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COMMENTS

The Selection Of Choice Of Law Provisions In International Commercial Arbitration: A Case For Contractual *Depeçage*

I. INTRODUCTION

With the tremendous growth in international trade, international commercial arbitration has become a frequently-used mechanism to settle contractual disputes.[1] There have been several traditional reasons why parties opt for international arbitration instead of litigation in national courts. For one, arbitration may speed the resolution and lower the expenses of disputes because it often avoids the delays associated with court litigation.[2] Parties who use arbitration also have the ability to select factfinders with experience and competence in the particular business area or the legal issues of the dispute.[3] Other benefits of arbitration include the reduction of uncertainties and complexities that accompany foreign litigation and the provision of a more neutral, convenient and certain forum of dispute resolution.[4] Of course, arbitration may involve costs that litigation does not include;[5] the expense of administrating the

1 REDFERN & HUNTER, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 17 (1986); Kerr, *International Arbitration v. Litigation*, 1980 J. BUS. L. 164, 164 (1980) (use of arbitration clauses in international transactions is "almost universal").

2 Ehrenhaft, *Effective International Commercial Arbitration*, 9 LAW & POL'Y INT'L BUS. 1191, 1191 (1977) (litigation tends to be expensive and protracted); Danielowicz, *The Choice of Applicable Law in International Arbitration*, 9 HASTINGS INT'L & COMP. L. REV. 235, 236 (1986); Note, *General Principles of Law in International Commercial Arbitration*, 101 HARV. L. REV. 1816, 1817 (1988).

3 Ehrenhaft, *supra* note 2, at 1193.

4 Danilowicz, *supra* note 2, at 236-7.

5 De Vries, *International Commercial Arbitration: A Contractual Substitute for National*

proceedings,[6] the delays inherent in selecting arbitrators and scheduling hearings,[7] and the relatively lesser ability to implement discovery[8] are not insignificant drawbacks of the process. In spite of these problems, the practice of using arbitration to resolve international contractual disputes is turning into an "almost universal" custom.[9]

One additional advantage of arbitration, the parties' ability to predetermine the law governing the resolution of the dispute, has gained growing recognition in recent years.[10] This recognition, however, has been myopic to some extent. Some commentators see choice of law options confined either to the selection of one national legal system from several possibilities[11] or to the selection of a single national, international, or anational legal system.[12] Such a self-imposed limitation of the applicable law to one system of law often denies parties many of the benefits and powers allowed them in international commercial arbitration. As an alternative, an agreement may direct an arbitrator to apply different systems of law to different areas of the dispute.[13]

This Comment will present the benefits and limitations of this alternative, which may be described as contractual *depeçage*.[14] Through a comparison of United States and German law, the first section will demonstrate the advantages of a choice of law provision in an international commercial arbitration agreement. An examination of the four types of choice of law options in the second section will reveal how an international arbitration that applies contractual *depeçage* principles may allow parties to maximize the benefits of choice of law provisions. The final section discusses how the intervention of national judicial institutions may entirely eliminate these benefits.

Courts, 57 TUL. L. REV. 42, 61 (1982); Higgins, Brown and Roach, *Pitfalls in International Commercial Arbitration*, 35 BUS. LAW. 1035, 1038 (1980); Ehrenhaft, *supra* note 2, at 193.

6 Kerr, *supra* note 1, at 176; De Vries, *supra* note 5, at 61; Ehrenhaft, *supra* note 2, at 1194.

7 Kerr, *supra* note 1, at 176; Ehrenhaft, *supra* note 2, at 1194.

8 Ehrenhaft, *supra* note 2, at 1193.

9 Kerr, *supra* note 1, at 164.

10 *See* Branson & Wallace, *Choosing the Substantive Law to Apply in International Commercial Arbitration*, 27 VA. J. INT'L L. 39, 39 (1986); DELAUME, LAW AND PRACTICE OF TRANSNATIONAL CONTRACTS 4 (1988); Note, *supra* note 2, at 1817.

11 *See* Branson & Wallace, *supra* note 10, at 39-42.

12 *See* YATES, *Arbitration or Court Litigation for Private International Dispute Resolution: The Lesser of Two Evils*, in RESOLVING TRANSNATIONAL DISPUTES THROUGH INTERNATIONAL ARBITRATION 233 (T. Carbonneau ed. 1982); REDFERN & HUNTER, *supra* note 1, at 72-3; Danielowicz, *supra* note 2, at 237.

13 *See* DELAUME, *supra* note 10, at 9.

14 "Depeçage can be defined broadly to cover all situations where the rules of different states are applied to govern different issues in the same case." Reese, *Depeçage: A Common Phenomenon in Choice of Law*, 73 COLUM. L. REV. 58, 58 (1973).

II. IMPORTANCE OF THE CHOICE OF LAW

A. The Outcome Determinative Quality of the Choice of Law

From the onset, it is important to note that an arbitrator might not limit the application of a transnational contract's choice of law clause only to situations where the substance of the contract is in dispute.[15] In arbitration, the chosen law may affect decisions concerning the hearings' procedure[16] or the agreement to arbitrate itself.[17] As a consequence, parties have much potential influence over the process and the product of an international commercial arbitration.

The best way to illustrate the significant outcome-determinative quality of choice of law provisions is to select two different systems of law and demonstrate how each would lead to different results in an arbitral setting, given certain factual problems and circumstances. Thus, the following sections will contrast the resolution of issues pertaining to the substance of the contract, the procedures of the arbitration, and the agreement to arbitrate under the legal systems of two nations heavily involved in international commerce: the United States and Germany.[18]

1. Substance of the Contract

By far the most important aspect of a choice of law provision is its effect on the resolution of disputes over the substance of the contract. The result of an arbitration, given a fixed set of facts, may entirely hinge upon which rule or rules the arbitrator applies. In such a case, the parties truly can dictate the outcome of arbitration by indicating in advance what rules will cover questions of contract validity and enforcement. A choice between two nations' laws thus can become a choice of which party will be victorious at arbitration.

a. Validity of the Contract

EXAMPLE (1): Widgetco, a firm based in the United States, agrees

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15 Danilowicz, *supra* note 2, at 237; Branson & Wallace, *supra* note 10, at 44.

16 Branson & Wallace, *supra* note 10, at 45; Danilowicz, *supra* note 2, at 237.

17 Danilowicz, *supra* note 2, at 237; *see* Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, Art. V(1)(a), 21 U.S.T. 2517, T.I.A.S. No. 6997, 220 U.N.T.S. 3 [hereinafter New York Convention].

18 The reference to the United States' "legal system" is misleading to some extent. The use of the term implies that there is a single set of contract principles applicable in the United States. There are, however, 50 separate state jurisdictions that establish their own contract laws. For the sake of clarity, this Comment discusses legal principles that are essentially consistent among the jurisdictions, and it will refer to these principles as "United States law." The Federal Republic of Germany, on the other hand, maintains a unified law of contracts; thus, the same type of terminology difficulties does not develop.

to manufacture a given number of widgets for Consumerco, a German company, and deliver them by the end of the year. Because of the difficulty of obtaining alternative sources of widgets, Consumerco requires Widgetco to promise to pay Consumerco 50% of the contract price as a "penalty" if Widgetco fails to deliver. The amount of the penalty was clearly designed to deter Widgetco from breaching its obligation and was not calculated to represent liquidated damages. Later, Widgetco finds a higher bidder for the widgets and defaults. Issue: Is the agreement to pay the default penalty valid?

