of 11 January 1982, (1982) Tijdschrift voor Arbitrage (no 3), 72–7; (1982) VII Ybk Comm Arbn 158; *Italian supplier v South Korean buyer*, Case No 4132110 (1983) *Journal du droit international (Clunet)* 891, with note Y Derains, 891–3; (1985) X Ybk Comm Arbn 49.

[34] See further, A. Maniruzzaman, 'International Arbitrator and Mandatory Public Law Rules in the Context of State Contracts: An Overview, (1990) 7 Journal of International Arbitration, No 3, 53–64.

[35] P Nygh, *Autonomy in International Contracts* (1999) at 172 stated that a *contrat sans loi* did not indicate 'the absence of, in Austinian terms, a rule or set of rules emanating from a sovereign authority and enforced by public authority'.

[36] In *Harris v Mitchell* (1704) 2 Ver 585 the election of an umpire by the arbitral tribunal by throwing cross and pile (an act similar to throwing dice) was set aside by the Court of Equity. The Master of the Rolls stated: 'An election or choice is an Act that depends on the will and the understanding, but the Arbitrators followed neither in this case, and it is distrusting of God's Providence to leave matters to chance.'

Institute for the Unification of Private Law (UNIDROIT) Principles of International Commercial Contracts.[37] In contrast the principles to be applied may not easily be ascertainable and the arbitral tribunal may have to 'find' or 'create' them though the development of existing case law.

Lex contractus

It has been suggested that the terms of the contract can amount to an applicable law, a *lex contractus*, without reference to a national law.[38] The terms of the contract define and prescribe the relationship between the parties. The concept of a *lex contractus* is almost a final embodiment of the principle of 'autonomy of the will' of the parties.[39] The principle that contracts should be performed is raised to the status of a law itself. The jurisprudential justification of such a theory is at odds with the views of many common law jurists such as Hart, Dworkin, and Austin. It is a theory without the need for rules, without policy and without principles. Professor Verdross, the leading exponent of the theory, states:[40] **6.2**

> The contract, created by a quasi-international agreement, is an independent legal order, regulating the relation between the parties exclusively. Naturally, the lex contractus may refer, for its interpretation of the filling up of the evidential gaps, to the legal order of the contracting State, or of the other Party, or to international law. But these legal orders can only be applied in as much as they are delegated by the lex contractus, because it is the mutual rights and duties of the parties.

No case has yet gone as far as fully endorsing the theory of a *lex contractus* although a number of cases have indicated that a national law is not a prerequisite for a valid arbitration.[41] In the case of *Petroleum Development Ltd v Sheikh of Abu Dhabi (Abu Dhabi)*[42] the arbitral tribunal rejected the municipal law of Abu Dhabi because, in its view, 'it would be fanciful to suggest that in this very primitive region, there is any body of legal principles applicable to the construction of modern commercial instruments'. The arbitral tribunal held that that the reference in the contract to principles of goodwill meant that rather **6.26**

[37] Rome 1994.

[38] A Verdross, 'The Status of Foreign Investments Stemming from Economic Development Agreements with Arbitration Clauses,' in *Selected Readings on Protection by Law of Private Foreign Investments* (1964) 117.

[39] AFM Maniruzzaman, 'Choice of Law in International Contracts—Some Fundamental Conflict of Law Issues', (1999) 16 Journal of International Arbitration (No 4) 141–71.

[40] A Verdross, 'The Status of Foreign Investments Stemming from Economic Development Agreements with Arbitration Clauses,' in *Selected Readings on Protection by Law of Private Foreign Investments* (1964) 117.

[41] *Sapphire International Petroleums v NIOC* [1967] 35 International Law Reports 136, (1964) 13 ICLQ 1011.

[42] (1951) 18 ILR 144.

than apply a national law it would apply 'principles rooted in good sense and common practice of generality of civilized nations—a sort of modern law of nature'. The arbitral tribunal therefore went on to determine the dispute by reference to the terms of the contract and by general principles of law.

6.27 The *lex contractus* theory is plagued with difficulties.[43] It is unlikely that a contract could be drafted in a way that it can stand in isolation from any municipal or transnational law. There will always be gaps and these gaps have to be determined by reference to some law. If the obligations under the contract are not founded in a national legal system then the parties will have no benchmark from which they will be able to determine how to present arguments on substantive points of law. A fundamental flaw of the *lex contractus* theory is therefore the uncertainty of the process. Furthermore, the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1959 (New York Convention) requires arbitration agreements to be recognized only where there is a defined legal relationship between the parties. The *lex contractus* theory starts from the premise that there is no defined legal relationship. It is independent from any legal order. There is therefore a very real risk that an award made using the *lex contractus* theory will be unenforceable.

Equitable principles

6.28 Equity clauses are clauses which allow the arbitral tribunal to resolve the dispute on the basis of what is 'fair and reasonable', rather than on the application of a particular national law. There has been some debate as to whether there is a difference between an equity clause, a clause requiring the arbitral tribunal to decide the dispute *ex aequo et bono*, and a clause that permits the arbitral tribunal to act as *amiable compositeurs*. It has been suggested that if there is a difference then it is that an equity clause would free the arbitral tribunal from the constraints of national law while a clause requiring the arbitral tribunal to act *ex aequo et bono* only permits the arbitral tribunal to mitigate the effects of a harsh law.[44] No distinction hereafter is made between equity clauses and clauses requiring the arbitral tribunal to act as *amiable compositeurs*.

6.29 Equity clauses take many different forms. However, they usually fall into two distinct categories. The first category permits the arbitral tribunal to act without applying all the principles of the relevant law. The arbitral tribunal may therefore be empowered to make its decision without applying rules of construction

[43] For an analysis of the practical and theoretical difficulties see AFM Maniruzzaman 'Choice of Law in International Contracts—Some Fundamental Conflict of Law Issues' (1999) 16 Journal of International Arbitration (No 4), 141–71; and F A Mann, 'The Proper Law of Contracts Concluded by International Persons', (1959) 35 BYBIL (1959) 34 at 49.

[44] Fouchard, Gaillard, and Goldman, *International Commercial Arbitration*, para 1502.

or rules of evidence. The contract may also permit the arbitral tribunal to militate against a harsh or unfair provision within the law. It is rare for these clauses to permit the arbitral tribunal to decide without reference to any law. The second category permits the arbitral tribunal to decide in accordance with some principles other than a national law. Such clauses will quite often refer to principles of 'equity and good conscience', or to the 'usages and customs of the trade', or to '*lex mercatoria*'.[45]

Equity clauses and English law

Prior to the enactment of the English Arbitration Act 1996 there was some **6.3** question whether an equity clause would be valid under English law, and whether an award made pursuant to an equity clause would be recognized and enforced.[46] The English courts questioned whether such clauses created legally enforceable obligations, whether such clauses were sufficiently certain to give rise to legally enforceable obligations, and whether such clauses were consistent with public policy.[47] In *Eagle Star v Yuval*[48] the Court of Appeal had to consider an equity clause and concluded that such a clause was valid. Goff LJ stated:

> I do not believe that the presence of such a clause makes the whole contract void or a nullity. It is a perfectly good contract. If there is anything wrong with the provision, it can only be on the ground that it is contrary to public policy for parties so to agree. I must say that I cannot see anything in public policy to make this clause void. On the contrary the clause seems to me to be entirely reasonable. It does not oust the jurisdiction of the Courts. It only ousts technicalities and strict constructions. That is what equity did in the old days. And it is what arbitrators may properly do today under such a clause as this . . .
>
> So I am prepared to hold that this arbitration clause, in all its provisions, is valid and of full effect, including the requirement that the arbitrators shall decide on equitable grounds rather than a strict legal interpretation.

