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The Determination of Applicable Law in International Commercial Arbitration

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The Determination of Applicable Law in International Commercial Arbitration

Cover Page Footnote

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**The Determination of
Applicable Law**

in

International Commercial Arbitration

By

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Introduction :

Arbitration as means of settling commercial disputes between parties of different nationalities has been a popular and successful alternative to national court proceedings. Moreover, arbitration allows the parties to choose the applicable law governing their agreement. International arbitral rules generally allow the parties to an arbitration agreement to choose the substantive law that will govern the dispute.¹ However, this right of choice of applicable law involves various elements, one of the most troublesome of which is the choice of substantive law to be applied in a given dispute.

An arbitrator is bound to reach a decision in accordance with the law chosen by the parties. But what happens if the parties fail to specify the applicable law, either because they cannot agree on the

1. See A. Redfern & M. Hunter, Law and Practice of International Commercial Arbitration, (1986) P. 70

choice of law, or else because they overlook the issue?² Should it be assumed that parties who remain silent on this issue do so in order that the choice of law governing their dispute be made by the arbitrators ? If so, is an arbitrator free to apply any law? What rules do arbitrators use to determine the applicable law? Is an arbitrator bound by such rules?

This paper will deal with the various factors involved in determining the applicable law which governs the substantive law of arbitration by the parties and the arbitrators. It will also examine to what extent the national law recognizes a choice of procedures or the merits of the dispute in accordance with universal legal principles , rather than those derived from the legal system of individual states, or whether such decisions are made without reference to any legal principles and in accordance with some broader principle such as the *Lex-Mercatoria*.

1. Party autonomy :

The parties to arbitration may try to agree on a particular law as being applicable in a dispute. The parties usually agree to choose a law which is neutral or well developed to govern their agreement.³

The international conventions and the model rules on international commercial arbitration recognise the freedom of the parties to choose the law which governs their contract or arbitration agreement. This recognition can be seen in almost every major treaty or uniform law

2. J. Stewart McClendon & Rosabel E. Goodman, International Commercial Arbitration in New York p.115.

3. Ole Lando " The law applicable to the merits of the dispute" , contemporary problems in international arbitration, (Law D.M. Edite) 1986 p.101.

affecting international contracts of arbitration.⁴ The New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards recognised indirectly the parties' right to choose the law governing their contractual relation. It provides: in Article V(1)(a) that the recognition and enforcement of a foreign arbitration award may be refused if the arbitration " agreement is not valid under the law to which the parties have subjected it " ⁵ The European Convention of 1961 recognised this directly , in providing : -

The parties shall be free to determine, by agreement, the law to be applied by the arbitrators to the substance of the dispute.⁶

The UNCITRAL Arbitration Rules provide that:-

The arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute.: ⁷

This principle has gained universal acceptance in the field of international commercial arbitration . Party autonomy has been explained by one writer saying: -

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

4. Lew J.D.M., Applicable law in International Commercial Arbitration (New York 1978) p. 85.

5. Ibid.

6. European Convention of 1961, Art. VII

7. UNCITRAL Arbitration Rules, Art. 33.1

various system) tacitly.⁸

The principle of party autonomy is well recognized both at common law and civil law⁹. An English Court upheld that : -

Parties are entitled to agree what is to be the proper law of their contract.¹⁰

But when is the time to choose ? Is this right limited to the time at which the contract is made, or is it open to the parties at any time during the dispute? Some writers say that choice is possible at any time, even during the hearing of the dispute. In a dispute between an Argentinian national, resident in Germany and a U.K. corporation, in relation to a contract made and performed in Argentina, the parties choose the Argentinian law to govern their agreement. The arbitrator said: -

The parties have agreed that Argentina law is the proper law of the commission agreement (or agreements), and should their choice of law, which was only made during the course of arbitration proceedings, not by itself be binding upon me, I have no doubts about the correctness of their conclusion in that respect.¹¹

There is no harm in giving the parties the right to choose the applicable law during the hearing of the dispute, because this will

8. Pierr Lalive, cited in law, (op.cit no. 4) p. 87.

9. Carlo Croff, " The applicable law in international commercial law: is it still a conflict of law problem " (1982)16 International Lawyer, 613-645.

10. Whitworth Street Estates (Manchester)Ltd. v. James Miller and Partners Ltd [1970] A.C 383.

11. Decision of Judge Lagergren, cited by law (op.cit. no.4) p. 98. save the arbitrators time. However,granting the parties this right may result in the parties choosing a law different from that which governed the contract when it was made. In Aminoil arbitration this point was considered by the arbitral tribunal:-

Although it may in theory be possible for litigation to be governed by an assemblage of rules different from that which, before the arbitration, governed the situations and matters that are the subject of the litigation, there must be a presumption that this is not the case.¹²

2. Limitations on party autonomy

An arbitrator should apply the law chosen by the parties and is obliged to respect their choice of that law and should not attempt to change it. This does not mean that the parties enjoy unlimited right to choose any law they want. The parties are free to choose the "proper law" governing their dispute. But this choice must not be unlinked with the dispute in that they may not choose a system of law which has no connection with the disputed transaction.¹³ If the intention of the parties is to avoid the implementation of a provision of public policy in their national law or law governing their contract, such a choice might be annulled by arbitrators on the grounds of violating the international public policy.¹⁴

12. American Independent oil Company Inc. (Aminoil) V. The Government of the State of Kuwait, (1982) 21 International Legal Material, 976, at p. 1000.

13. Eiz-Aldeen Abudleh " Conflict of law in international arbitration" Al-adaleh vol. 22 [1979] p. 47-64.

14. El-Hakim Jacques "Governing law Effects of silence or hurried choice" paper submitted in MMEIA Conference Cairo January

7-12,1989.

The 1950 and 1979 English Arbitration Acts are silent on this point. Under English practice, however, the parties may state their choice of law in their agreement. It is the duty of the arbitrator to respect their choice. So long as the intention expressed is "bona fide and legal"¹⁵.

The vagueness of the above-mentioned Acts has been filled out by the rules of private international law. On applicable law, the requirements of the English system may be summarized thus:-

No court, it is submitted, will give effect to a choice of law (whether English or foreign) if the parties intended to apply it in order to evade the mandatory provisions of that legal system with which the contract has its most substantial connection and which for this reason, the court would in the absence of an express or implied choice of the law have applied.¹⁶

The US legislature approached this point in a general sense, the Restatement of Law 2nd by the American Law Institute, provides the following in section 186:-

Issues in contracts are determined by the law chosen by the parties.