The answer to the dispute depends upon which system of law a court or arbitrator applies. Since the rule in the United States concerning the validity of penalty clauses is the opposite of that in the Federal Republic of Germany, Consumerco's success in collecting the penalty hinges on the chosen law.

In the United States, both statutory and common law prohibit the enforcement of agreements for the payment of penalties upon breaches of contract.[19] To be enforceable, a predetermined payment due upon default must be a reasonable estimate of damages that are difficult or impossible to ascertain prior to the breach; otherwise, the payment is considered a penalty and will not be valid.[20] Some courts additionally require a showing that the parties intended the payment to be liquidated damages in order to enforce the promise.[21]

A court in the United States would find Example (1) to involve a penalty.[22] In *Samson Sales, Inc. v. Honeywell, Inc.*,[23] defendant agreed to pay plaintiff a specified sum in case defendant's security system failed to operate properly. The court held that this sum represented a penalty since the damages would have been easy to estimate through a valuation of the goods to be protected.[24] Similarly, the parties in Example (1) would have also been able to easily forecast the damages caused by a breach since both the price of widgets under the contract and the prevailing market price would be easy to determine.[25] Thus, Widgetco would

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19 U.C.C. § 2-718(1) (1977); Samson Sales, Inc. v. Honeywell, Inc., 12 Ohio St. 3d 27, 28, 465 N.E.2d 392, 394 (1984); Southeastern Land Fund, Inc. v. Real Estate World, Inc., 237 Ga. 227, 228, 227 S.E.2d 340, 342 (1976); Kealy v. Harter, 682 F.2d 198, 200 (8th Cir. 1982); RESTATEMENT (SECOND) OF CONTRACTS § 356.

20 Samson Sales, 12 Ohio St. 3d at 28, 465 N.E.2d at 394; Southeastern, 237 Ga. at 230, 227 S.E.2d at 343; Kealy, 682 F.2d at 200.

21 Southeastern, 237 Ga. at 230, 227 S.E.2d at 343; Kealy, 682 F.2d at 200.

22 *See* Samson Sales, 12 Ohio St. 3d at 29, 465 N.E.2d at 394; Southeastern, 237 Ga. at 230, 227 S.E.2d at 343; Kealy, 682 F.2d at 200.

23 12 Ohio St. 3d 27, 465 N.E.2d 392 (1984).

24 *Id.* at 29, 465 N.E.2d at 394.

25 Under the Uniform Commercial Code, the restitution damages for Widgetco's breach would

not have to pay the penalty sum if United States law were applied to the case.

In contrast, the general rule in Germany is that a defaulting party must pay any penalty to which it agreed in the contract.[26] This rule, of course, is not unlimited. If a court finds that the amount of the penalty is unreasonably high, it may reduce the penalty to a reasonable level.[27] Thus, a German court would have to enforce a promise by one party to pay a penalty to another in the event of a breach.[28]

The penalty in Example (1) would clearly be enforceable under German law.[29] In a 1974 decision, the *Bundesgerichtshof* (German high court) allowed a jukebox distributor to collect a 2,000 DM penalty for which her contract with a defaulting tavern owner provided.[30] Likewise, German law would require Widgetco to pay its contractual penalty upon its default[31] although a court might reduce the amount.[32] In sum, an arbitrator or court would reach contrasting decisions regarding the validity of the penalty provision depending on whether it was bound by German or United States law.

b. Performance of the Contract

EXAMPLE (2): Yankeecorp, an American firm, agrees to sell and export widgets to Tehranco, an Iranian firm. After several months of untroubled performance, an Islamic revolution occurs in Iran and causes, among other things, changes in laws and disruption of normal commerce, making further performance of the contract impracticable. Issue: What relief is available to the parties?

The United States and German systems of law require two different

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be "the difference between the market price at the time when the buyer learned of the breach and the contract price." U.C.C. § 2-713 (1977).

26 BGB § 339; Judgment of November 27, 1974, Bundesgerichtshof, Neue Juristische Wochenschrift 1975, 163. BGB § 339 reads in part: "If the [obligor] promises the [obligee] the payment of a sum of money as a penalty in case he does not perform his obligation or does not perform it in the proper manner, the penalty is forfeit if he is in default. . . ." Translation from FORRESTER, GOREN AND ILGEN, THE GERMAN CIVIL CODE 55 (1975).

27 BGB § 343. This code section reads in part: "(1) If a penalty which is due is disproportionately high, it may be reduced to a reasonable amount by court decision on the application of the [obligor]. In the determination of reasonableness every legitimate interest of the [obligee], not merely his property interest, shall be taken into consideration." Translation from FORRESTER, GOREN AND ILGEN, THE GERMAN CIVIL CODE 56 (1975).

28 *See* Judgment of November 27, 1974, Bundesgerichtshof, Neue Juristische Wochenschrift 1975, 163.

29 *Id.*

30 *Id.*

31 BGB § 339.

32 BGB § 343.

resolutions to the situation in Example (2). In the United States, the doctrine of commercial impracticability[33] would allow a court or arbitrator to excuse performance by both parties.[34] In order to be excused from performance under the doctrine, a party must demonstrate that a contingency has occurred to make performance impracticable and that the occurrence of the contingency was a "basic assumption" on which the contract was made.[35] "The relevant inquiry is whether the risk of the occurrence of the contingency was so unusual or unforeseen and the consequences of the occurrence of the contingency so severe that to require performance is to grant the buyer an advantage he did not bargain for in the contract."[36]

The exporter in Example (2) could easily meet these requirements. In *McDonnell Douglas Corp. v. Islamic Republic of Iran*,[37] Iran sued a United States defense manufacturer for damages resulting from the firm's failure to provide replacement parts as called for by the contract. Because of the political turmoil that developed from the Iranian Revolution and the subsequent export prohibitions that the United States imposed, the court found that it was "commercially impracticable" for the defense manufacturer to deliver the parts to Iran,[38] and it therefore released the firm from its obligation to perform.[39]

A court or arbitrator would resolve the above example in a different way if it had to apply German law. Through the German Civil Code provision that requires contracting parties to deal in good faith,[40] the

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33 "Although impossibility or impracticability of performance may arise in many different ways, the tendency has been to classify the cases into several categories. These are: 1) Destruction, deterioration or unavailability of the subject matter or the tangible means of performance; 2) Failure of the contemplated mode of delivery or payment; 3) Supervening prohibition or prevention by law; 4) Failure of the intangible means of performance and 5) Death or illness." BLACK'S LAW DICTIONARY 680 (5th ed. 1979).

34 U.C.C. § 2-615(a) (1977); Waldinger Corp. v. CRS Engineers, Inc., 775 F.2d 781, 786 (7th Cir. 1984); Nora Springs Coop. Co. v. Brandau, 247 N.W.2d 744, 748 (Iowa 1976); Eastern Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429, 438 (S.D. Fla. 1975). U.C.C. § 2-615(a) reads in part: "Delay in delivery or non-delivery in whole or in part by a seller. . .is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid."