However, in *Home and Overseas Insurance v Mentor Insurance*[49] the Court of **6.3** Appeal came to an opposite conclusion on the facts of the case. Parker LJ stated: 'I have no hesitation in accepting . . . that a clause which purported to free arbitrators to decide without reference to law and according, for example, to

[45] Stewart Boyd, 'Arbitrator not to be bound by the Law Clauses' (1990) Arbitration International (No 2), 122–32.

[46] In 1979 Lord Devlin had argued for the recognition of equity clauses and clauses *ex aequo et bono*. In opposition to this proposal it was argued that the development of the law would suffer if decisions on debatable points were not published in the law reports. Lord Devlin's caustic response was: 'So there must be an annual tribute of disputants to feed the Minotaur. The next step would, I suppose, be a prohibition placed on the settlement of cases containing interesting points of law' (1979) *The Judge*, 104–9.

[47] Stewart Boyd, 'Arbitrator not to be bound by the Law Clauses' (1990) 6 Arbitration International (No 2), 122–32.

[48] [1978] 1 Lloyd's Rep 357, 362.

[49] [1989] 1 Lloyd's Rep 473, 485.

their own notions of what would be fair would not be a valid arbitration clause.' The English Arbitration Act 1996 now appears to reverse this position.[50] Section 46(1)(b) permits the parties to agree that the substantive dispute should be resolved 'in accordance with such other considerations as are agreed by them or determined by the tribunal'. However, before section 46(1)(b) comes into play there must be an agreement by the parties.

Equity clauses and the UNIDROIT Principle of International Commercial Contracts

6.32 It has been held that the reference to an equity clause within an international contract allows the arbitral tribunal to refer to the UNIDROIT Principle of International Commercial Contracts to aid in the construction of the contract.[51] In *Andersen Consulting Business Unit Member Firms v Arthur Andersen Business Unit Member Firms and Andersen Worldwide Société Coopérative*[52] the arbitration clause stated that:

> The arbitrator shall decide in accordance with the terms of this Agreement and of the Articles and Bylaws of [AWSC]. In interpreting the provisions of this Agreement, the arbitrator shall not be bound to apply the substantive law of any jurisdiction but shall be guided by the policies and considerations set forth in the Preamble of this Agreement and the Articles and Bylaws of [AWSC], taking into account general principles of equity . . .

The arbitral tribunal considered the relevant Articles and Bylaws and concluded that these failed to provide guidelines for a decision on the issue in dispute. The arbitral tribunal therefore elected to apply Article 17.1 of the ICC Rules, general principles of law and the general principles of equity commonly accepted by the legal systems of most countries. The arbitral tribunal stated that the UNIDROIT Principles of International Commercial Contracts were a reliable source of international commercial law in international arbitration for they 'contain in essence a restatement of those *principes directeurs* that have enjoyed universal acceptance and, moreover, are at the heart of those most fundamental notions which have consistently been applied in arbitral practice'.

[50] Stewart Boyd (n 45 above) at 132: 'The fact is that arbitration, unlike the Courts, depends for its vigour on market forces, and the market in which English arbitration operates in an international market where equity clauses are almost universally recognized. If London will not accommodate equity clauses (and I believe it can), Alsatia undoubtedly will.'

[51] *Andersen Consulting Business Unit Member Firms v Arthur Andersen Business Unit Member Firms and Andersen Worldwide Société Cooperative* (2000) 15 Mealey's International Arbitration Report, (Issue 8), A1–A45; 1998 US Dist LEXIS 3252; (2000) XXV Ybk Comm Arbn 641.

[52] ibid.

E. Transnational Law

Since the late 1970s there has been a strong movement from the Institute of International Law to endorse the use of transnational law in international state contracts. In 1992 the International Law Association adopted the following resolution: **6.33**

> The fact that an international arbitrator has based an award on transnational rules (general principles of law, principles common to several jurisdictions, international law, usages of trade, etc.) rather than on a law of a particular State should not in itself affect the validity or enforceability of the award; (1) where the parties have agreed that the arbitrator may apply transnational rules.

The phrase 'transnational law' therefore covers a multitude of different rules or laws. Within this chapter we consider the most common expressions of transnational law. These include the *lex mercatoria*, the codified principles of international law, and public international law. Transnational law has sometimes been criticized in that the rules formulating the law often have gaps or are not properly developed in specific areas.[53] This criticism has often been focused at whether the *lex mercatoria* can be construed as providing a coherent and complete system of law. Transnational law has also been criticized in that it is a product of developed economic states and therefore benefits the stronger and more developed contractual party.[54] **6.34**

Lex mercatoria

Lex mercatoria is the law of trade and commerce. Its origins are unknown although it can be traced back to about the ninth century when the Arabs dominated trade in the Mediterranean. By the twelfth century, Italy was a cornerstone for trade in Europe and at that time the *lex mercatoria* was the law used between merchants. During the following centuries the use of the *lex mercatoria* developed in most of the North European countries and became part of the accepted law in many trading nations. Gerard de Malynes' seminal work on *lex mercatoria* in 1622 recognized law merchant as a universal system of customary law and not a law established by the sovereignty of any prince.[55] De Malynes wrote regarding law merchant that: 'Reason requireth a Law not too **6.35**

[53] Lord Mustill, *The New Lex Mercatoria: The First Twenty-five Years* in I Brownlie and M Bos (eds), *Liber Amicorum for Lord Wilberforce* (1987).

[54] Toope, *Mixed International Arbitration* (1990) at 96: 'It would appear that the so-called *lex mercatoria* is largely an effort to legitimise as "law" the economic interests of Western corporations.'

[55] For further reading on the history of Law Merchant see H West Bradlee, *A Student's Course on Legal History* (1929).

cruell in her Frownes, nor to partial in her Favors. Neither of these defects are incident to the Law Merchant.'[56] Law merchant was recognized by English common law jurists for many years as a part of the laws of England. However, the use of the law merchant faded in subsequent centuries as the courts became more jealous of their powers and the laws of different countries developed providing a comprehensive commercial code of law.

6.36 In the early 1960s the concept of the *lex mercatoria* re-emerged. Its use in modern international trade contracts was considered by a number of European jurists and in particular Berthold Goldman.[57] Goldman's views were developed by his contemporaries and applied to international commercial arbitration. In 1987 Lord Mustill considered the development of the *lex mercatoria*.[58] In what has become a frequently quoted phrase Lord Mustill stated that: 'Commercial arbitration exists for one purpose only: to serve the commercial man. If it fails in this, it is unworthy of serious study.' Ignoring the common lawyers' distaste for what has often been considered as a 'non-subject' Lord Mustill analysed the principles of the *lex mercatoria*. Lord Mustill addressed the question of what is the *lex mercatoria*? His answer was that:

> In the first place, the lex mercatoria is 'anational'. This concept has two facets. First, the rules governing an international commercial contract are not, at least in the absence of an express choice of law, directly derived from any one national body of substantive law. Second, the rules of the lex mercatoria have a normative value which is independent of any one legal system. The lex mercatoria constitutes an autonomous legal order.

Lord Mustill also concluded that because the *lex mercatoria* was 'a-national' it could not simply be derived from a comparative analysis of different legal systems. The new *lex mercatoria* adopted national legal principles and rules of trade usage and custom. Principles of *lex mercatoria* are also found within the writings of jurists and legal commentators.