This section accepts party autonomy. However, this acceptance is tied to certain conditions, in requiring that any law the parties choose should have a substantial relationship to the parties or the transaction, and the chosen law must not be contrary to the

15. Vita Food Products, Inc. V.Unus Shipping Co.,[1939] A.C.290.

16. Dicey & Morris The Conflict of laws Rule 145 sub-rule I [1980 10th.ed] pp. 755-56.

fundamental policy of the state where the arbitration takes place.¹⁷ The principle of party autonomy, even though accepted, is subject to certain limitations which differ in several conflict of law systems. However, the different limitations of the principle of party autonomy are in fact irrelevant because in practice parties usually do choose the law which has the closest connection with their contract except in some cases where the parties refuse to apply the law with the close connection. When international traders from different countries decide to include an arbitration clause in their contract they may feel that choosing the national law of either party could prove unsatisfactory to the other party. In such a case they would choose the law of a third country which would not necessarily have any connection with either party or the contract.¹⁸

The opinions of writers vary regarding the role of the arbitrators on the issue of the parties' choice of applicable law. Are arbitrators able to intervene in the choice by imposing limitations on it, or may they merely ensure that the parties' choice is not in conflict with the law of a nation?

The pioneer in this point was Sauser-Hall, who, at the meeting of the Institute of International law, suggested a preliminary solution of the issue. He is one of the supporters of the "mixed nature" of arbitration. Nevertheless, he emphasized that parties do not have unbounded freedom on the choice of the applicable law. The choice must be pursuant to the conflict rules of the legal system of the *lex fori*.¹⁹ According to one of the writers the choice of the applicable law is not made by the parties alone but by the parties by means of the *lex*

17. Restatement of law 2nd by American Law Institute sec. 187.

18. Croof (op.cit 9) p. 617.

19. Sauser-Hall, *Annuaire de l'Institut de Droit International*, 394(1957-II).

fori²⁰. Mann takes a strict position by disregarding party autonomy if the applicable contract law has no connection under the conflict rules of the *lex fori*²¹. The notion held by Mann is based on the principle of *lex fori* which, according to him, is the main source used to determine the applicable law. According to Mann's view, applicable law in an arbitration agreement must not be chosen without national law having a close connection with the contract.

A third writer sees this point in a different way from the former writers: he maintains that the parties should be allowed to choose the applicable law because "it {the law} might have a reference to the case which at first sight is not apparent." For example, parties choose the national law of the arbitrators because they (the arbitrators) are familiar with it.²² However this does not apply in all kinds of contract. In certain contracts parties may choose only the law which does not violate fundamental public policy. In this situation arbitrators are required to disregard the parties' autonomy.²³

Finally, one writer is a follower of the theory of the contractual nature of arbitration. He says:-

When two parties with an agreement decide to settle their dispute by arbitration they have the right to choose the law which should be applied by the arbitrators, that choice should be

20. Mann, *lex facit arbitrum*, in Liber Amicorum for Martin Domke, 157 (The Hague 1978) quote from Croff (op. cit 8).

21. Ibid.

22. Haardt, "Choice of Law in Arbitration Agreements", in Essays on the law of International Trade. Festschrift Shmitthoff, 215 (1973).

23. Ibid.

respected and it cannot be disregarded.²⁴

He justifies his view by arguing that the arbitrator's power " does not derive, as in the case of national court, from a sovereign state, but from the parties' agreement".²⁵ According to him the seat of arbitration is fortuitous and there is no system of private international law competent to challenge the choice of applicable law by the parties.²⁶

The writers' opinions regarding the limitation of the choice of law varies between, on the one hand, support for the limitation, and on the other, disagreement with the limitation on party autonomy. If one accepts the principle that arbitrator should examine the law produced by the parties under some conflict of law body, that means that arbitration may act as any national court.

Arbitrators should select one system of private international law from among several which has a close connection with the dispute: i.e. with the seat of arbitration; and/or the law of place where the contract was performed. The arbitrator's choice must not diverge away from these alternatives, because any departure from this principle might be taken as a matter of evading national law.

Another opinion follows the same conditions brought by the previous writer, but the latter goes one step further in that he declares that the will of the parties should be respected without examination of whether there is a limit to party autonomy under some of the conflict of law rules. Supporters of this opinion are the people who support the

24. Fouchard, L'Arbitrage Commercial International 356 (Daloz-Paris 1965).

25. Ibid.

26. Ibid.

"denationalization" of arbitration , who give the parties the right to choose a non-national system of law, e.g.the general principle of international trade law or perhaps even an extra-legal standard e.g. *amiable composition*.²⁷

Probably the opinions of the first group are closer to being right than those of the second group which disregard any connection between the *lex-foi* and the agreement. It is likely that this latter principle will not be appreciated and supported by the state where enforcement is sought in a case where the applicable law chosen by the parties has no link with dispute. Thus arbitrators should judge the applicable law in the light of the enforcement of the award and the connection of it and the other elements which play an important role in it (such as the law of the arbitrators; the nationality of the parties,subject matter of the contract, the place of performance...); all these features must be taken into account, by the arbitrator and if he should find no connection between these factors and the choice of applicable law he may disregard this choice.

3. The implied or tacit choice of law by the parties

Parties to an arbitration agreement sometimes fail to include the law governing their contract in the agreement due to disagreement on the choice of applicable law, because of the different countries they come from with different economic and political and legal backgrounds, or because they simply overlook the issue, preferring to leave it open rather than not to conclude the contract, postponing to leave it open rather than not to conclude the contract, postponing it until a dispute arises. This causes unnecessary expenditure and delays

27. Lew. (op.cit no.4) pp.82-84

in settling conflicts problems.²⁸

The parties' failure to choose a law governing their dispute present the arbitrators with a myriad of choices. Two possibilities are examined here. The first is where the parties' intention is not clearly expressed but can be derived from the agreement. The second choice is where the parties fail to designate the law and no inferred choice can be detected from the terms of the agreement.

3.1. The concealed choice

Where the parties' intention is not clearly expressed in the agreement there may be a strong presumption of the proper law. The implied choice of law is an 'actual'²⁹ choice by the parties, however it is concealed, and the arbitrators or a court of competent jurisdiction have the right to investigate it.³⁰

Arbitrators in international commercial arbitration select the substantive law where the agreement is silent in two stages: first they seek those rules of conflict-of-law which have the closest connection with the case. Then they determine the applicable law according to those rules. The arbitrators decide the applicable law according to the features of and circumstances surrounding the contract, such as the arbitration institution handling the arbitration; language used in the contract; nationality of the parties and the arbitrators.³¹

28. David J. Branson and Richard E. wallace, "Choosing the Substantive Law to apply in International Commercial Arbitration", 27 Virginia Journal of International Law, p.39-64.

29. The House of Lords Judgment in Amin Rasheed Shipping Corp.,
Infra

30. Supra note no. 10.

31. Eiz-Aldeen op. cit no.13.

An English court held that an agreement to submit to the jurisdiction of the court or to arbitration in a particular country is evidence of an intention to apply the law of that country.³² In Tzortzis v. Monark Line A/B³³, the parties failed to specify the applicable law. The court's decision was "... there is a strong presumption that the proper law of contract {including the arbitration clause} is the law of the country in which the arbitration is to be held".³⁴ But this presumption, though strong, can be rebutted. That was what the House of Lords upheld in Compagnie d'Armement Maritime SA v. Compagnie Tunisienne de Navigation³⁵, in which a contract was made in France between a French shipowner and a Tunisian charterer for the transport of oil from one Tunisian port to another, payment to be made in France. The parties provided for arbitration in London. However, the House of Lords considered French law to be applicable even though the parties chose London as a forum for the arbitration. This departed from the old approach to the forum, since the contract has no connection with England except in the arbitration clause. The House of Lords, in the former case, emphasized that an arbitration clause is only one of several circumstances to be considered in determining the proper law.³⁶

32.Choice of the applicable law by the arbitrators

Where the parties fail to indicate expressly or implicitly the law which will govern the substantive of the agreement, and circumstances do not give any indication of the intention of the parties,

32. Hamlyn & co. V. Talisker Distillery, [1894], A.C.202

33. [1968] 1WLR 406 C.A.