35 Waldinger, 775 F.2d at 786; Nora Springs, 247 N.W.2d at 748; Eastern Air Lines, 415 F. Supp. at 438.

36 Waldinger, 775 F.2d at 786 (citation omitted).

37 591 F. Supp. 293 (E.D. Mo. 1984), *aff'd on other grounds*, 758 F.2d 341 (8th Cir. 1985).

38 *Id.* at 299.

39 *Id.*

40 BGB § 242. The text of this section reads: "The [obligor] is bound to effect performance according to the requirements of good faith, giving consideration to common usage." Translation from FORRESTER, GOREN AND ILGEN, THE GERMAN CIVIL CODE 41 (1975).

German high courts have developed the doctrine of *Geschäftsgrundlage* (foundation of the transaction) that deals with matters of impossibility, commercial impracticability, and frustration of contract.[41] The doctrine essentially allows a court to "adjust" (*anpassen*) the terms of a contract[42] in the event that the "foundation" of the agreement has been severely impaired or destroyed, regardless of cause.[43] Consequently, a court may equalize the position of the parties and compensate for the disruptions caused by the unforeseen event.[44]

In practice, this doctrine would solve Example (2)'s performance problem in a manner quite different from its counterpart in the United States. In one case[45], the *Bundesgerichtshof* encountered a dispute where an Iranian import firm was unable to further perform its contract with a German beer distributor because of the newly-formed Iranian government's prohibition of the sale of alcohol. The court determined that this new law rendered the Iranian firm's performance impossible, destroyed the foundations of the contract, and therefore required the excuse of both parties' further performance.[46] As a result, however, the two parties had to jointly bear the loss of this change, and the German brewery had to partially repay the Iranian firm for the beer that was delivered but not sold.[47] Example (2) almost exactly parallels the circumstances of this case and would most likely lead to a similar resolution of the dispute if German law applied.[48]

In sum, the laws of Germany and the United States present different methods of resolving performance difficulties. While a United States court would excuse performance without taking subsequent losses into account, a German court would ensure that the parties would jointly bear resulting losses in an equitable manner.

These two examples demonstrate how the systems of law in the United States and the Federal Republic of Germany confront issues of contractual validity and performance with varying approaches. Given these differences, the outcome of an arbitration will greatly depend on

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41 Dawson, *Judicial Revision of Frustrated Contracts: Germany*, 63 B.U.L. REV. 1039, 1040 (1983).

42 *Id.* at 1039.

43 *Id.* at 1040.

44 *Id.* at 1097; 2 MUENCHENER KOMMENTAR ZUM BUERGERLICHEN GESETZBUCH 205 (H. Heinrichs ed. 1984); Judgment of February 8, 1984, Bundesgerichtshof, Neue Juristische Wochenschrift 1984, 1746, 1747.

45 Judgment of February 8, 1984, Bundesgerichtshof, Neue Juristische Wochenschrift 1984, 1746.

46 *Id.* at 1747.

47 *Id.* at 1748.

48 *Id.*

the particular issues disputed and on the particular law identified in the contract as the applicable law.

2. *Arbitration Procedure*

A choice of law provision may also regulate the procedures used in an arbitration.[49] Usually, an agreement to arbitrate makes reference to an institution's rules of arbitration and provides for their governance over the hearings' procedures. These rules, however, often refer to "the governing law" regarding whether an arbitrator may institute certain procedures.[50] Even if the arbitration agreement contains no reference to an established set of rules, other applicable law may require the implementation of particular procedures by the arbitrator.[51] Again, a reference to United States and German laws concerning arbitration procedures demonstrates that the choice of law can have a significant effect on the procedures used in an arbitration.

EXAMPLE (3): Bigco and Megacorp enter arbitration. At one proceeding, Bigco presents a witness who damages Megacorp's case greatly. Counsel for Megacorp therefore desires to cross-examine the witness in order to discredit her testimony. Issue: Must the arbitrator allow counsel to cross-examine the witness?

Depending upon which country's laws the arbitrator must apply, it may or may not be required to allow cross-examination. In Germany, arbitrators almost never allow cross-examination.[52] In German trial proceedings, the judge conducts the examination of the witnesses.[53] Likewise, arbitrators control the questioning during their proceedings.[54] Given that arbitrators have discretion over the hearings' procedures absent expressed agreement by the parties[55] and that German law has no provision concerning cross-examination in an arbitration, the arbitrator in Example (3), if bound by German law, would not have to allow parties

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49 Branson & Wallace, *supra* note 10, at 45; Danilowicz, *supra* note 2, at 237.

50 *See, e.g.*, COMMERCIAL ARBITRATION RULES OF THE AMERICAN ARBITRATION ASSOCIATION, Rule 27 (oaths); Rule 30 (arbitration in absence of a party); Rule 31 (evidence); Rule 41 (time of the award); Rule 42 (form of the award); Rule 45 (delivery of award to parties) (1984).

51 *See* Ehrenhaft, *supra* note 2, at 1205 (statutes such as the United States Arbitration Act may serve as a source of arbitration procedure).

52 GLOSSNER, COMMERCIAL ARBITRATION IN THE FEDERAL REPUBLIC OF GERMANY 17 (1984).

53 *Id.*

54 *Id.* at 17.

55 ZPO § 1034. However, parties to the arbitration may provide for cross-examination in their agreement.

to conduct cross-examination.[56]

Many American jurisdictions take a contrary position. Although an arbitrator in the United States may control cross-examination in order to prevent harassment or intimidation of the witness, the arbitrator generally allows such examination.[57] Moreover, the Uniform Arbitration Act, in force in twenty-six states,[58] provides that "parties are entitled. . .to cross-examine witnesses appearing at the hearing."[59] Thus, an arbitrator in Example (3) would be required to permit cross-examination if the choice of law mandated the application of the Uniform Arbitration Act.[60] These two approaches to the examination of witnesses show how a choice of law provision can have a significant impact on an arbitration hearing's procedure.

3. Agreement to Arbitrate

Parties to a transnational contract may designate their choice of law to apply to the arbitration agreement itself as separate from the contract in general.[61] Courts may be required to settle certain types of issues concerning the agreement to arbitrate under both German and United States law.[62] Regardless of the legal institution making the initial decision, the choice of applicable law should influence the resolutions of disputes over the validity and application of the arbitration agreement.[63]

EXAMPLE (4): Americorp and Deutschfirm conduct a transaction whose characteristics place it outside the scope of both the Uniform Commercial Code and the German Commercial Code. The parties agree to resolve any future disputes arising from the transaction through arbitration. This agreement is contained in a clause conspicuously printed within the body of the main contract. Issue: Does a legally enforceable agreement to arbitrate exist?

By this point, the reader should not be surprised that the answer to this issue depends on the applicability of German or United States law. On one hand, a German court would find that the agreement to arbitrate

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56 GLOSSNER, *The Federal Republic of Germany*, in 1 INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION 12 (P. Sanders ed. 1984).

57 HOLTZMANN, *The Unites States*, in 2 INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION 18 (P. Sanders ed. 1984).