6.37 It would be a misconception to equate the *lex mercatoria* with equitable principles. The *lex mercatoria* is a set of principles and norms from which the arbitral tribunal will derive its decision. There is no question of the arbitral tribunal arriving at a decision from its own sense of justice. The more difficult problem is, however, to establish the principles that make up the *lex mercatoria*. Lists of the constituent elements of the *lex mercatoria* have been compiled.[59] The lists are by no means definitive and include: public international law; uniform laws; the general principles of law; the rules of international organizations; customs and usage; standard form contracts; and the reporting of arbitral awards. From the general principles of law which make up the *lex mercatoria* the most fundamental principle that overrides all others is the principle of *pacta sunt servanda* (contracts should be performed). The principle of good faith between the parties is also frequently cited as a fundamental principle of the *lex mercatoria*.[60] Lord Mustill cited twenty rules, which he considered constituted a 'tolerably complete account of the rules'.[61] Lord Mustill concluded that even with these twenty rules the principles of the *lex mercatoria* are at best vague.[62] However, there have been criticisms of the approach of simply listing a set of rules in order to determine the *lex mercatoria*. More recent works on *lex mercatoria* consider that a three-stage approach is required.[63] First the arbitral tribunal should seek to establish the intention of the parties and determine whether they have agreed an approach to ascertaining the *lex mercatoria*. Second, the contentions of the parties should be tested against the law established. Third, in ascertaining whether a principle can be construed as a general principle of law the question will be whether the principle supports wide recognition rather than being universally accepted.

6.38 A further criticism of the *lex mercatoria* has also been in regard to the difficulty in ascertaining the applicable rules. Lord Mustill considered that the real question relating to the use of *lex mercatoria* was 'whether it can and does exist as a viable system'. Many theorists disregard this criticism; however it is a criticism that does create problems. Commerce, if it is about anything, is about certainty. Businessmen want to know the effects of their acts. If it is impossible to provide the businessman with any clear answer to a question, because the law that is applicable is unclear, then it is a law that will fall into disrepute. However, the *lex mercatoria* is developing. Recent commentators now consider that the

[56] Gerard De Malynes, *Consuetudo, Vel Lex Mercatoria, or the Ancient Law-Merchant* (1622).

[57] Goldman, 'La Compagnie de Suez, société internationale,' Le Monde, 4 October 1956, 3; Goldman, '*Frontières du droit et lex mercatoria*' (1964) Archives de philosophie du droit, 177 et seq, Goldman, *La lex mercatoria dans les contrats et l'arbitrage internationaux: réalité et perspectives* (Clunet 1979) 475 et seq, Goldman, *Festschrift P. Lalive* (1993), 241 et seq.

[58] Lord Mustill, 'The New Lex Mercatoria: The First Twenty-five Years, in *Liber Amicorum for Lord Wilberforce* (1987).

[59] O Lando, 'The Lex Mercatoria in International Commercial Arbitration' (1985) 34 ICLQ 747.

[60] While the obligation of good faith is seen as a tenant of the *lex mercatoria* and is found in many civil law systems English common law does not recognize the concept in commercial or contract law, except in a number of defined relationships. This lack of good faith in the application of legal remedies under English common law has been described as 'at once the most remarkable and most reprehensible feature of English contract law': R Goode, *Commercial Law* (1st edn, 1982), at 117.

[61] Lord Mustill, 'The New Lex Mercatoria: The First Twenty-five Years', from *Liber Amicorum for Lord Wilberforce* (1987); (1988) 4 Arbitration International (No 2), 86, 114.

[62] However, since Lord Mustill's comments in the late 1980s the *lex mercatoria* has continually developed and the CENTRAL Transnational Law Database now lists over 70 principles.

[63] E Gaillard, 'Transnational Law: A Legal System or a Method of Decision Making' (2001) 17 Arbitration International (No 1) 59–72.

principles of the *lex mercatoria* are becoming clearer and more developed[64] and that it can now 'fulfil satisfactorily, in practice, the function of a proper law'.[65]

6.39 The CENTRAL Transnational Law Database[66] now list over seventy principles which form the basis of the *lex mercatoria*. The Transnational Law Database supports the view that there is a creeping codification of transnational law.[67] The Transnational Law Database lists the principles that make up the *lex mercatoria* and this is continuously updated adding further references to new awards and principles. In this way the criticism that the *lex mercatoria* is too vague to provide a comprehensive set of decision-making rules that can be applied to resolve a dispute is undermined. In the last few decades the *lex mercatoria* has therefore developed into a substantial code for the formulation of disputes. In practice it is also being frequently used and the principles of the *lex mercatoria* are often cited and relied upon by the Iran–United States Claims Tribunal. Furthermore, if the parties elect to resolve their dispute by the application of the *lex mercatoria* then the courts of the *lex fori* will usually uphold this choice. Most modern arbitration legislation will permit the parties to choose an applicable law or 'rules of law' even if the choice of the applicable law is not a national law but the *lex mercatoria*.[68] The use of the *lex mercatoria* in France as the applicable law has been accepted for the last few decades and in the *Valenciana* case[69] the French Cour de cassation stated that an arbitral tribunal was permitted to choose *lex mercatoria* as the applicable law even if it has not been chosen by the parties.

Uniform laws and codified principles

6.40 The UNIDROIT, the ICC and the World Intellectual Property Organization (WIPO) have all undertaken substantial work in providing uniform laws and codified principles that can be used in all international trade contracts. It has been suggested that these uniform laws and codified principles form part of the

[64] Klaus Peter Berger, *The Creeping Codification of the Lex Mercatoria* (1999).

[65] L Yves Fortier, 'The New, New Lex Mercatoria, or, Back to the Future' (2001) 17 Arbitration International (No 2) 121, 122.

[66] At http://www.tldb.de.

[67] Klaus Peter Berger, *The Creeping Codification of the Lex Mercatoria* (1999).

[68] However, H Holtzmann and J Neuhaus *A Guide to the UNCITRAL Model Law on International Commercial Arbitration—Legislative History and Commentary* (1989) put forward the argument that the phrase 'rules of law' within the UNCITRAL Model Law covers transnational rules such as the codified principles of international law but is not intended to permit the parties to chose as the applicable law the *lex mercatoria*.

[69] *Compania Valenciana de Cememtos Portland v Primary Coal* (1992) Rev Arb 457, commentary by P Lagarde; (1993) Ybk Comm Arbn 137–9.

lex mercatoria.[70] However, uniform laws, such as the UNIDROIT 'Principles of International Commercial Contracts', can amount to an applicable law in their own right. Codified rules or principles may also be adopted by the parties in order to assist in the interpretation of any contract. An example is the International Commercial Terms (INCOTERMS) 2000.

The INCOTERMS 2000

6.41 The INCOTERMS 2000 provide standard definitions for words and phrases commonly used in trade contracts. Terms such as CIF, FOB. are common in international trade contracts. However, these terms have no legal status and the courts of one country may interpret their meaning differently to those of another. It is not until the courts have given these terms a meaning that they have any legal standing and there is a risk of inconsistency in the interpretation of such terms. In order to overcome, or at least reduce, the risk of this potential problem, in the 1920s the International Chamber of Commerce conducted a study on the interpretation of the more important trade terms. The outcome resulted in the first publication of 'International Rules for the Interpretation of Trade Terms' in 1936. These were subsequently amended in 1953, 1967, 1976, 1980 and 1990, and in 2000. The main reason for the revisions to the INCOTERMS was the need to bring the terms into line with contemporary commercial practice. In the 1980 revision, therefore, the term Free Carrier (now FCA) was introduced. It had become common that the reception point in maritime trade was no longer the traditional FOB-point, ie passing the ship's rail. Instead, the goods were delivered to a point on land prior to the loading on board a ship and there stored in a container. It had therefore become common for the seller to require that its risk ceased on delivery to the port and that the risk was taken up by the buyer.