34. Ibid

35. [1970] 2 Lloyds Rep 99; [1971] A.C.572

36. Ibid.

the search for applicable law is made by assuming the hypothetical "presumptive will" of the parties.³⁷ Such a search is the task and responsibility of the arbitrators. This is the second possibility in which the agreement is silent as to substantive law. The theory of "presumptive will" provides that the will of the parties exists, even though it is not recognized.

a. Seat Theory.

Some scholars believe that an arbitrator is bound by the principle of conflict-of-laws to apply the law where the arbitral tribunal is seated to consider the substantive law governing the arbitration agreement. According to one supporter of the theory "an arbitration clause, as any other contract between private parties, cannot be suspended in the air, but must draw its authority from a national law provision."³⁸ The theory has been confronted with a case in which the arbitration was held in more than one place. What then is the will of the parties? It is likely this situation could be resolved according to the International Convention: the New York Convention of Recognition and Enforcement of Arbitral Awards of 1958. Article V considers that the solution to a case in which an arbitration was seated in more than one place, would require the arbitrators to consider where the award was to be "rendered". That location would then be considered to be the seat of the arbitration, and, in corresponding with the seat, the substantive law will be notified. Article VI of the European Convention of 1961 adopted the same approach.

The failure of the arbitrators to ascertain and determine the applicable law or the "presumptive will" of the parties has been taken as an omission attributed as a waiver by the arbitrators of the parties'

37. English law no longer accepts the "Presumptive will" theory

38. Croff op. cit no. 9 p. 625

right to choose the applicable law. The privilege of choosing the applicable law shifts to the arbitrators. However, the choice of the substantive law must come in the light of the implied will of the parties.³⁹ The arbitrators are entitled to this right pursuant of Article VII of the European Convention which provides for the case in which the parties fail to specify the applicable law:

... Failing any induction by the parties as to the applicable law the arbitrators shall apply the proper law under the rule of conflict which the arbitrators deem applicable.

Under the rules of the Convention, which rules of conflict should arbitrators apply? Is it the law of the place of the performance of the contract, or should they use the rules of the place of contract formation, or even some other conflict rules? Arbitrators could choose any substantive law that might be designated by any given conflict of law rules, indeed both the ICC and ICSID arbitration rules provide that , in the absence of guidance from the parties, the choice of law may be made by whatever conflict rules the arbitrators deem appropriate.⁴⁰

One writer considers that the rules of conflict of the forum designated by the parties for arbitration may be taken to consider the applicable law.⁴¹ The courts in the United Kingdom and the United States follow the same approach concerning the forum: forum selection

39. El-Hakim (op. cit no. 14).

40. ICC Rules art. 13(3); ICSID Rules 42 (1)

41. Goldman B., "International Arbitration In Europe", IBA Seminar in Arbitration in Western Europe, Moscow 5-7 June 1988, p. 34.

is construed as the implied choice of the forums law.⁴² In the UK the choice of the forum is considered to be "irresistible". However, in Compagnie d'Armement Maritime SA⁴³ the forum was considered as one factor, but was not held to be irresistible.⁴⁴ Because parties often choose the forum for arbitration without any intention of submitting to the forum's law, parties may choose a forum for its geographic convenience or because the arbitration institution is in it, although it has nothing to do with the substance of the dispute or an implicit choice of law.⁴⁵ The theory is criticized on the grounds that "focus upon the jurisdictional aspect of arbitration leads to attribute to the seat of arbitration all of the characteristics of an ordinary seat of jurisdiction... localization of the proceeding, there are no organic links between the dispute and the place of proceeding."⁴⁶ Another criticism is that the seat of the arbitration is sometimes not obvious. Where the parties do not specify the place of arbitration in an arbitration clause, the will of the parties fails to determine the applicable rules of conflict; and the choice of the applicable rules is made at the arbitrators discretion, not by the will of the parties.⁴⁷

42. Scherk v. Alberto-Culver Co., 417 US 509,519 (1974):Lummus Co.V. Commonwealth Oil Ref. Co., 280 F. 2nd 915, 924 (1st Cir. 1960)

43. Supra

44. [1971] A.C 572 H.L.p. 596, par Lord Wilberforce"... should not be treated as giving rise to a conclusive or irresistible inference"

45. See Groff (op. cit no. 9) at p. 626

46. Jean Robert and Thomas E. Carbonneau, " The French law of arbitration " (New York 1983) PP. 4.11

47. Croff (op. cit no. 9).

b. The conflict-of-law rules of the court which has original jurisdiction.

The second technique used, is to recognize the substantive law by applying the conflict-of-law system of the court which would have jurisdiction if there were no arbitration agreement.⁴⁸ This theory has been advanced by the Italian scholar Dionisio Anzilotti. The theory has been criticized on the grounds of the difficulty in determining the national court which would have jurisdiction in a case which involved transactions between parties from different countries.⁴⁹

C. The arbitrators or the parties rules of conflict-of-law.

According to this theory arbitrators should apply those conflict-of-law rules of which the arbitrators have the best knowledge. This assumes that the arbitrators are connected to the legal system, and can recognize the conflict-of-law rules of his personal law.⁵⁰ The weakness is that it overlooks the test theory that should be followed by the arbitrators to consider the conflict-of-law: the nationality, the domiciler or the residence of the arbitrators. The theory assumes much about the arbitrators' personal knowledge of law. The knowledge of the arbitrator of his personal law must not be taken as knowledge of conflict-of-law rules.⁵¹ This may be taken as underestimating the international arbitrators by considering them unable to understand their own conflict law system. Arbitrators are sometimes not

48. Ibid.

49. Ibid.

50. Ibid.

51. Pierre Lalive, Les regles de conflit de lois appliquees au fond du litige par l'arbitre international seegeant en Suisse. Rev. ARB. 155(1976).

specialist in the field: they may have expertise in the Business law of their country, but not the conflict rules of that country.

Regarding the option of applying the parties conflict-of-law; this will not pose a problem in case where both parties are from the same country. But the practice is that the parties coming from a different jurisdiction take the law of either one of the parties which may leave the other party dissatisfied.

d. The cumulative of conflict of law system concerned with the dispute.