58 *Id.* at 2.

59 Uniform Arbitration Act § 5(b) (1987).

60 *Id.*

61 *See* Danilowicz, *supra* note 2, at 237.

62 For the United States, *see* United States Arbitration Act, *infra* note 136, at §§ 4 (validity), 10(d) (powers of arbitrator), 11(b) (scope); for the Federal Republic of Germany, *see* ZPO §§ 1026 (form), 1027 (form), 1045 (termination), 1046 (scope).

63 *But see infra* notes 142-60 and accompanying text.

in Example (4) would be invalid.[64] The German Civil Code requires that an agreement to arbitrate be in writing and contain no other agreements (except relating to arbitration procedure).[65] Since the agreement in Example (4) was not separate from the main contract, it would not be enforced under German law.[66]

If United States law governed, the arbitration agreement in Example (4) would be valid.[67] As in Germany, an agreement to arbitrate must be in writing in order to be enforced.[68] However, no courts or legislatures in the United States have developed any further requirements concerning the form of such an agreement.[69] As a result, an otherwise valid arbitration clause embedded within a contract, such as the one in Example (4), is enforceable if United States law applies.[70] This difference in the two nations' laws regarding arbitration agreements demonstrates how a choice of law provision can be quite determinative in the effect of an arbitration agreement.

The foregoing analysis demonstrates the importance of a transnational contract's choice of law provision. Not only can that choice influence the ultimate outcome of an arbitration, but it can also affect whether certain procedures will be available to parties in the proceedings and whether such proceedings will even take place. By agreeing upon the law that will apply to the substance of the contract, the arbitration procedures, and the agreement to arbitrate, parties to a transnational contract can have a significant impact on the resolution of conflicts between them.

B. Other Benefits of The Choice of Law

Although quite important, the ability to influence the outcome of the dispute is not the sole benefit associated with an adequate choice of law. Other considerations become apparent upon a broader examination of the parties' interests in the overall transaction.

A significant advantage of a choice of law provision is that it prevents the application of conflict of laws rules.[71] Because no party can be sure of which conflict rule will apply in the event of a dispute (unless the

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64 ZPO § 1027.

65 *Id.*

66 *Id.* If the German Commercial Code was applicable to the transaction, this limitation on the form of the agreement would not apply. *Id.* at para. 2. Whether the Code governs depends upon, among other things, whether both parties are considered "merchants" under the Code. *See* HGB §§ 1-7.

67 *See* Prima Paint Co. v. Flood & Conklin, 388 U.S. 395, 401 (1967).

68 U.S.A.A., *infra* note 137, at §§ 2 and 4; Uniform Arbitration Act § 1 (1987).

69 Holtzmann, *supra* note 57, at 4.

70 Prima Paint, 388 U.S. at 401.

71 REDFERN & HUNTER, *supra* note 1, at 94.

forum is contractually set),[72] uncertainty can be great. In addition, the mere application of a nation's conflict of law provisions can be difficult and time consuming in a judicial or arbitral setting.[73] A choice of law clause will eliminate these application expenses as long as it is accompanied by an agreement to arbitrate.[74]

A choice of law provision may be useful in its delineation of the legal rules and parameters of the transaction prior to the development of any dispute.[75] With prior knowledge of the system or systems of applicable law, parties can more readily determine what rules will govern a dispute and what remedies may be available. As a result, the outcome of dispute resolution may be more certain and predictable, and parties may be more inclined to negotiate a settlement, thereby saving the expense of arbitration.[76] In this way, the choice of law may eliminate the need to arbitrate altogether.

Finally, a choice of law clause may allow parties to choose the methods and remedies by which an arbitrator will resolve their disputes.[77] For instance, parties to a contract may foresee the value of maintaining good long-term relationships with each other. In order to minimize disruptions, they may wish to grant an arbitrator powers to reform a contract in light of changed circumstances instead of excusing parties' performance obligations. As noted above, a choice of German law would grant the arbitrator such powers.[78] In sum, parties gain many benefits and advantages by negotiating a choice of law provision in transnational contracts.

III. CHOICES IN THE CHOICE OF LAW

Adequate choices of law clearly decrease many of the risks and costs associated with international commercial disputes. However, still at issue are what constitutes an "adequate" choice of law and whether some choices are better than others for a given contractual setting. Essentially, parties to a transnational contract subject to international arbitration have four types of options: a single international law; anational substan-

72 *See* SCOLES & HAY, CONFLICT OF LAWS 1 (1984) (Rules of conflicts law differ among jurisdictions).

73 *See id.* at 4 (Resolution of conflict of laws issues involve balancing two objectives that are at times opposing: individual justice and protection of societal interest).

74 As opposed to an arbitrator, a court may require that the choice of law bear some reasonable relationship to the transaction. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187.

75 DELAUME, *supra* note 10, at 4.

76 *Id.*; *see* Higgins, Brown and Roach, *supra* note 5, at 1041.

77 *See* Ehrenhaft, *supra* note 2, at 1194 (arbitration can be "custom-tailored to suit the parties' needs and desires").

78 *See supra* notes 40-48 and accompanying text.

tive rules; a single national system of law; and contractual *depeçage*. This Section will examine the four types and determine which maximize the advantages of a choice of law clause.

A. International Law

As international trade has grown at its rapid pace, the need for an international system of commercial law has developed. In response to this need, various international treaties and conventions have attempted to set forth trade-facilitating legal rules.[79] An examination of one such agreement, the United Nations Convention on Contracts for the International Sale of Goods,[80] will show that international treaties do not serve as adequate choices of law by themselves.

The purpose of the CISG was "to set out basic rules to govern international commercial contracts in the absence of expressed contractual provisions to the contrary."[81] After twelve years of work,[82] however, the United Nations only created a document that is full of "indeterminate rules"[83] and that provides no "meaningful guidance in concrete situations."[84]

There are, as a result, numerous examples of provisions in the CISG that offer mere vague and uncertain standards. For instance, certain rules governing applicability of the CISG, such as the place of business determination[85] and the definition of goods,[86] lend themselves to several possible interpretations.[87] References to various contract doctrines, including excuse[88] and good faith,[89] are also without any certain defini-

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79 *See, e.g.*, New York Convention, *supra* note 17; United Nations Convention on Contracts for the International Sale of Goods, *infra* note 80.

80 *Conference on Contracts for the International Sale of Goods*, U.N. Doc. A/CONC. 97/19 (1980), *reprinted in* S. TREATY DOC. No. 98-9, 98th Cong., 1st Sess. 22 (1983) *and* 19 INT'L LEGAL MATERIAL 668 (1980) [hereinafter CISG].

81 S. EXEC. REP. No. 20, 99th Cong., 2d Sess. 1 (1986).

82 *Id.*

83 Note, *Unification and Certainty: The United Nations Convention on Contracts for the International Sale of Goods*, 97 HARV. L. REV. 1984, 1989 (1984).

84 Rosett, *Critical Reflections on the United Nations Convention on Contracts for the International Sale of Goods*, 45 OHIO ST. L.J. 265, 282 (1984).