6.42 The INCOTERMS 2000 consist of thirteen terms and provide a detailed meaning to each term. Where the INCOTERMS 2000 are incorporated into the contract then phrases such as CIF, 'FOB named origin' and 'FCA named origin' are interpreted by reference to the text of of the INCOTERMS 2000. The INCOTERMS do not have any legal status, unless they are incorporated into the contract of sale. Both parties to the sale contract should ensure that they understand and interpret the INCOTERMS in the same way. The INCOTERMS deal with the sale contract and not the contract of carriage. Further, they do not provide for all the duties which parties may wish to include in a contract of sale. For example, they do not determine ownership in the goods and do not deal with the consequences of breach of contract and any exemptions from

[70] O Lando, 'The Lex Mercatoria in International Commercial Arbitration' (1985) 34 ICLQ 747.

liability. The seller and buyer must look to other provisions of the contract or the applicable law to determine these questions.

The UNIDROIT Principles of International Commercial Contracts

6.43 UNIDROIT has drafted a set of 'Principles of International Commercial Contracts', which are intended to be a statement of general principles of international contract law. The Principles are comprehensive and deal with the formation of the contract. They can be used as an aid for domestic contract legislation and in the determination of international disputes. One of the intentions behind the Principles was that they would provide a systematic and well-defined set of rules for the interpretation of any contract. Therefore, by adopting the Principles the parties avoided the extreme vagueness of such concepts as 'lex mercatoria' or 'general principles of law'. UNIDROIT hoped that the Principles would be seen as being neutral to the parties and could therefore be used in any country. The Preamble deals with the use of the Principles in contracts. The Preamble states:

> These Principles set forth general rules for international commercial contracts.
>
> They shall be applied when the parties have agreed that their contract be governed by them.
>
> They may be applied when the parties have agreed that their contract be governed by general principles of law, the lex mercatoria or the like.
>
> They may provide a solution to an issue raised when it proves impossible to establish the relevant rule of the applicable law.
>
> They may be used to interpret or supplement international uniform law instruments.
>
> They may serve as a model for national and international legislators.

6.44 The Principles have been used by national courts in order to assist in the interpretation of words and phrases. In *Bottling Companies v Pepsi Cola Panamericana*[71] the Supreme Court of Venezuela used the Principles in order to assist it in the interpretation of the word 'international'. The facts of the case were that two Venezuelan companies entered into a contract containing an arbitration clause, which stated that disputes should be referred to arbitration in New York under the ICC Arbitration Rules. Article 1 of the ICC Arbitration Rules stated that the Arbitration Rules applied to 'disputes of an international character'. One of the parties commenced an arbitration. The other party objected to the arbitration and alleged that jurisdiction remained vested in the ordinary Venezuelan courts because the dispute was not of an international character.

[71] Uniform Law Review/Revue de droit uniforme, 1998, 176–7.

The Supreme Court of Venezuela held that there was a valid arbitration agreement. The court concluded that while both of the parties were Venezuelan companies one of the companies was a subsidiary of a company incorporated in the United States. The court therefore concluded that the dispute was international in character. The Supreme Court found support for this broad interpretation from the Comments to the Preamble to the UNIDROIT Principles of International Commercial Contracts, which state: 'The assumption, however, is that the concept of "international" contracts should be given the broadest possible interpretation, so as ultimately to exclude only those situations where no international element at all is involved, ie where all the relevant elements of the contract in question are connected with one country only.'

Comment 4 to the Preamble to the UNIDROIT Principles of International Commercial Contracts states: 'Parties who wish to adopt the Principles as the rules applicable to their contract would however be well advised to combine the reference to the Principles with an arbitration agreement.' The reasons for this is that where a national court is asked to determine a dispute then it will do so by the application of a national law and that the UNIDROIT principles, if agreed to by the parties or referred to within that national law, will only apply so far as they are necessary to supplement that law. Equally, where a national law is chosen by the parties then the arbitral tribunal may only apply the UNIDROIT Principles to supplement, if necessary, that national law. For example, in *An Ad Hoc Arbitration*[72] the arbitral tribunal applied the UNIDROIT Principles to supplement the national law of a State where its law contained a number of lacunae and ambiguities. However, an arbitral tribunal resolving an international dispute is not bound to apply any national law and may apply 'rules of law' or other principles if the parties so agree. The parties may therefore choose to free themselves from any national law by selecting the UNIDROIT principles as the law to govern their contract. **6.4**

Public international law

Public international law is principally concerned with the relationship between States. It is, however, becoming more common to use public international law in order to resolve disputes between States and individuals.[73] The sources of public international law can be found within Article 38 of the Statute of the International Court of Justice. This states: **6.4**

[72] Special Supplement—ICC International Court of Arbitration Bulletin (2002), 51, 54.

[73] See for example *Channel Tunnel Group v Balfour Beatty Construction Ltd* [1993] AC 334. where public international law was used not only to govern the relationship between France and

1. The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:
   a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
   b. international custom, as evidence of a general practice accepted as law;
   c. the general principles of law recognized by civilized nations;
   d. subject to the provisions of Article 5—judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.
2. This provision shall not prejudice the power of the Court to decide a case en aequo et bono, if the parties agree thereto.'

An international convention, in this context, means a treaty. Article 2(1)(a) of the Vienna Convention on the Law of Treaties (1969) defines the word treaty as follows: ' "treaty" means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation'.

6.47 Customary international law should be distinguished from usage, in that it arises out of the practice of the State coupled with a belief on the part of the State that the rule is required in order to comply with international law.[74] The general principles of law that are referred to are generally understood to include the principles of good faith, estoppel, and equity.[75] In *ICC Case No 6474 of 1992*[76] the arbitral tribunal were asked to conclude that they had no jurisdiction to deal with a dispute on the basis there was a violation of international public policy. The defendant claimed that as the international community did not recognise X as a State it would be violation of international public policy to proceed with an arbitration where it was alleged that it was a party. The arbitral tribunal held that it had jurisdiction over the dispute holding that a denial of justice would contradict the principle of good faith, one of the most fundamental principles of transnational public policy.

[74] *Lotus Case (France v Turkey)* (1927) PCIJ Rep, Ser A, No 10; *Fisheries Case (UK v Norway)* (1951) ICJ Reports 116; *North Sea Continental Shelf Cases* (1969) ICJ Reports 1; and *Nicaragua Case, Merits (Nicaragua v US)* (1986) ICJ Reports 14.

[75] *Diversion of water from the Meuse Case (Netherlands v Belgium)* (1937) PCIJ Rep Ser A/B, No 70, 76–7 (opinion of Judge Hudson).

[76] *Supplier (European Country) v Republic of X* (2000) XXV Ybk Comm Arbn 278–310.