The theory provides the arbitrators with various alternatives from which to choose the one which best suits the case. According to this theory arbitrators examine all conflict-of-law rules adopted by the different national legal systems connected with the dispute submitted to them.⁵² Arbitrators ascertain that all these legal systems lead to the same conclusion. They all selected the same national law as the law applicable to the contract.⁵³ The arbitrator does not need to choose one set of private international law rules, but can base his decision according to cumulative choice connected with the dispute. The theory has the practical advantages that both parties will be satisfied, and the country where the arbitral award might be enforced will recognize the applicable law chosen by the arbitrators, since the choice of applicable law is based on the conflict-of-law rules related to the dispute. This has been illustrated in this award:

52. Pierre Lalive, "Possible conflict of law and the rules applicable to the substance of the dispute", ICCA Lausanne Interim Meeting 1984 Report VI

53. Croff (op. cit no. 9)

Even if it is generally admitted that judges decide on the applicable law according to conflict of laws rules of the state for which they render justice, the arbitrator cannot have recourse to such rules to the extent that they do not derive their power from any state. But if they can show on the question in issue that the conflict rules of the different states with which the matter submitted to apply these common conflict rules since they can be sure of satisfying the implicit or supposed intention of the parties from which they derive their power.⁵⁴

The theory has been restricted to particular cases. First there must be a "false conflict". Among conflict of law rules "false conflict" occurs where the systems connected to the dispute lead to the same result in the rules of conflict. Secondly the arbitrator has to decide which countries are connected with the dispute.⁵⁵

The weakness in this theory is that it assumes that the conflict-of-law rules in the countries connected with the dispute have the same rules, and lead to the same result in the disputes at issue. Where there are different conflict of law rules (and this is common in international arbitration dispute) this theory does not apply.

e. International conflict of law rules.

This is the last stage before arbitrators abandon any indication to a national law. The principle is based on the bodies of private international law such as the Hague Convention on the law applicable to International Sale of Goods of 1955. The international arbitrators

54. ICC case No.1176, cited by L.Collins *infra*.

55. Croff (*op.cit* no.9) p. 627

choose a set of general principles of conflict of law from these international bodies for settling the dispute.⁵⁶ The arbitrators examine several bodies of international law from which to choose a set of general principles of conflict of law.⁵⁷

f.The choice of substantive national law.

In this stage the arbitrators choose one national substantive rule and apply it to the dispute without reference to any conflict-of-law rules. Thus an arbitrator may settle a dispute by directly applying the law of England for instance, without referring to any of the foregoing conflict-of-law analysis.⁵⁸ In all the cases so far discussed the arbitrators have relied on specific rules of conflict-of-laws. So, rather than the arbitrators following rigid conflict-of-laws rules and applying the law of place of contracting, or the law of payment, or the law of the place where the principle has his main business establishment, the arbitrators consider all these factors of the case and then apply the law of that country.⁵⁹

The arbitrators make such a choice, in two different types of situation:(i) when there is a false conflict of laws . The rules lead to the same outcome, in that he may apply one of the substantive law and disregard the rules of conflict.⁶⁰ In the ICC arbitration concerning sale of goods between a German and a Swiss individual, the arbitrators did not apply any conflict rules when he found that the

56. Ole Lando (op.cit no. 3).

57. Article VII of the European Convention, art. 33 of the UNCITRAL RULES AND ART.13(3) OF THE ICC Rules authorize arbitrators to apply such texts.

58. Croff (op.cit no. 9) p.632

59. See Lew (op.cit no. 4) p. 341.

60. Ibid p. 632.

Swiss and the Germany conflicting law do not differ, so he choose a substantive provision common to Germany and Swiss law:-

It is necessary to underline from the outset that the question of the law applicable is only of interest if there exists between the system of law to which the parties are submitted a true conflict of law. As German and Swiss laws impose similar solutions in matter of the law of obligation and commercial law, one may thus, as general rule abandon the research for the applicable law.⁶¹

(ii) When there is a true conflict of law. Arbitrators may face a case in which the substantive rules of the various countries connected with the dispute do not lead to a similar outcome. Arbitrators in this case can apply a national law directly without having recourse to any conflict rule and without giving reason for the application of such substantive law of a certain country.⁶²

The theory is helpful to arbitrators in international commercial arbitration. An arbitrator can in this way reach the most appropriate solution by choosing the applicable law according to his experience in this field without resorting to rigid rules such as the rules of conflict. In practice, many arbitral awards have been determined by the arbitrators with out reference to the rules of conflict. There are several arbitral awards where the applicable law has been determined by the arbitrators as the proper law of the contract. A clear application can be drawn in an award on a dispute between a Yugoslavian seller and an Iranian buyer in a contract concluded in Iran. The arbitrators examined several factors to determine the system of law which had the closest relation to the contract, like the place where the contract was concluded, the place where the contract

61. ICC award No. 2172, Doc. No.410/2384, 1974.

62. Croff (op. cit no. 9) p. 632.

was performed and residence of the parties. The arbitrator, after an analysis of these and other factors came to a conclusion, without considering any conflict rules, that the contract had its closest and most real connection with Iran.⁶³

In domestic systems it is closely akin to the English "proper law" test. It has been defined by Dicey & Morris as :-

The system of law by which the parties intended the contract to be governed, or, where their intention is neither expressed nor to be inferred from the circumstances, the system of law with which the transaction has its closest and most real connection.⁶⁴

The same theory is found in the American private international law :-

The right and dispute of the parties with respect to an issue in contract are determined by the local law of the state which with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in sec.5.⁶⁵

One writer attributed the development of the theory to the movement away from rigid conflict of law presumptions towards a more flexible and realistic conflict of laws methodology.⁶⁶ This is a modern solution in the determination of the substantive law applicable to the dispute directly without passage via the rigid conflict of law

63. ICC award No.1717, 1972.

64. Dicey & Morris " The Conflict of Law ",(1987 11th ed.) p. 1161.

65. Restatement of Conflict of laws 2nd by the American Law Institution sec.188.

66. Lew (op.cit no.54) p.342.

rules.⁶⁷ This must not be taken as dismissal of the conflict-of-law rules, but rather in the course of looking for the applicable law arbitrators should not go so far as to determine a particular (national) conflict of law system. Instead it suffices that they will determine the rule of conflict deemed most relevant.⁶⁸

g.The application of non-national rules.

In the absence of any choice of substantive law by the parties, and arbitrator, in some cases may apply a full non-national standard such as *Lex-Mercatoria*, standard usages, or general principles of law. In this case the arbitrators do not only disregard the rules of conflict law but also those of any national system. In general two elements in a contract might permit the application of such non-national standards. First, the existence of an arbitration clause in an international transaction, together with the international nature of the dispute. Secondly, when considering a dispute over an economic development agreement, particularly those containing a "stabilization clause" which limits a sovereign's capacity to alter the rights of private parties, arbitrators invoke a non-national standard to assess the validity of the stabilization clause in order to protect the private party's right.⁶⁹

The principle sought is to detach international commercial arbitration from state control by the law of place. The dispute will be settled by a set of rules that do not owe their origin to any national law.⁷⁰

67. Marc Blessing "International Arbitration Procedure-II"(1989) 17

68. See ICC Article 13.3

69. A.Redfern & M. Hunter (op.cit no.1) p.79

70. The principle shall be discussed in detail infra

What is the most appropriate theory by which to determine the applicable law? This question is not easy to answer. The answer depends on the particular circumstances of each case: the facts, the place where the arbitration took place, the place of the enforcement, the extent of the arbitrator's jurisdiction, and the parties to the arbitration agreement. All these factors play an important role in the choice of a suitable theory. Where a theory is accepted in the West, it does not mean that it will be accepted in Eastern countries. The last-mentioned theory, for example, does not yet command full support from some countries and they consider it as a violation of public policy. Therefore the arbitrator should consider all these facts when determining the applicable law and choosing the right theory in the light of rules of conflict of the state. He should examine the attitude of the country where the enforcement is sought towards the rules he will apply. Also, choosing one of the theories limits the field of applicable law. Arbitrators should have more alternatives in this matter so they can select the proper applicable law for each case.