85 CISG, *supra* note 80, at Art. I, para. 1; *see* Rosett, *supra* note 84, at 279; Note, *Contracts for the International Sale of Goods: Applicability of the United Nations Convention*, 69 IOWA L. REV. 209, 220 (1983).

86 CISG, *supra* note 80, at Art. II; *see* Note, *supra* note 85, at 227.

87 Rosett, *supra* note 84, at 279 (place of business standard); Note, *supra* note 85, at 220 (place of business standard) and 227 (definition of goods). For instance, a place of business under the CISG could mean either the location of a party's primary business activity or simply a permanent foreign office. Note, *supra* note 85, at 220.

88 CISG, *supra* note 80, at Art. LXXIX, para. 1; Note, *supra* note 83, at 1992.

tion.[90] Finally, the CISG provides no guidance as to when its subjective[91] or objective[92] canon of interpretation applies.[93] In sum, the CISG creates too great a potential for conflicting interpretations of its provisions.[94]

The CISG certainly has the advantage of being a neutral body of law since it was thoroughly negotiated under the auspices of the United Nations.[95] Being such a negotiated instrument, however, the CISG resulted in many compromises in order to accomodate the various legal systems of its signators.[96] Another drawback to the CISG is its limited scope. The convention applies only to the commercial sale of goods[97] and excludes contracts concerning distribution agreements[98] or sale of services.[99] The CISG also does not apply to issues of validity, such as unconscionability, mistake, duress, and fraud.[100] Thus, a contract that selects the CISG as applicable law also requires another general body of law to supplement it to avoid any gaps.

In sum, any contract that includes a choice of an international agreement such as the CISG as its exclusive source of applicable law would leave many legal issues to the discretion of the arbitrator, decrease certainty and predictability in the resolution of the dispute, and prevent the parties from enjoying most of the advantages of the choice of law.

B. Anational Substantive Rules

Another response to the growth in international commercial arbitration has been the develoment of anational substantive rules.[101] As the name implies, parties attempt to designate as applicable law a group of

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89 CISG, *supra* note 80, at Art. VII, para. 1; Rosett, *supra* note 84, at 289; Note, *supra* note 83, at 1991.

90 Rosett, *supra* note 84, at 289 (good faith); Note, *supra* note 83, at 1991 (good faith) and 1992 (excuse). For instance, "good faith" may have different connotations depending upon which jurisdiction's definition one uses. Rosett, *supra*, at 290.

91 CISG, *supra* note 80, at Art. VIII, para. 1.

92 CISG, *supra* note 80, at Art VIII, para. 2.

93 Rosett, *supra* note 84, at 288.

94 It has been contended that these problems could be reduced if courts used foreign decisions to help with their own interpretation and application of CISG terms. Note, *The Need for Uniform Interpretation of the 1980 United Nations Convention on Contracts for the International Sale of Goods*, 50 U. PITT. L. REV. 197, 199 (1988).

95 S. EXEC. REP. No. 20, 99th Cong., 2d Sess. 1 (1986).

96 Rosett, *supra* note 84, at 282; Note, *supra* note 83, at 1989.

97 CISG, *supra* note 80, at Art. II.

98 CISG, *supra* note 80, at Art. I; Int'l Trade Rep., May 20, 1987, at 678, col. 1.

99 CISG, *supra* note 80, at Art. III, para. 2.

100 CISG, *supra* note 80, at Art. IV; Rosett, *supra* note 84, at 280; Int'l Trade Rep., May 20, 1987, at 68, col. 1.

101 Smit, *A-National Arbitration*, 63 TUL. L. REV. 629, 629 (1989).

rules that are isolated from the influences of individual countries' laws.[102] Due to their lack of attachment to specific national systems, anational substantive rules supposedly serve as a neutral source of governing law.[103] These rules also may be better suited than national laws to handle certain issues that are exclusively international in nature.[104] Parties to a contract additionally select anational substantive rules because they may serve as a reasonable compromise when the parties are unable to agree upon any other general source of law.[105] These benefits may provide a legitimate basis for the election of anational substantive rules as a choice of law.

More often, however, the lack of clear definition renders these rules inadequate for the choice of law.[106] The two primary forms of anational substantive rules, the general principles of law[107] and the *lex mercatoria*[108], demonstrate this defect. The phrase "general principles of law" has its origins in Article 38 of the Statute of the International Court of Justice.[109] Although widely used in international commercial contracts,[110] the general principles have escaped any definite formulation in international law or academic circles upon which parties can rely when choosing governing law.[111] The *lex mercatoria*, a modern version of the international law merchant,[112] also suffers from a lack of consistent, specific sources[113] although it is recognized generally as being a combination of general principles of law and customs of trade.[114] In sum, neither system offers any clear, definitive rules to apply to international commercial disputes.

Because of this lack of definition, the choice of either the general principles of law or the *lex mercatoria* greatly eliminates benefits that the

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102 *See id.*

103 Note, *supra* note 2, at 1816.

104 REDFERN & HUNTER, *supra* note 1, at 77; Note, *supra* note 2, at 1820.

105 Note, *supra* note 2, at 1816.

106 REDFERN & HUNTER, *supra* note 1, at 86.

107 *See* REDFERN & HUNTER, *supra* note 1, at 85; Note, *supra* note 2, at 1819.

108 *See* Delaume, *Comparative Analysis as a Basis of Law in State Contracts: The Myth of the Lex Mercatoria*, 63 TUL. L. REV. 575, 576 (1989); Highet, *The Enigma of the Lex Mercatoria*, 63 TUL. L. REV. 613, 613 (1989); Note, *supra* note 2, at 1819.

109 *See* Note, *supra* note 2, at 1819 n.16.

110 REDFERN & HUNTER, *supra* note 1, at 84.

111 *See* Note, *supra* note 2, at 1819; REDFERN & HUNTER, *supra* note 1, at 86 (both describing the vagueness of general principles of law).

112 Highet, *supra* note 108, at 617; REDFERN & HUNTER, *supra* note 1, at 89. The *lex mercatoria* is the "system of laws which is adopted by all commercial nations, and constitutes the law of the land." BLACK'S LAW DICTIONARY 821 (5th ed. 1979).

113 Highet, *supra* note 108, at 623; REDFERN & HUNTER, *supra* note 1, at 91.

114 Danilowicz, *supra* note 2, at 273.

choice of law gives parties.[115] Without the benefit of clear, definite statements of the law, arbitrators essentially apply such choices of law by determining *de novo* what the rules require for each separate dispute. The results of arbitration thus become unpredictable,[116] eradicating the outcome-determinative[117] and the dispute reducing[118] qualities of choice of law. Parties governed by such a choice also do not have any control over the methods and remedies implemented during the proceedings since these rules give the arbitrator a practically unbridled discretion in these areas. In this way, the choice of either anational substantive rule system defeats the purpose of the choice of law in transnational business contracts.

C. National Systems Of Law

In spite of the growing trend of using international rules, most transnational contracts that include a choice of law provision make use of a single national[119] system of law.[120] There are several strong reasons for such a choice. A national system is a complete general body of law that provides solutions for most every legal issue.[121] In addition, parties and arbitrators alike can determine more easily the rules applicable to a given situation when a national, rather than an international, legal system applies.[122] The choice of a national law may also be the only selection recognized and enforced in some international arbitral fora.[123] Consequently, a choice of a particular national set of laws provides certainty in dispute resolution.