F. Conflict of Laws

It is almost impossible to avoid issues relating to conflict of laws in international commercial arbitrations. Although most modern arbitration legislation recognizes the principle of party autonomy, ie that the parties may expressly choose a law or laws to govern the arbitration, the principle exists because it is permitted by a country's national law. The relationship between the right to choose a law and the applicable law of the contract was considered by Professor Dupuy acting as sole arbitrator in the *TOPCO*[77] arbitration. He stated that: '. . . unless one were to concede that, in the initial stage where the parties are to choose the applicable law, the relevant contractual stipulation may depend solely on their choice, it is necessary to determine the legal system in which the clause designating the applicable law is found and from which that same clause will draw its binding force'. **6.4**

The parties' right to choose an applicable law is therefore a right that exists because of the law which governs the parties contractual relationship. If that law *does not* permit the parties freedom to choose the law applicable to the merits of the dispute then the arbitral tribunal should ignore the choice made by the parties and apply the appropriate law by reference to the appropriate conflict of laws. However, as stated above, it would be rare for a municipal law to restrict the choice of applicable law by the parties. In the following sections consideration will be given to: (1) the choice of laws made by the parties; (2) ascertainment where the parties do not choose a law; and (3) the different laws which the arbitral tribunal may apply. **6.4**

An express or implied choice of law made by the parties

Most modern arbitration legislation, arbitration rules and international treaties and conventions recognize the right of the parties to choose a law applicable to the merits of the dispute, to the procedure, and to the arbitration agreement. The principle of autonomy of the parties to choose the law applicable to their arbitration is a cornerstone of modern arbitral practice. In *ICC Award No 1512*[78] it was stated that few principles are more universally recognized in private international law than the principle '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'.[79] **6.5**

[77] *Texaco v Libya* (1977) 53 ILR 389.

[78] (1980) V Ybk Comm Arbn 171.

[79] See S Jarvin and Y Derains, *Collection of ICC Arbitral Awards 1974–1985* (1990), 210; and 'Final Award in Case No 6379' (1992) XVII Ybk Comm Arbn 212; and 'Partial Award in Case No 5073' (1988) XIII Ybk Comm Arbn 53.

6.51 Where there has been no express choice of applicable law then a court or arbitral tribunal must decide whether there has been an implied or tacit choice of law. In *Agent (Syria) v Trading Co (Germany)*[80] the claimant argued that there had been a tacit choice of German law because the contract had been signed in Germany. The arbitral tribunal disagreed. The arbitral tribunal held that the fact that the contract was signed in Hamburg did not indicate a tacit acceptance of German law. The arbitral tribunal considered the surrounding circumstances relating to the agreement and concluded that the signature took place in Germany for practical reasons and not because the parties wanted to or intended that German law should be the applicable law of the contract.

6.52 The parties may expressly or by implication choose a national law to govern the dispute. Alternatively, the parties may agree that the arbitral tribunal should apply other considerations to the resolution of the dispute. Most modern arbitration legislation now permits the arbitral tribunal to act as *amiable compositeurs* or to apply transnational laws. Where the parties choose to have their dispute decided other than by a municipal law then the question arises whether such a choice will be permitted under the *lex arbitri* or the law which governs the arbitration agreement. In the following subsections consideration is given to the position where the parties choose to resolve their dispute by (1) amiable composition; (2) by transnational rules of law; or (3) by national law.

Amiable composition and ex aequo et bono[81]

6.53 Most modern arbitration legislation and arbitration rules now recognize that the parties are free to choose a clause whereby the dispute can be resolved by principles of equity. However, not all countries will recognize such a clause. Prior to the Arbitration Act 1996 there was some debate in England as to whether the parties could free themselves from municipal laws. In *Home and Overseas Insurance v Mentor Insurance*[82] the English Court of Appeal stated: 'that a clause which purported to free arbitrators to decide without reference to law . . . would not be a valid arbitration clause'. This principle, although no longer applicable under English law, may still be applicable in some Commonwealth countries.[83]

6.54 Most modern arbitration legislation now permits the arbitral tribunal to act as an *amiable compositeur*. However, this power must be specifically given to the arbitral tribunal. In the absence of such an agreement then the arbitral tribunal

[80] *Partial award in case no 8113 of 1995* (2000) XXV Ybk Comm Arbn 323–327.

[81] The use of amiable composition agreements and clauses *ex aequo et bono* have been discussed in paras 6.28 et seq above.

[82] [1989] 1 Lloyd's Rep 473, 485.

[83] For example see Lawrence G S Boo, 'Singapore' ICCA Handbook, Suppl 21 (August/1996), ch 5; and see further paras 6.28 et seq.

should decide in accordance with a national law or such other laws or principles as appropriate. However, even when the parties have expressly authorized the arbitral tribunal to act as an *amiable compositeur* the arbitral tribunal should not ignore any mandatory laws relevant to the dispute and, in order to determine which mandatory laws are relevant, the arbitral tribunal will have to apply conflict of laws principles.

Transnational law and lex mercatoria[84]

6.55 The municipal law at the seat of the arbitration must permit the arbitral tribunal to decide the dispute by applying transnational rules. It is now quite common to find within national legislation or arbitration rules references to 'rules of law'.[85] *Lex mercatoria* derives its existence from established principles of international commerce (sometimes referred to as principles of trade and usage). Its existence is therefore rooted in general principles of law (rather than any particular law). A problem for the arbitral tribunal, where the parties have chosen *lex mercatoria* to resolve the dispute, is that there are gaps in the law and the *lex mercatoria* does not always provide the detail necessary.[86] Where there is a gap within the *lex mercatoria* then the arbitral tribunal must fill it by the application of a municipal law. In filling this gap the arbitral tribunal may have to apply conflict of laws rules in order to determine what law it should apply.

6.56 Where there are mandatory rules applicable to the dispute then the arbitral tribunal must apply such rules. Once again, in order to determine which mandatory laws are relevant, the arbitral tribunal will have to apply conflict of laws principles. The UNIDROIT Principles of International Commercial Contracts, which are often cited as part of the *lex mercatoria*, specifically refer to the application of mandatory rules. Article 1.4 states: 'Nothing in these Principles shall restrict the application of mandatory rules, whether of national, international or supranational origin, which are applicable in accordance with the relevant rules of private international law.'

National law and mandatory requirements

6.57 The principle that national courts ought to permit parties to choose the law to govern the substantive dispute is illustrated at Article VII(1) of the European Convention of International Commercial Arbitration of 1961. This states that:

[84] Transnational law and the application of *lex mercatoria* has been discussed at paras 6.35 et seq above.

[85] For example, art 1496 of the French New Code of Civil Procedure grants the parties the right to select the *rules of law* (*règles de droit*) that will govern their contract without requiring that they choose a national law.

[86] An example of this problem was illustrated by B Wortmann, 'Choice of Law by Arbitrators: The Applicable Conflict of Laws System' (1998) 14 Arbitration International (No 2) 97–114, 'When can *pacta sunt servanda* be set aside by *rebus sic stantibus*?'

'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 arbitrators deem applicable . . .' This principle of party selection is now almost universally accepted. In *ICC Award in Case No 1512*[87] the arbitral tribunal stated:

> 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. The differences which may be observed here between different national systems relate only to the possible limits of the parties' power to choose the applicable law or to certain special questions or to modalities, but not to the principle itself, which is universally accepted.