According to some of the previous theories arbitrators have unlimited autonomy to choose the applicable law. These theories which grant the arbitrators such a right, find no support in some national legal systems. For instance, arbitrators in English Law are subject to mandatory rules relating to arbitral procedure, and they are subject also to the review procedure of the arbitration Act of 1979.⁷¹ Thus where an arbitration takes place in England pursuant to International Chamber of Commerce rules it is an English arbitration and not super-national arbitration. An English arbitrator "{cannot} apply any conflict of law rules other than English rules; nor can he apply substantive law other than that of a fixed and recognizable system...arbitrators in English arbitration must apply English law or some specific foreign law."⁷²

71. Dicey & Morris (op.cit. p.542).

72. Ibid at p. 543

4. The International Convention provision on the applicable law.

4.1 The European Convention on International Commercial Arbitration 1961.

This section will examine the regulation of applicable law in the International Conventions. Article VII of the European Convention 1927 deals with the issue of the applicable law in an international arbitration:

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 arbitrator deems applicable. In both cases the arbitrators shall take account of the terms of the contract and the trade usage.

Article VII specifies the ways by which to determine the applicable law in an international arbitration agreement. It contains three situations of interest. First, it considers the case whereby the parties specify the applicable law. This recognition of "party autonomy" obliges the arbitrators to apply without change the law chosen by the parties. The arbitrators' authority in this situation is limited to applying the law chosen by the parties.

The second situation is where the intention of the parties is not clearly expressed. "Failing any indication the arbitrators shall apply the rules of conflict that they deem applicable". Although it may look as if the arbitrators have chosen the applicable law, the work of the arbitrators is confined to application of the rules of conflict to determine the applicable law. The parties' choice is implied, and the role of the arbitrators is to look for that implied choice, not to choose

the law.⁷³ Others consider the arbitrators as the agent of the parties and make a determination on their behalf which does not involve the actual merits of the dispute.⁷⁴

Thirdly, the case where the parties fail to indicate the applicable law "In both cases the arbitrators shall take account of the terms of the contract and trade usage." Even in this situation the arbitrators do not have unlimited choice to determine the law, but their choice is levelled by the reference to the terms of the contract and trade usage.

Article VII uses the phrase "take account of". This might cause problems where national law conflicts with trade usage. Does national law prevail? Dr. Samia Rashid consider that national law must yield to *lex mercatoria*.⁷⁵ To what extent this principle is implemented depends on the state's attitude towards *lex mercatoria*. But will national law yield to non-national rules? In theory it might, but in practice it is doubtful.

4.2 New York Convention of Recognition and Enforcement of Foreign Arbitral Awards of 1958.

The New York Convention does not specify the applicable law issue (in contrast with the European Convention of 1961), because the specific subject of the Convention does not interfere with the issue of applicable law, nor did it establish a system regulated by conflict rules. Its purpose is to render compulsory among parties the enforcement of an arbitral award. Therefore the Convention subject does not interfere with the issue of applicable law. However, one can argue that article V of the Convention does in fact deal implicitly with

73. see Eiz-Aldeen (op. cit no. 13).

74. See Jean Robert and Thomas E. Carbonneau (op.cit.)

75. Infra.

the issue at hand, that is, the applicable law in an arbitration agreement.⁷⁶ Supporters of this theory argue that Article V of the Convention deals implicitly with this issue. Article V(1)(a) of the Convention provides that the law applicable to the arbitration agreement is "the law to which the parties have subjected it or, failing any indication thereon,...the law of the country where the award made" . Writers who support this approach include Mr. Van den Berg. According to him:

A systematic interpretation of the Convention in principle, permits the application by analogy of the conflict rules of Article V(1)(a) ⁷⁷

The uniform conflict rules for determining the applicable law are not expressed in the Convention. They come in the course of discussing the enforcement of the arbitral award.⁷⁸ Article V(1)(a) provides for two conflict rules. The first rule is party autonomy, which accords to the parties the choice of the law which is to govern the arbitration agreement. The second rule refers to any case where the parties fail to indicate the applicable law. The award may be governed by the law of the country where the award was made.

76. Samia Rashed,"Arbitration in Private International Relation", Vol.1, Cairo, 1984

77. Albert Jan Van den Berg,"The New York Arbitration Convention of 1958",(Kluwer Netherland 1981) p.126

78. Ibid.

5 The *lex mercatoria*⁷⁹

This issue should be discussed in the course of the discussion of the theories of the applicable law. However, it has been necessary to postpone discussion to the end due to the controversial nature of this issue. This issue is disapproved of by some states. Enforcing an award according to these rules is considered contrary to public policy, and as ousting the right of the national law to supervise arbitration taking place in its territory.

The phenomenon of the "delocalisation" of the arbitral process is a concept which has been propounded in recent years by some writers as part of the internationalisation of commercial law. Arbitration has taken many steps to reach this point. When the system of arbitration was in its infancy parties preferred to take their disputes to special tribunals in order to settle the dispute under the supervision of a competent court, which has the right to review, remit or set aside an award under Sections 22 and 23 of the English Arbitration Act of 1950, if the arbitral tribunal violated the law. After some time, the parties were granted the right to exclude court interference from the arbitration process by embodying in their agreement the exclusion agreement under Sections 1 and 2 of the 1979 Act. However, this did not abolish all court powers. A more fundamental restriction on intervention has arisen in the context of transnational arbitration, leading the parties and the writers who oppose court supervision to

79. It is not easy to provide an exhaustive list of all the elements of the *Lex-mercatoria*. The main elements of which the system consists are Public International law, Uniform law for example, Uniform Law, on the Sale of Goods of 1964, The general Principle of law among such principles are the *pacta sunt servanda*, the Rules of International Organisations such as the UN, UNCTAD.. ect, Customs and Usages such as the INCOTERMS, Standard form Contracts, Reporting of Arbitral Award.

look for a system which excludes the court's right to interfere. By applying international law, this is deemed to deprive the court of all its jurisdiction. The rule is controversial even among arbitration commentators. Some support the rule⁸⁰ other argue against it⁸¹.

This theory may be defined as the proposition that arbitration should be independent of any domestic arbitral system, including the law of the country where the arbitration takes place.