However, such a choice creates certain disadvantages that parties may find significant. One such problem is the potential loss of neutrality since a law specifically designed by the chosen nation to aid one party may control the outcome of the arbitration.[124] A national system also may lack sufficient sophistication to handle certain issues found only in

115 *See* Higgins, Brown and Roach, *supra* note 5, at 1041 (vague and uncertain standards decrease ability of parties to assess their positions and negotiate a settlement).

116 Note, *supra* note 2, at 1819.

117 *Id.*

118 *See* Higgins, Brown and Roach, *supra* note 5, at 1041.

119 *See supra* note 18.

120 REDFERN & HUNTER, *supra* note 1, at 76.

121 *Id.*; *see* Danilowicz, *supra* note 2, at 274 (reference to national law regarding certain problems such as periods of proscription is necessary where anational or international laws do not cover the issues).

122 REDFERN & HUNTER, *supra* note 1, at 76; *see* Note, *supra* note 2, at 1819 (general principles of law can be vague and unpredictable).

123 Park, *National Law and Commercial Justice: Safeguarding Procedural Integrity in International Arbitration*, 63 TUL. L. REV. 647, 666-7 (1989).

124 REDFERN & HUNTER, *supra* note 1, at 78; Note, *supra* note 2, at 1820.

an international or complex business setting.[125] In such a situation, an arbitrator may resolve the dispute in a way that the parties neither foresaw nor desired. Finally, confining the applicable law to one national system necessarily prevents parties from taking advantage of dispute resolution methods and principles present in other systems of law that may be useful in their particular transaction. Therefore, a choice of one nation's set of laws may be inadequate and inappropriate under certain circumstances.

D. Contractual *Depeçage*

As revealed above, each of the three types of choice of law options has significant drawbacks that may make each individually inadequate for a given international transaction as a choice of law. However, a combination of any or all of thee options may eliminate the insufficiency. By employing the principle of *depeçage* within a choice of law provision, parties to a transnational contract can agree to apply certain areas of the various systems of law to delineate potential issues or parts of the transaction.[126]

The implementation of contractual *depeçage* involves a three-step process. First, through a comparative analysis, the parties must identify the principles and methods of the potentially applicable national legal systems that would be most advantageous to them in the particular transaction. Categories of system characteristics that may benefit parties include opportunities to attack the contract's validity (such as formal contract requirements, unconscionability, and duress), legal rules and devices of interpretation, performance requirements, and remedial principles and methods.

The next step for the parties is to decide which legal system should govern the different potential areas of dispute. Possible categories include the substantive contractual issues, the arbitration procedural issues, and issues concerning the arbitration agreement itself. In addition, the parties can determine whether to assign sets of laws to specific types of substantive issues, such as contractual validity, interpretation, and performance, or to certain relationships within multiparty contract.[127]

A final evaluation would be useful as to whether a general body of international or anational law should supplement the systems selected above. At this stage, the parties should consider whether their particular transaction may develop problems that national systems of law cannot

125 REDFERN & HUNTER, *supra* note 1, at 77; Note, *supra* note 2, at 1820.
126 DELAUME, *supra* note 10, at 9.
127 *Id.* at 10.

presently handle and whether the uncertainty of an arbitrator's decision based upon the supplemental system would be too great.

Contractual *depeçage* creates many benefits that the other choice of law options cannot provide by themselves. *Depeçage* allows parties to take full advantage of their autonomy over the choice of law and tailor the rules to their greatest advantage. It retains, for the most part, the certainty and determinability of the single national system option. Unless unequal bargaining power exists, *depeçage* will also result in a neutral body of law. Further, this method may allow the resolution of some choice of law negotiation barriers: objection aspects of certain legal systems may be contractually excluded. Finally, the agreed system will most likely be able to handle any conflict issue that may arise.

Unfortunately, two significant disadvantages burden the method of contractual *depeçage*. A principal difficulty is the high negotiation cost associated with the process. To implement this choice of law option, the parties' legal counsel must possess comparative law skills that are scarce.[128] The attorney must be fairly familiar with the variety of potential applicable systems of law in order to determine which ones should be selected.[129] In addition, parties will have to expend much time and effort in ascertaining what the legal needs of their transaction are and which systems best meet those needs. Although significant, these costs may decrease significantly as attorneys become accustomed to the process and become knowledgeable and experienced with the more common contract requirements.

A second problem with contractual *depeçage* arises in the application of multiple systems of law. Under the *depeçage* approach, an arbitrator may need to classify a given issue in order to determine which law governs. It is conceivable that an issue may not clearly fit into a particular category. The classic example of this problem is the classification of a statute of limitations as procedural or substantive law.[130] Statutes of limitations are generally considered to be matters of procedure.[131] However, in situations where the statute bars not merely the remedy for the cause of action but the cause of action itself, it is considered to be substantive law.[132] The determination of applicable law may consequently rest upon

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128 *Id.* at 11; *see* Delaume, *supra* note 108, at 578 (attorney should know and review the laws of each potentially applicable legal system).

129 Delaume, *supra* note 108, at 578.

130 SCOLES & HAY, *supra* note 72, at 59.

131 RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 142; Colhoun v. Greyhound Lines, Inc., 265 So.2d 18, 20 (Fla. 1972); Cuthbertson v. Uhley, 509 F.2d 225, 226 (8th Cir. 1975).

132 RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 143; Alabama Great Southern R.R. Co. v. Allied Chem. Corp., 467 F.2d 679, 682 (5th Cir. 1972).

the determination of whether the statute of limitations limits the rights or the remedies of the parties. Thus, this aspect of *depeçage* may undercut the goal of certainty and predictability in the choice of law.

In sum, contractual *depeçage* may not always be a viable alternative for parties to a transactional contract subject to arbitration. Nonetheless, if the parties' counsel are experienced or if the type of transaction requires highly structured and predictable dispute resolution, this method of choice of law may be the best option.

IV. JUDICIAL INTERFERENCE AND NONINTERFERENCE WITH CHOICE OF LAW

In theory, parties to a transnational commercial agreement have a variety of options in their choice of law to influence the outcome of disputes. Governmental intrusion, however, severely curtails this exercise of control and autonomy. Judicial institutions may intervene at several points in the course of an arbitrable dispute and alter its outcome, in spite of the choice of law.[133] The following examination of applicable United States law[134] will demonstrate how national courts may act to thwart the original goals of the parties and change the form and substance of arbitration proceedings.

Since transactions underlying international commercial arbitrations involve, by definition, "commerce among the several States or with foreign nations,"[135] the United States Arbitration Act[136] and the federal substantive law created by the U.S.A.A.[137] are the sources of applicable

133 DELAUME, *Court Intervention in Arbitral Proceedings*, in RESOLVING TRANSNATIONAL DISPUTES THROUGH INTERNATIONAL ARBITRATION 196 (T. Carbonneau ed. 1982). Judicial interference does not occur if the arbitration takes place under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 575 U.N.T.S. 159. *Id.* However, there have been very few of this type of proceedings. *See id.* at 196 n.3.