6.58 Where, however, the parties have made an express choice of law then the arbitral tribunal is still bound to comply with mandatory requirements of any relevant municipal law. Not all mandatory requirements will, however, be relevant and thus binding on the arbitral tribunal. In *ICC Award in Case No 1512*[88] the arbitral tribunal had to consider the nexus between any mandatory requirement and the applicable law. In this case the contract was governed by Indian law which had been chosen by the parties. The arbitrator stated that once the choice had been made he had no power to substitute his own choice to that of the parties. The rhetorical question then posed by the arbitral tribunal was 'whether the Pakistani emergency legislation, which considered as illegal any payment to an Indian party by reason of the hostilities, could have freed the Pakistani Bank from its obligation'. In answering this question the arbitral tribunal looked at the link between the Pakistani emergency legislation and the arbitration. Pakistan was not the seat of the arbitration. Pakistani law was not the proper law of the contract. Pakistan was not the place of performance of the contract (the '*lex loci solutionis*'). The arbitral tribunal therefore concluded that the Pakistani emergency legislation was not a mandatory requirement of law which it was bound to apply.

6.59 In contrast, in *ICC Preliminary Award Case No 4132*[89] the parties, an Italian seller and a South Korean buyer, entered into a contract. The contract was governed by Korean law and a significant portion of the contract was to be performed within the territory of the Republic of Korea. The arbitral tribunal held that where it would be acting in conflict with rules of public policy of the

[87] (1976) I Ybk Comm Arbn 128.
[88] ibid.

Republic of South Korea, and such acts would negate any award made by the arbitral tribunal, it ought to take these mandatory requirements of the law into consideration. However, it was for the party which raised these public policy arguments to prove that this reflected the law and to what extent. On the facts the case was not made out and the arbitral tribunal continued with the arbitration.

Where the parties have not chosen an applicable law

Where the parties have not chosen an applicable law then the arbitral tribunal or **6.60** arbitral institution must select the applicable law. There are two common approaches. The arbitral tribunal may determine the laws to be applied to the arbitration by using a conflict of laws approach. This is the traditional approach. Alternatively, the arbitral tribunal may choose the laws by direct application of a substantive law. Within this section consideration is given to these two methods of choosing an applicable law.

Application of conflict of laws rules

Where the parties have not chosen an applicable law then this law must be **6.61** chosen by the arbitral tribunal or an arbitral institution. The arbitral tribunal could simply select a law at random. For example, the arbitral tribunal could choose the law of the place of performance of the contract, the law where the contract was concluded, or the national law of one of the parties. However, such choices may lead to unpredictability not only to the outcome of the case but also as to how the arbitration would be conducted. Until that law is chosen the parties would not know whether the claims were time barred, whether they could plead *force majeure*, whether interest was claimable. It order to overcome these uncertainties private international law or conflict of laws can be used to ascertain the laws applicable to the arbitration.

Most modern arbitration legislation and arbitration rules provide that where the **6.62** parties have not chosen an applicable law to determine the merits then the arbitral tribunal may apply the law determined by the conflict of law rules 'which it considers applicable'.[90] It follows that where national legislation gives to the arbitral tribunal this freedom then it does not necessarily need to apply the conflict of laws rules derived from the applicable law, or the law of the seat of the arbitration, or the law of the place of performance. The arbitral tribunal must, however, apply some conflict of laws rules to determine the applicable

[90] See, for example, the European Convention of International Commercial Arbitration of 1961, art 7; Article 29(2) of the UNCITRAL Model Law, art 29(2); English Arbitration Act 1996, s 46; and UNCITRAL Arbitration Rules, art 33(1).

law. In *ICC Award in Case No 4237*[91] the arbitral tribunal considered that this approach reflected a generally accepted principle in international commercial arbitrations. In this case the arbitral tribunal held that the applicable conflict of laws rules were those which had the closest connection to the dispute. The arbitral tribunal stated that:

> 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 the kind under consideration. The decided 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.

6.63 It has been suggested that some arbitral tribunals, when faced with a clause which permits it to determine the applicable law by reference to the conflict of law rules 'which it considers applicable', will simply choose an applicable law and then seek to justify the choice by finding a conflict of laws rule which points to that applicable law.[92] However, if the arbitral tribunal adopts this approach then it brings greater uncertainty in the arbitral process. In effect, by ignoring the application of conflict of laws rules the arbitral tribunal directly applies a substantive law ('*voie directe*'). The conflict of laws rules in some countries may prescribe how the arbitral tribunal is to determine the applicable law. For example, under the United States' conflict of laws rules—section 188(2)(a) and (3) of the Restatement of Law (2d) of Conflict of Laws, vol 1, the place where the contract was agreed is significant to determining the relevant applicable law. Similarly, under Syrian law the place where the contract was agreed determines the applicable law.[93] In contrast the German conflict of laws rules does not consider that the place where the contract was agreed is a significant factor in determining the applicable law.[94]

6.64 The 1988 ICC Rules of Arbitration provided that where the applicable law was not specified by the parties then the arbitral tribunal was to determine the applicable law 'by the rule of conflict which he deems appropriate'.[95] In *Agent (Syria) v Trading Co (Germany)*[96] the arbitral tribunal stated that Article 13.3 of the 1988 Rules of Arbitration prohibited them from determining the applicable law by direct application. The arbitral tribunal held that Swiss rules of conflict

[91] (1985) X Ybk Comm Arbn 52.

[92] J Lew, *A Practical Guide to the New Arbitration Act 1996 Scope and purpose of the New Act*, IBC Conference, 4 July 1996.

[93] Syrian Civil Code 1949, art 20(1).

[94] Introductory Law of the Civil Code, art 28.

[95] Article 13.3. Note, however, that the 1998 Rules of Arbitration now permit the arbitral tribunal to determine the applicable law without reference to conflict of laws rules.

[96] *Partial Award in Case No 8113 of 1995*, (2000) XXV Ybk Comm Arbn 324.

of laws should not be used even though Zurich was the seat of the arbitration because the contractual relationship between the parties has no connection whatsoever with Switzerland. The arbitral tribunal took into account the following factors: that the claimant was a Syrian citizen whose place of business was in Syria, that the services were to be performed in Syria, with a view to obtain a Syrian contract with a Syrian authority. On this basis the arbitral tribunal held that Syrian conflict of laws rules had the closest connection to the dispute and were therefore applicable.

Direct application of the applicable law

The concept of the delocalized arbitration brings into question the need for **6.6** deciding the choice of law provision by reference to any conflict of laws rules. Party autonomy, which has been described[97] as 'an international conflict of law rule as part of public international law', permits the parties to choose their own applicable law without reference to any conflict of laws rules. The 1998 ICC Rules of Arbitration,[98] for example, permit the arbitral tribunal to directly select the applicable law without reference to conflicts of law rules. Equally the American Arbitration Association (AAA) International Rules permit direct selection of an applicable law. The theoretical basis for the delocalized arbitration permits the arbitral tribunal to float free from national laws, and in particular the *lex arbitri*, and its only constraints are principles of international public policy. The approach has been criticized because of the uncertainty that can occur.[99]

> One purpose of conflict of laws rules is to provide parties with a measure of certainty about substantive law governing their conduct. 'Directly' applying a substantive law without conflict of laws analysis leaves the parties' substantive rights to turn on subjective, unarticulated instincts of individual arbitrators and does little to further interests of predictability or fairness. The better (albeit difficult) course is to develop conflicts of laws rules which can be predictably and transparently consulted and applied in reasoned awards.

Some modern arbitration legislation reflects a movement away from a conflict of **6.6** laws approach. Under French law, for example,[100] 'the arbitrator shall decide the dispute according to the rules of law chosen by the parties; in the absence of such a choice, he shall decide according to the rules of law he deems

[97] AFM Maniruzzaman, 'Choice of Law in International Contracts—Some Fundamental Conflict of Law Issues' (1999) 16 Journal of International Arbitration (No 4), 141–71.