It has also been defined as :-

The customs of the business community may combine all general principles of law to create a system of commercial self-determination.⁸²

One commentator has formulated the issue :-

The parties to an international contract sometime agree not to have their dispute governed by national law. Instead they submit it to the custom and usages of international trade, to the rules of law which are common to all or most of the states engaged in international trade or to those states which are connected with the dispute. Where such common rules are not ascertainable the arbitrator applies the rule or choose the solution which appears to him to be the most appropriate and equitable. In doing so he considers the laws of several legal systems. This judicial

80. See Jan Paulsson, in, *Arbitration unbound: Award detached from the law of its country of origin*, (1981)30 ICLQ 359-387.

81. See William Park, *The "Lex loci Arbitri and International Commercial Arbitration"*, (1983)32 ICLQ 21-52.

82. W.L.Craig, W.W.Park, and J.Paulsson, *International Chamber of Commerce Arbitration* (Paris 1984), Article 35.02.

process, which is partly an application of legal rule and partly a selective and creative process, is here called application of the *Lex mercatoria*.⁸³

The rule may come as a clause of an agreement to exclude the application of every municipal law, and provide for exclusive application of the general principles and usages of international trade.⁸⁴ The rule of *Lex-Mercatoria* in certain contractual clauses may imply, for example, an amiable composition clause, which empowers the arbitrators to decide *ex aequo et bono*.⁸⁵

83. Ole Lando, "The *lex mercatoria* in International Commercial Arbitration" (1985) 34 ICLQ 747.

84. ICC Award, Case No.1110/1963, cited by *lew.op.cit* at 553

85. Berthold Goldman, "The Applicable Law: General principles of law-the law of *lex mercatoria*", Contemporary problems in international arbitration (Lew, ed. 1987) p.113.

The theory disregard the place of arbitration, that is, location is of no significance in determining the applicable law. The arbitral tribunal is not connected to the law of the place where the arbitration takes place. Thus the parties avoid any involvement in the technicalities of any national system and their rules which may be unsuited to international contracts. The theory goes further, stating that conflict-of-law is irrelevant to international commercial arbitration, because the arbitrators should not decide the dispute according to any municipal substantive law⁸⁶

5.1 The origins of the system

The system has its source and support from Article VII of European Convention of 1961. Its text, and particularly Art. VII about applicable law, "has been widely commented upon and widely used by arbitrators acting beyond the field of its ratification".⁸⁷ This Convention provides for arbitrators a way in which they can determine the applicable law, and in the case of parties failing to indicate the applicable law, arbitrators "shall apply the proper law under the rules of conflict that the arbitrators deem applicable. In both cases the arbitrators shall take account of the terms of the contract and trade usage".

The term "trade usage" which is the chief component of *Lex mercatoria*, has been taken as an indication that the *lex mercatoria* is allowed by the Convention and is the foundation of non-national arbitration.⁸⁸

86. Michael Mustil & Stewart C. Boyd, *The law and Practice of Commercial Arbitration in England* (London 1989) P.80-82.

87. Anghelos Foustoucos "Lex-Mercatoria (Its dangers and means to guard against misuse)" Paper submitted in MMEIA Cairo January 7 - 12-1989.

88. Ole lando (op.cit no.83)

Article 42(1) of the Washington Convention of 1965 also supported this issue when it provides:-

The tribunal shall decide a dispute in accordance with such rule of law as may be agreed by the parties. In the absence of such agreement, the tribunal shall apply the law of the contracting state party to the dispute (including its rules on the conflict of law), and such rules of international law as may be applicable.

Finally, Article 33(3) of the UNCITRAL Arbitration Rules and Article 13(5) of the ICC Arbitration Rules, provide the rules for determining the applicable law, and give the arbitrators the right to take account of the relevant trade usage.⁸⁹

These are the International authorities which support the use of *lex-mercatoria*, which, in the absence of any choice of substantive law by the parties, arbitrators are required to apply if they deem them to be applicable. Scholars and writers, like Goldman, take Article VII of the European Convention as the authority which arbitrators should follow in this kind of situation even though the Convention does not state to what circumstances the rules of *lex mercatoria* are considered to apply precisely. Rather, the Convention is dedicated to the determination of the rules of conflict which should be applied in the case where the parties fail to do so. The matter of "trade usage" (*lex mercatoria*) ranks as subordinate. The Convention, during its discussion of the rules which determine the applicable law, does not state that "trade usage" is a rule which arbitrators should apply, but only that they may "take account" of it, at least if required. The Convention introduced this section as a guide to arbitrators in order to assist them in their work. This applies equally to the UNCITRAL and the ICC rules. The rules must not be taken as an original reference, to be applied instead of municipal law, but rather as matter of a gap-filler in the municipal system of substantive law.

89. Goldman (op. cit no. 85) p.123.

5.2 Why Lex mercatoria?

The question arises, why resort to lex mercatoria? Why do parties choose to delocalise their agreement from the municipal or the national law? One reason lies in a consideration of the general rules. Parties may fail to choose any substantive law which arbitrators could apply if there is no suitable rule or no suitable equivalent in the applicable national law, or if national law is not applicable (in a case where a contract is concluded outside the scope of any national law), or sometimes the parties (where one of the parties is a government) disagree with one of the applicable laws. A state government does not wish to submit to the law of foreign states. A private party may also not wish to have the contract governed by the laws of a foreign government because of the partiality of its courts, or maybe because there is some obligation in the law of this government which could prove contrary to the interests of the private party. In this case the arbitrators may apply "*Lex-mercatoria*". Private parties, when entering into an agreement with a state government, fear the application of the national law of that state for lack of impartiality or the possibility of a change in the national law such as the "nationalization law . " The TOFCO⁹⁰ decision illustrates the application of this principle. In that case the Libyan Government accepted stabilization clauses in a concession agreement with the foreign parties. The arbitration held:-

The recognition by international law of a state's right to nationalize is not sufficient to allow a state to disregard its previous contractual commitments, because the same principle also recognises the power of a state to commit itself internationally.⁹¹

90. Texaco Overseas Petroleum Co., V. Government of the Libyan Arab Republic (1978) 17 ILM 1.

91. Ibid.

Applying the rules of *Lex-mercatoria* may lead to avoidance of any challenge to "state sovereignty" which could arise were arbitrators to apply the laws of another nation. In the dispute between the Arabian American Oil Company and the Kingdom of Saudi Arabia, Arbitration was held in Geneva under an *ad-hoc* submission agreement.⁹² The arbitral tribunal refused to apply the Swiss law even though it is the law of the seat of the arbitration. It justified its refusal by saying:-

Although the present arbitration was instituted, not between states, but between a state and private American corporation, the Arbitration Tribunal is not of the opinion that the law of its seat-should be applied to the arbitration...