134 This analysis could include applicable German law as well. However, such an examination seems unnecessary in light of the similarity of the modes of judicial review in the United States and the Federal Republic of Germany. For instance, both countries allow attacks on the validity and enforceability of agreements to arbitrate based on principles of contract. *Compare* GLOSSNER, *supra* note 52, at 8-9 (Federal Republic of Germany) *with infra* notes 142-60 and accompanying text (United States). Additionally, both German and United States courts may set aside an award if varying standards of procedural fairness or public policy are violated. *Compare* ZPO § 1041 (Federal Republic of Germany) *with infra* notes 161-80 and accompanying text (United States). Finally, both nations are parties to the New York Convention, Audi NSU Auto Union Aktiengesellschaft v. Overseas Motors, Inc., 418 F.Supp. 982, 983 (E.D. Mich. 1976), and therefore share the same standards of review for nondomestic awards.

135 U.S.A.A., *infra* note 137, at § 1.

136 9 U.S.C. § 1 et seq. (1988) [hereinafter U.S.A.A.].

137 *See* Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).

law for review of such arbitrations by United States courts.[138] In addition, the fact that international arbitrations necessarily involve legal relationships not solely between citizens of the United States requires that the United States judiciary also apply the New York Convention to such reviews.[139] Courts must therefore impose both the U.S.A.A. and the New York Convention as standards of review for transnational commercial arbitrations.

Both standards may be divided into two groups of rules based upon the stage the arbitration has reached. If confronting an uncooperative adverse party, a party may need to request judicial assistance either to enforce an agreement to arbitrate (pre-arbitration review) or to enforce an arbitration award (post-arbitration review).[140] Both the U.S.A.A. and the New York Convention differentiate between these two types of judicial intervention and require different modes of review.

A. Pre-Arbitration Review

Pre-arbitration review occurs, as noted above, when one party appeals to a national court in order to enforce its agreement to arbitrate with another party. In this case, the party makes use of the coercive power of the state to force the uncooperative party to participate in the arbitration proceedings.[141]

The U.S.A.A. and the New York Convention provide for similar pre-arbitration review standards. Under the U.S.A.A., a court must direct the parties to arbitration unless there are issues regarding the making or the performance of the arbitration agreement.[142] In order to defend itself against a motion to compel arbitration, a party may attack the validity,[143] enforceability,[144] or scope[145] of the agreement to arbitrate.

Along similar lines, the New York Convention requires that a court "refer the parties to arbitration, unless it finds that the [arbitration] agreement is null and void, inoperative or incapable of being per-

138 Becker Autoradio U.S.A., Inc. v. Becker Autoradiowerk GmbH, 585 F.2d 39, 43 (3d Cir. 1978).

139 9 U.S.C. § 202 (1988); Ledee v. Ceramiche Ragno, 684 F.2d 184, 187 (1st Cir. 1982).

140 DELAUME, *supra* note 133, at 196. A party may also need judicial intervention concurrent with the arbitral proceedings, *see id.* at 206, but such review does not affect the influence of the arbitration agreement's choice of law.

141 *See* U.S.A.A., *supra* note 136, at § 4 (proceedings to compel arbitration) and § 3 (action to stay judicial proceedings during arbitration).

142 U.S.A.A., *supra* note 136, at § 4; Prima Paint, 388 U.S. at 404 (1967).

143 Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 632 (1985).

144 Genesco, Inc. v. T. Kakiuchi & Co., Ltd., 815 F.2d 840, 844 (2d Cir. 1987); *see* Mitsubishi Motors, 473 U.S. at 628.

145 Mitsubishi Motors, 473 U.S. at 626; Becker, 585 F.2d 39, 44 (3d Cir. 1978).

formed."[146] Essentially, this review of the agreement parallels that under the U.S.A.A.[147] Thus, United States courts require a showing of some defect in the agreement to arbitrate before they deny a motion to compel arbitration.

Judicial intervention of this type does not necessarily limit the effect of the agreement's choice of law clause. In theory, it should make no difference whether an arbitrator or a judge applies the law provided for in the agreement. Both would impose the same rules to the same factual situation and arrive at the same conclusion.

The difficulties arise when the courts use a law different from that in the choice of law clause. In *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*,[148] the United States Supreme Court held that the U.S.A.A. had, in effect, "create[d] a body of federal substantive law of arbitrability, applicable to *any* arbitration agreement within the coverage of the Act."[149] Because of this mandate, and because the New York Convention did not specify which nation's laws should apply in such reviews, United States courts apply this substantive law to agreements covered by the New York Convention as well.[150]

In fact, an agreement's choice of law provision may not prevent the employment of federal law to the review.[151] The courts in the United States ignore the choice of law in these situations primarily because federal law preempts any other law that may be applicable[152] and because the issue of an arbitration agreement's enforceability falls within the law of remedies, over which the law of the forum usually governs.[153]

A clear example as to how such a standard of review can frustrate parties' intentions is *Becker Autoradio U.S.A., Inc. v. Becker Autoradiowerk GmbH*.[154] In that case, the two litigants had entered an agreement

146 New York Convention, *supra* note 17, at Art. II(3).

147 *See* Mitsubishi Motors, 473 U.S. at 628 (review under both U.S.A.A. and New York Convention); *compare* Rhone Mediterrane Compaignia Francese di Assicurazioni e Riassicurazoni v. Lauro, 712 F.2d 50, 52 (3d Cir. 1983) (review under New York Convention alone) *with* Genesco, 815 F.2d at 844 (review under U.S.A.A. alone).

148 460 U.S. 1 (1983).

149 *Id.* at 24 (emphasis added). In reviewing such agreements, courts must apply general principles of contract law as the federal substantive law. Genesco, 815 F.2d at 845.

150 Becker, 585 F.2d at 43; *see also* Mitsubishi Motors, 473 U.S. at 626 (on the basis of the New York Convention and the U.S.A.A., court refers to federal substantive law in determining the enforceability of an arbitration agreement).

151 Webb v. R. Rowland & Co., Inc., 800 F.2d 803, 806 (8th Cir. 1986); Becker, 585 F.2d at 43; Matter of Ferrara, 441 F. Supp. 778, 780 (S.D.N.Y. 1977), *aff'd* 580 F.2d 1044 (2d Cir. 1978).

152 *See* Becker, 585 F.2d at 43.

153 Ferrara, 441 F. Supp. at 781 n.2.

154 585 F.2d 39 (3rd Cir. 1978).

to arbitrate all disputes arising from their contract.[155] The choice of law clause provided that German law would govern the agreement,[156] and one party argued that the court should apply German law in resolving the dispute over what issues the arbitrator could resolve.[157] The court refused and instead applied United States federal substantive law to resolve the issue.[158] By applying a law different from that in the contract, the court may have produced an outcome that neither side had foreseen or originally desired.[159] Consequently, the intervention of United States courts in pre-arbitration disputes may serve to defeat parties' original expectations and diminish any benefits of certainty and predictability that a choice of law provision may have created.

B. Post-Arbitration Review

Similar problems with the enforcement of choice of law provisions develop during post-arbitration review. At this stage, the party victorious at the arbitration proceedings might enlist judicial assistance in enforcing the arbitrator's award.[160] However, the standards of review that Unites States courts use may limit the effectiveness of the arbitration agreement's choice of law.