[98] Article 17(1) and (2) of the ICC Rules of Arbitration states: '1. The parties shall be free to agree upon the rules of law to be applied by the Arbitral Tribunal to the merits of the dispute. In the absence of any such agreement, the Arbitral Tribunal shall apply the rules of law which it determines to be appropriate. 2. In all cases, the Arbitral Tribunal shall take account of the provisions of the contract and the relevant trade usages.'

[99] G Born, *International Commercial Arbitration* Part 2, Chapter 7 (2001) at 531.

[100] New Code of Civil Procedure of 1981, art 1496.

appropriate. In all cases he shall take into account trade usages.'[101] Similarly under Swiss law:[102] 'The arbitral tribunal shall decide the dispute according to the rules of law chosen by the parties or, in the absence of such a choice, according to the rules of law with which the case has the closest connection.'

6.67 In *ICC Case No 6527*[103] a dispute arose regarding the sale of goods between an Austrian buyer and a Turkish seller. The contract did not provide for the proper law of the contract but included a reference that arbitration would be referred to the ICC. Under the ICC Rules of Arbitration, applicable at the time, the arbitral tribunal was to decide the proper law in accordance with conflict of law rules, which it deemed appropriate. The arbitral tribunal considered whether it should apply the conflict of laws rules in force at the place of the arbitration in 'accordance with the classical doctrine on conflicts of law'. The arbitral tribunal, however, noted that this doctrine had been criticized in respect of arbitral proceedings because of the fact that the arbitral tribunal, unlike a judge, had no *lex fori* (the law of the forum). The arbitral tribunal therefore applied general principles of private international law as stated in international conventions. The arbitral tribunal examined the Hague Convention, which provided that where the proper law of the contract was not specified then that law should be the law of the place of residence of the seller. The arbitral tribunal also considered the Rome Convention, which pointed to the State that has the most significant connection with the contract. The arbitral tribunal noted that although neither the Hague Convention nor the Rome Convention had been ratified by Austria or Turkey it was entitled to take note of these Conventions as setting prevailing principles in private international law. On the facts of the case the arbitral tribunal found that the proper law of the contract was therefore Turkish law.

Ascertainment of the law to determine the approach

6.68 Prior to deciding whether it should choose the applicable law by direct application or by a conflicts of law approach the arbitral tribunal will need to decide on what law it should base its decision. The right to choose a law by direct application or by conflict of laws rules is a right based upon a municipal law. For example, French law permits the arbitral tribunal to apply an applicable law by direct application. However, on what basis should the arbitral tribunal decide

[101] This is similar to the provision with art 17(2) of the ICC Rules of Arbitration. It has been suggested in some ICC awards that this provision and provisions relating to good faith and good will indicate that the parties intend that the *lex mercatoria* should be applied to resolve the dispute rather than any national law: *Sapphire International Petroleums v NIOC* (1967) 35 International Law Reports 136, (1964) 13 ICLQ, 1011.

[102] Swiss Private International Law Act of 1987, art 187 (1).

[103] (1991) 7 ICC Ct Bull (No 1, May 1996) 88.

that it ought to apply French law? In this section we consider the different methods that the arbitral tribunal can adopt in order to ascertain which law is applicable to this question. This is therefore a first step which needs to be undertaken before the arbitral tribunal can rule on the conflict of laws rules to be adopted or whether it is permitted to select the applicable law by direct application. The various approaches that can be used by the arbitral tribunal are: (1) the law of the place which would have had jurisdiction but for the arbitration clause; (2) the law of the seat of the arbitration; (3) the laws of all countries which have a connection with the dispute; (4) the application of no law; or (5) a law derived from International Treaties.

The law of the place which would have had jurisdiction but for the arbitration clause

6 There is a line of argument which suggests that the conflict of laws rules which ought to be applied are those that would have been applied but for the arbitration clause.[104] The rationale for this is that the arbitration agreement permits the arbitral tribunal to stand in the place of a court. However, it does not free the arbitral tribunal from applying the law which that court would have to apply. This theory has not gained widespread acceptance and can be criticized because it leaves open the issue of which country has jurisdiction over the dispute.[105] A number of countries may claim that the conflict of laws rules should be determined under their particular law. There appears to be no arbitration where this theory has been adopted.[106]

The law of the seat of the arbitration

6 The traditional approach has been to look to the conflict of laws rules at the seat of the arbitration in order to determine the approach for deciding the applicable law.[107] The conflict of laws rules of the seat may permit the arbitral tribunal to choose a law by a reference to a set of conflict of laws rules which has its closest connection to the dispute or may permit the arbitral tribunal to decide what the applicable law is without reference to a set of conflict of laws rules. In *Lebanese distributor v Western European car manufacturer*[108] the above approach was agreed by the parties. The facts of the case were that a dispute arose which was referred to arbitration under the ICC Rules of Arbitration in Paris. The parties agreed that the arbitral tribunal had to determine the law applicable to the

[104] D Anzilotti, *Rivista di Diritto Internazionale* (1906), 467.

[105] B Wortmann, 'Choice of Law by Arbitrators: The Applicable Conflict of Laws System' (1998) 14 Arbitration International (No 2), 97–114.

[106] C Croft, 'The Applicable Law in International Commercial Arbitration: Is it Still a Conflict of Laws Problem?' (1982) Intern Lawyer 613, 624.

[107] See further paras 7.09–7.16.

[108] *ICC Award No 1250 made in 1964* (1980) V Ybk Comm Arbn 168.

contract by starting with the French rules of conflict of laws (ie the conflict of laws rules of the seat of the arbitration). These rules permitted the arbitral tribunal to look at laws other than those at the seat of the arbitration. In particular the choice of applicable law was to be determined having regard to the express or implied choice of law by the parties.

6.71 This approach has certain advantages especially where the seat of the arbitration is agreed at the outset. In such cases there is a great deal of predictability as to the applicable law. However, where the seat of the arbitration has not been agreed then there will be uncertainty because the nominating authority can select a seat in almost any jurisdiction. This may result in the arbitral tribunal finding that the applicable law is one which neither party intended to be imposed. The parties' choice of the seat of the arbitration will also have little to do with that country's conflict of laws rules. If the parties choose a seat it is usually because it is a convenient neutral location. If the seat of the arbitration is chosen by an arbitral institution, for example, then it cannot be said that this choice of conflict of laws reflects the express or implied choices by the parties. The benefits and detriments of using the seat of the arbitration as the basis of the choice of conflict of laws rules have been expressed as follows:[109] 'Summing up, it has to be said that the advantages of the seat approach, namely the implied predictability of disputes' results, only carry weight as long as the parties have agreed upon the seat of the arbitration. Otherwise it appears that the disadvantages of the theory prevail.'

The laws of all countries which have a connection with the dispute

6.72 An approach which has been used on occasion is to determine which countries' laws have a connection with the dispute and then ascertain whether all their conflict of laws rules lead to a jurisdiction which can establish the applicable law.[110] If they do then the arbitral tribunal can adopt the applicable law based on that jurisdiction's conflict of laws rules without fear that a challenge will subsequently be made to that choice. This is a theory known as a 'false conflict'. It is 'false' because the arbitral tribunal does not choose a conflict of laws rule. It jumps the first step and simply adopts a countries conflict of laws rules because all choices lead it there. However, it is a time consuming and costly exercise and in many cases there will not be a single conflict of laws rule which can be adopted.