Considering the jurisdictional immunity of a foreign state, recognized by international law in a spirit of respect for the essential dignity of sovereign power, the Tribunal is unable to hold that arbitral proceedings to which a sovereign state is a party could be subject to the law of another state. . . For these reasons, the Tribunal find that the law of Geneva cannot be applied to the present arbitration. It follows that the arbitration, as such, can only be governed by international law...⁹³

Also it can serve to resolve the difficulty between states and private parties concerning the so-called " mixed state contracts " to avoid the tangle of nationalization and unilateral action by the host state.⁹⁴ Another reason given for avoiding the application of a host country's laws is the inadequacy of those laws, especially in

92. Aramco Arbitration (1963)27 I.L.R. p117

93. Ibid at p.155-156

94. Keith Hight, " The Enigma of The Lex Mercatoria", (1989)163 Tulane Law Review 613-628

developing countries.⁹⁵

5.3 The courts attitude towards *lex mercatoria*

Before discussing court attitudes towards *lex mercatoria* it is helpful to examine whether or not *Lex-mercatoria* favours court regulation and interference in arbitration?

Delocalisation implies more than the autonomy of arbitration within a legal system. It envisages detachment of the process from any one system, at least until enforcement of the award is sought. In particular, "the obligatory force of an arbitral award need not necessarily be derived from the law of the place where the award happened to be rendered".⁹⁶

Thus the fact that a mandatory rule of procedure of the *Lex-loci arbitri* is infringed, thus Preventing execution of the award in that country, is irrelevant to its enforcement in another state not possessing a similar rule. This study will move on to examine the system in civil law countries, and in common law countries, and to what extent the court is willing to apply this principle. Is the court able to enforce an award even if it has been settled according to *lex mercatoria*?

95. See, *Amin Rasheed shipping Corp., v. Kuwait Ins. Co.*, [1983] 3WLR 241 (law of Kuwait did not include marine insurance provision and the case was turned on marine insurance contract)

96. J.Pulsson, *Delocalisation of International Commercial Arbitration: when and why it matters*, (1983) 32 ICLQ 53.

The first example will be in a civil law country. This is a dispute about the validity and the enforceability of an award rendered in Vienna by an arbitral tribunal under the auspices of the ICC.⁹⁷ The award concerned the termination of an agency agreement between the French corporation (Norsolor) and its Turkish agent (Pabalk). The award did not rely on any national legal system. The arbitral tribunal was faced with the difficulty of choosing a national law sufficiently applicable to comply. In this award the tribunal concluded that, given the international nature of the agreement, international *lex mercatoria* should be applied. The judgment of the arbitral tribunal found in favour of the Turkish party by finding the French party responsible for the termination of the agency agreement. The French party challenged the award on the grounds of violation of mandatory rules according to Article 595(5) and (6) of the Austrian code of civil procedure (ZPO) which stated:-

an award rendered in Austria could be set aside *inter alia* if the arbitral Tribunal dealt with matters beyond those referred to it... and if the award violated mandatory provisions of law⁹⁸.

The Tribunal of Commerce of Vienna dismissed the Norsolor claim. However, the Court of Appeal set aside the award on the grounds that the arbitral tribunal exceeded its power in referring to *lex mercatoria*. The arbitral tribunal should have grounded its decision in a particular national legal system.

The Austrian Supreme Court, however, disagreed with the Court of Appeal, and reversed this decision on the following grounds:-

1. in relying on the principle of good faith to determine the principal's liability for the damage caused by the termination of the

97. (1985) 24 ILM 360-363.

98. Pabalkticaret V. Norsolor, (1985) 24 ILM 360-363.

agency agreement, it did not infringe any mandatory rules within the meaning of Article 595(6) of the ZPO and;

2.in determining the amount of damages on the basis of equity without special authorization from the parties, the arbitral tribunal did not transgress the limits of its competence within the meaning of Article 595(5) ZPPO.⁹⁹

French jurisprudence adopted the same approach in the same case the *tribunal de grands instance* of Paris, held that applying the principle of good faith (*lex mercatoria*) the arbitrators did not rule as *amiables compositeurs* and therefore they did not exceed their power under the agreement.¹⁰⁰

The civil law court is not reluctant to enforce an award rendered according to the *lex mercatoria*. The only requirement of the Court of *Cassation* in France to enforce this kind of award is that the award has not violated public policy.¹⁰¹

We may ask what is the English attitude to the *lex-mercatoria*. With regard to the limitations of a system whereby arbitrators reach their decision without relying on any particular national legal system, and by ignoring the mandatory rules of English law, do the courts still have the same attitude or has it changed with time?

The traditional attitude of the English court is unreceptive to an arbitrator's application of non-national principles. Such an application might be taken as ousting judicial jurisdiction which is not possible in England. Lord Justice Scrutton stated that:-

99. Ibid.

100. Ibid.

101. Ibid.

an agreement to shut out the power of the King's Courts to guide the proceedings of inferior tribunals without legal training in matters of law before them is calculated to lead to erroneous administration of law and therefore injustice, and should therefore not be recognized by the court...I think commercialmen will be making a great mistake if they ignore the importance of administering settled principles of law in commercial disputes and trust to the judgment of business man.¹⁰²

The approach remains one of considering any departure from these rules as invalid because it would violate or offend public policy.

In the case of Orion Cia. Espanola de Segores v. Belfort Meats¹⁰³

the contract comprised a clause in the following terms:

The arbitrators and umpire are relieved from all judicial formalities and may abstain from following the strict rules of the law. They shall settle any dispute under this agreement according to an equitable rather than a strictly legal interpretation of its terms and their decision shall be final and not subject to appeal.

Megaw, J, stated¹⁰⁴: -

... it is the policy of the law of this country that, in the conduct of arbitration, arbitrators must in general apply a fixed and recognizable system of law, which primarily and normally would be the law of England, and that they (arbitrators) cannot be allowed to apply some different criterion such as the view of the individual arbitrator or umpire on abstract justice or equitable principles, which, of course ,

102. Czarnikow v. Roth Schmidt[1922]2 K.B.478 at p.488

103. [1962] 2 Lloyds Rep.257

104. Ibid.

does not mean "equity" in the legal sense of the word at all.

The arbitrators in an English arbitration must apply the law, otherwise, the award will be considered an "Alsatia of the King's writ".¹⁰⁵ In English law, a contract is governed either by English law or by some specific foreign law. But not by different principles such as *Lex mercatoria*. The court will set aside awards based on such rules.

By 1978 the court attitude show signs of "softening" on the principle of *lex mercatoria*. More recent occurrences might be taken as an indication of a willingness to depart from the old principle. In Eagle Star V. Yuval Inns¹⁰⁶, the arbitration clause was set out in terms similar to the clause in the *Orion* case. The expectation was that it would settle in accordance with the judgement of *Orion*.¹⁰⁶⁽¹⁾

The Court of Appeal's decision was unexpected in considering the agreement, even if based on "equity". Lord Denning justified this action by arguing that the "equity" clause in the case does not oust the jurisdiction of the court but only ousts technicalities and strict construction. The only ground on which anything could be found wrong would be "public policy". Lord Denning found no reason to invoke that ground.¹⁰⁷

In Amin Rasheed Shipping Corporation v. Kuwait Insurance Co.¹⁰⁸ Lord Diplock remarked that contracts are incapable of existing in a legal vacuum. It will not be more than a piece of paper, unless made by reference to some system of private law.