Both the U.S.A.A. and the New York Convention afford limited bases for refusals to enforce arbitration awards.[161] Under the U.S.A.A., a court may vacate the award upon proof that one of the conditions enumerated in 9 U.S.C. § 10 was met,[162] the arbitrator demonstrated a

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155 *Id.* at 42.

156 *Id.* at 42 n.3.

157 *Id.* at 43.

158 *Id.*

159 As shown in the text accompanying *supra* notes 19-48, the application of another jurisdiction's law to the same contract may lead to a completely opposite resolution of a dispute.

160 DELAUME, *supra* note 133, at 196.

161 Sidarma Societa Italiana di Armamento Spa, Venice v. Holt Marine Industries, Inc., 515 F. Supp. 1302, 1306 (S.D.N.Y.), *aff'd*, 681 F.2d 802 (2d Cir. 1981) (U.S.A.A.); Parsons & Whittemore Overseas Co., Inc. v. Societé General de L'industrie du Papier (RAKTA), 508 F.2d 969, 973 (2d Cir. 1974) (New York Convention).

162 Smigma v. Dean Witter Reynolds, Inc., 766 F.2d 698, 707 (2d Cir. 1985); Sidarma, 515 F. Supp. at 1306. 9 U.S.C. § 10 provides:

> In either of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration:
> (a) Where the award was procured by corruption, fraud, or undue means.
> (b) Where there was evident partiality or corruption in the arbitrators, or either of them.
> (c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.
> (d) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made. . . .

"manifest disregard" of the law,[163] or the award compels a violation of the law or is contrary to public policy.[164] Similarly, defenses to the enforcement of an award under the New York Convention are limited to those set forth in Article V,[165] including violation of public policy.[166] The two sets of standards of review overlap to some extent,[167] and the U.S.A.A. provisions apply to those awards governed by the New York Convention except to the extent that the U.S.A.A. may conflict with the Convention.[168]

The two major areas of review in which United States courts may interfere with the functioning of a choice of law provision are the scope of the arbitrator's powers and the conformity with public policy. When determining whether an arbitrator exceeded his powers in issuing an award, courts apply federal common law in construing what powers the arbitration agreement granted.[169] Such is the case even if the arbitration

163 Wilko v. Swan, 346 U.S. 427, 436-7 (1953); French v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 784 F.2d 902, 906 (9th Cir. 1986).

164 W.R. Grace & Co. v. Local Union 759, Int'l Union of the United Rubber, Cork, Linoleum & Plastic Workers of America, 461 U.S. 757, 766 (1983); Diapluse Corp. of America v. Carba, Ltd., 626 F.2d 1108, 1110 (2d Cir. 1980).

165 Parsons & Whittemore, 508 F.2d at 973. Article V of the New York Convention, *supra* note 17, provides:

1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:
(a) The parties to the agreement. . .were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or
(b) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or
(c) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contain decisions on matters submitted to arbitration may be recognized and enforced; or
(d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or
(e) The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.
2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:
(a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or
(b) The recognition or enforcement of the award would be contrary to the public policy of that country.

166 New York Convention, *supra* note 17, at Art. V(2)(b).

167 Bergesen v. Joseph Muller Corp., 710 F.2d 928, 934 (2d Cir. 1983).

168 Parsons & Whittemore, 508 F.2d at 973.

169 Raytheon Co. v. Automated Business Systems, 882 F.2d 6, 11 n.5 (1st Cir. 1989).

agreement included a choice of law clause.[170]

For example, the plaintiff in *Bonar v. Dean Witter Reynolds, Inc.*[171] argued that the arbitrator exceeded its powers when granting defendant punitive damages because New York law, the law selected in the arbitration agreement, prohibited punitive damages in arbitral awards.[172] Holding that under the U.S.A.A. federal law governed regardless of the choice of law, the court allowed the award of punitive damages.[173] If the parties initially had chosen New York law in part because of its restriction on punitive damages, such rules of review would have defeated the expectations of the parties, thereby eliminating one advantage of the choice of law.

The public policy evaluation of arbitration awards similarly deteriorates the choice of law's benefits. Courts may deny enforcement of a foreign arbitral award if it would violate United States public policy.[174] "Such a public policy. . .must be well defined and dominant, and is to be ascertained 'by reference to the laws and legal precedents. . . .' "[175] Essentially, the arbitrator's award must create an explicit conflict with statutory or case law.[176]

Example (1) in Part I of this Comment well illustrates how this public policy review would thwart the aims of an agreement's choice of law. As noted above, if the arbitrator applied German law to the example's fact scenario, he would have upheld the penalty provision of the contract and granted an award accordingly.[177] However, both statutes and case law in the United States hold such penalties to be illegal and against public policy.[178] In such a case, it is unlikely that a United States court would enforce such an award in spite of the parties' intentions to create a penalty valid under German law.[179]

As this analysis demonstrates, the intervention of United States courts diminishes the role of the choice of law in an arbitration agree-

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170 Raytheon, 882 F.2d at 12; Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378, 1387 (11th Cir. 1988).

171 835 F.2d 1378 (11th Cir. 1988).

172 *Id.* at 1387.

173 *Id.*

174 Waterside Ocean Navigation Co., Inc. v. Int'l Navigation Ltd., 737 F.2d 150, 152 (2d Cir. 1984); Parsons & Whittemore, 508 F.2d at 974.

175 W.R. Grace, 461 U.S. at 766 (*quoting* Muschany v. United States, 324 U.S. 49, 66 (1979)).

176 United Paperworkers International Union, AFL-CIO v. Misco, Inc., 484 U.S. 29, 43 (1987).

177 *See supra* notes 26-32 and accompanying text.

178 *See supra* notes 19-25 and accompanying text.

179 *See* Amalgamated Meat Cutters and Butcher Workmen of North America AFL-CIO, Local Union 540 v. Great Western Food Co., 712 F.2d 122, 124 (5th Cir. 1983) (court refuses enforcement of award that would violate statutory and case law).

ment, thereby destroying the value that the choice initially created for the parties. By applying its own forum's law, national courts effectively limit the extent to which the chosen law influences the operation and outcomes of international commercial arbitrations.

V. CONCLUSION

The choice of law in transnational contracts can have a significant effect on the resolution of conflicts through international commercial arbitration. Through their choice, parties have the potential to influence the outcome of their disputes, the types of procedures that an arbitration utilizes, and even the type of institution that will eventually resolve the disputes. An arbitration clause may name a set of anational substantive rules or a single national or international system of law. However, these various systems may be combined through contractual *depeçage* in order to make the arbitration as predictable, neutral, and complete as possible while allowing parties to enjoy only the most advantageous aspects of the different systems of law.

Unfortunately, national governments pose a significant obstacle to the realization of these advantages. Through pre-arbitration and post-arbitration review, courts may force arbitrators to conform the operation of proceedings and their subsequent awards to a particular set of laws, regardless of the parties' explicit choice of law. As long as national judicial institutions refuse to apply the law selected by the parties, the advantages of contractual *depeçage* may never be fully realized.

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