[109] B Wortmann, 'Choice of Law by Arbitrators: The Applicable Conflict of Laws System,' (1998) 14 Arbitration International (No 2) 97, 107.

[110] ICC Award No. 953/1956 '... the principles of international private law developed in Germany, as well as in Greek law and in Swiss law, led to the same result ...' referred to by B Wortmann, 'Choice of Law by Arbitrators: The Applicable Conflict of Laws System', (1998) 14 Arbitration International (No 2) at 108.

The application of no law

An alternative to the above approaches is for the arbitral tribunal to choose the applicable law or the conflict of laws rules to apply directly and, at this stage, without reference to private international law. The rationale for this is that an arbitral tribunal, in an international commercial arbitration, is not like a judge. It does not have a 'forum' from which it derives its jurisdiction. The arbitral tribunal is a creature of contract. It is therefore a legal fabrication to require it to make a choice of applicable law by reference to a national law. In the *BP* arbitration[111] this approach was specifically endorsed by a leading international arbitrator. Judge Lagergren stated that:[112]

> In contradistinction to all national courts, the ad hoc international arbitral tribunal created under an agreement between a State and an alien, such as the present Tribunal, at least initially has no lex fori which, in the form of conflicts of law rules or otherwise, provides it with the framework of an established legal system under which it is constituted and to which it may have ultimate resort. With respect to the law of the arbitration, the attachment to a designated national jurisdiction is restricted to what, broadly speaking, constitute procedural matters and does not extend to the legal issues of substance. It is erroneous to assume, as has been done doctrinally, on the basis of the territorial sovereignty of the State where the physical seat of an international arbitral tribunal is located, that the lex arbitri necessarily governs the applicable conflicts of law rules. Even less does it necessarily constitute the proper law of the contract. Instead, if the parties to the agreement have not provided otherwise, such an arbitral tribunal is at liberty to choose the conflicts of law rules that it deems applicable, having regard to all the circumstances of the case

The genesis of this approach can be seen in the case of *Sapphire International Petroleums v NIOC.*[113] In this case the arbitral tribunal held that it was not bound by any conflict of laws rules at the seat of the arbitration and that any choice of conflict rules must be based on the common intention of the parties. The arbitral tribunal therefore considered that its starting point was to analyse the terms of the contract and distil the law applicable from the terms of the contract. In effect the arbitral tribunal endorsed the principle of a *lex contractus.*[114] It is of note that if the arbitral tribunal had applied Iranian law[115] then Sapphire would not have been protected against changes in legislation made in Iran. This conflicted with an obligation within the contract of good faith and goodwill. The arbitral tribunal therefore concluded that this provision created a

[111] *British Petroleum v Libya (Merits)* (1979) 53 ILR 297.

[112] ibid at 326.

[113] (1967) 35 International Law Reports 136, (1964) 13 ICLQ 1011.

[114] See paras 6.25 et seq above.

[115] This was the law of the place where the contract was made and the place of execution of the contract.

negative indication that the parties intended Iranian law to apply. Furthermore, the arbitral tribunal held that the reference to the obligation of good faith indicated that the parties did not intend to apply the strict rules of a particular legal system, but instead that they intended to rely upon the rules of law common to civilized nations. Therefore, the arbitral tribunal held: 'It is in the interest of both parties to such agreements that any disputes between them should be settled according to the general principles universally recognized and should not be subject to the particular rules of national laws.'

International treaties

5.75 An approach adopted in *ICC Case No 6527*[116] was to ignore national conflicts of law rules and to derive a supranational conflict of laws rule from international treaties. In *ICC Case No 6527* the arbitral tribunal considered both the Rome Convention and Hague Convention. The Rome Convention has been enacted in many European States.[117] The Rome Convention is not limited simply to disputes amongst the European signatories to the Convention but extends to all contract cases involving a foreign element. The Rome Convention applies 'to contractual obligations in any situation involving a choice of law between different countries'.[118] Although the Convention does not apply to arbitration agreements[119] it will apply to the rest of the contract that contains an arbitration clause.

5.76 The Rome Convention expressly supports the choice of law clauses within a contract.[120] The choice may be express or implied. An implied choice of a country's law may be found in a clause providing for arbitration in that country, particularly where the contract contains standard clauses with well-known meanings according to the law of that country. In *Egon Oldendorff v Libera Corp*[121] the court held that the arbitration clause itself, which was not subject to the Rome Convention, indicated impliedly the choice of law by the parties to govern the balance of the contract. However, not all European courts have interpreted the Rome Convention in the way that the English courts have. The choice of arbitral forum is not always considered as an implied choice by the parties. In particular, the choice of arbitral forum by an arbitral institution nominated by the parties should not be considered as an implied or tacit choice by the parties. In such cases the contract should be governed by the law of the

[116] (1991) 7 ICC Ct Bull (No 1, May 1996) 88.

[117] In England the Rome Convention was brought into effect by the Contracts (Applicable Law) Act 1990.

[118] Article 1(1).

[119] Article 1(2)(d).

[120] Article 3(1).

[121] *Egon Oldendorff v Libera Corp* [1995] 2 Lloyd's Rep 64, [1996] CLC 482; and *Egon Oldendorff v Libera Corp (No 2)* [1996] 1 Lloyd's Rep 380.

country which has a 'stricter connection' to the contract.[122] The Rome Convention also lays down rules for determining the applicable law. Factors to take into account include: (1) the law of the country which is most closely connected with the contract; (2) the place of residence or place of business of a party who is performing the contract.[123]

Summary

6.77 The arbitral tribunal has to undertake a three-stage process in order to determine the applicable law. The arbitral tribunal must (a) choose which conflict of laws rules will govern the dispute; (b) apply those conflict of laws rules in order to ascertain the applicable law; and (c) apply the applicable law to the substance of the dispute. If the parties have specified a seat for the arbitration then the conflict of laws rules that the arbitral tribunal is likely to adopt will be those of the seat. Where no seat is specified then the arbitral tribunal may look to the conflict of laws rules of the county which has the closest connection to the dispute and then see whether there is some other law which ought to apply instead.[124] Having chosen the conflict of laws rules to apply the arbitral tribunal must then determine the applicable law. The conflict of laws rules will specify how the arbitral tribunal chooses the applicable law. The conflict of laws rules may require the arbitral tribunal to choose a specific law: for example, the law with the closest connection with the contract or if a law has been chosen by the parties then that law. Alternatively, the conflict of laws rules may permit the arbitral tribunal to choose the applicable law without reference to any external factor, '*voie directe*'. The law chosen by the arbitral tribunal need not be a municipal law but may be transnational law or principles of equity. However, whether an arbitral tribunal is entitled to choose a law other than a municipal law will depend on the arbitration laws of the seat of the arbitration and any rules of arbitration which the parties have selected.

[122] Article 4(2).

[123] The commercial court in *Tonicstar Ltd v Amercian Home Assurance Co* [2004] EWHC 1234 (Comm) held that where there was 'no implied choice of law, there is a presumption under the Rome Convention that the applicable law is that of the place of business of the party whose performance is characteristic of the contract'. However, it is possible for these two factors set out in the Rome Convention to be in conflict and it is not clear when one will override the other: *Definitely Maybe (Touring) Ltd v Marek* [2001] 4 All ER 283.

[124] This is the approach taken within Article 4 of the Rome Convention.