105. Supra note 102.

106. [1978] Lloyd Rep[.357].

106 (1). Supra

107. Ibid p. 362

108. [1984] A.C.50,[1983]3 WLR 241

In Bank Mellat v. Hellniki Techniki S A,¹⁰⁹ Kerr L J stated:-

Despite suggestions to the contrary by some learned writers under other systems, our jurisprudence does not recognize the concept of arbitral procedures floating in a transnational firmament, unconnected with any municipal system of law.

Two decisions followed Lord Denning's decision to uphold the traditional view of the English court as being unreceptive to an arbitrators application of any non-national principle to a contractual dispute. The Court of Appeal's decision in Deutsche Schachtbau- und Tiefbohrge-sellschaft m.b.h.v. Ras Al Khaimah National Oil Co.,¹¹⁰ concerning a case where the arbitral tribunal had determined in pursuance of ICC Rules Article 13(3), that the proper law was "*internationally accepted principles of law governing contractual relations*". The decision in this case contradicted the prior case. However, it was supported by Lord Denning's decision in *Eagle Star* in his attempt to enforce the arbitral award. Even though this arbitral award was based on non-national principles and in terms that the enforcement would be contrary to public policy, Sir John Donaldson stated in his judgement:-

I am left in no doubt that the parties intended to create legally enforceable rights and liabilities and that the enforcement of the award would not be contrary to public policy... By choosing to arbitrate under the rules of the ICC and, in particular, Article 13(3), the parties have left, the proper law to be decided by the arbitrators and have not in terms confined the choice to the national systems of law.¹¹¹

109. [1984] Q.B. 291.

110. [1987] 2 Lloyds Rep., 246.

111. *Ibid* p. 245

Nevertheless, the policy of the English court must keep in line with other countries by showing some "softness" regarding this system which has spread throughout Europe, in order to avoid losing its position amongst the other states as a centre of commercial arbitration. No harm will come from the enforcement of an arbitral award on the ground of *ex aequo et bono* provided that it does not violate public policy, or by imposing the limitation on this principle or by adopting a clear policy of not enforcing such an award.

The willingness of English courts to enforce an arbitral award based on this principle is obvious when examining some cases in the English courts. Decisions have indicated a possibility of approving the principle of *Lex-mercatoria* even though this approval is not disclosed formally yet, but it may be assumed that such approval will be forthcoming in the near future.

6. The law governing Procedure

The law governing procedure is the law which regulates the arbitral tribunal regarding its constitution, and the course arbitrators should follow during the hearing of the case, as well as requirements pertaining to the proceedings and matters that follow from it, the appointment of the arbitrators, the law which the arbitrators have to apply, powers and duties of the arbitrators and the requirements relating to the arbitral award.

The parties are free to designate, or provide for the designation of arbitrators, by defining the procedure to be followed in arbitral proceedings. The proper determination may be made in the arbitral agreement as in *ad-hoc* arbitration or reference to domestic rules applicable within the context of institutional arbitration. Article 11 of the ICC Rules provides:-

The rules governing the proceedings before the arbitrator shall be those resulting from these Rules and, where these Rules are silent, any rules which the parties (or, failing them, the arbitrator) may settle, whether or not reference is thereby made to a municipal procedural law to be applied to the arbitration.

In the case where the parties failed to make use of their autonomy, the arbitrator is given the freedom to determine the procedural law either directly or by reference to a seat of arbitration rules. The New York Convention considers that the applicable law to arbitral procedure is subject to a variable degree of autonomy: that of the seat of arbitration or the law chosen by the parties.¹¹²

In contrast, the Inter-American Convention of 1975 provides in Article 3:-

In the absence of an express agreement between the parties, the arbitration shall be conducted in accordance with the rules of procedure of the Inter-American Commercial Arbitration Commission.

The European Convention of 1961, de-emphasizes the significance of the seat of arbitration as a connected factor, and gives party autonomy the outer limits.¹¹³ The freedom of the parties and the arbitrators is not limited by the mandatory rules of municipal law, or the law of the place of arbitration. The *Lex situs* arbitration may be applied where the parties do not agree on the rules of procedure, and the arbitrators have not settled such a rule.¹¹⁴ However, the freedom of the parties and the arbitrators must not be contrary to public policy.

112. Article V (1) (d).

113. Georges R. Delaume, *Transnational Contracts: applicable law and settlement of disputes*, booklet 15, (1986).

This is, in general, the rule by which parties and arbitrators determine the law governing the procedure in international commercial arbitration. The same rules may be used in domestic arbitration in cases where the parties fail to choose the law. The legal systems are not at odds with the international arbitration on this point. To what extent has this point been dealt with in domestic arbitration?

In England, the 1950 and 1979 Arbitration Acts did not provide a comprehensive set of rules for procedure law; these acts said little about how the procedure by which arbitration should be conducted.¹¹⁵ The parties are able to choose the law, however, this liberty must not oust the court's supervisory jurisdiction over the tribunal or be used with the intention of violating mandatory rules.¹¹⁶

When the parties' agreement is silent on the proper law, arbitrators may consider the proper law according to the seat of the arbitration. There is a "...strong presumption" that applicable law may be the proper law which is the law of the country where the arbitration took place.¹¹⁷ In this case the applicable law has been determined according to the law of the seat. However, parties may sometimes choose a law of procedure, other than the law of the place of arbitration. The normal situation is where the parties may choose the place or the seat of the arbitration and thereby choose a procedure in that place.¹¹⁸ In Cia Maritima Zorroga SA v. Sesostris SAE (The Marques de Bolarrque), a charter party between a Spanish Shipowner and Spanish charterers provided that it was to be governed by the Spanish law and any disputes were to be settled by arbitration in

114. Goldman (op. cit 85) p. 124

115. Hans Smit and Vratislav Pechota, *The World Arbitration Reporter*, (vol.2 A,1988) p. 2736.

116. See Bank Mellat V. Helleniki Techniki supra.

117. Tzortzis v. Monark Line A/B[1968] 1 WLR 406.

118. Lawrence Collins, *The Law governing the agreement and Procedure in international arbitration in England*.

London. When a dispute arose, the Spanish owners sought to restrain an arbitration in London on the ground that the arbitration clause was invalid. On the evidence of Spanish law it was held that an agreement by a Spanish company to arbitrate in London was not contrary to Spanish law. In the argument it was suggested that it might be possible for the arbitration in London to be subject to Spanish law. Hobhouse J. seems to have thought that although it might be "*conceptually possible* ... it would, for practical purposes, be impossible."¹¹⁹ Thus arbitrators in England are subject to the mandatory rules of English law relating to arbitral procedure.¹²⁰

Obviously the parties sometimes refer to a procedure law of another state, in order to avoid the implementation of the provision of mandatory rules or public policy in the place of arbitration law. Such a choice may be annulled because it violates public policy. Parties may choose the rules of "*lex-mercatoria*" although they may have no link with the dispute, purely to avoid the mandatory rules in the place of arbitration. This option does not find support in English law. Arbitrators in England are subject to mandatory rules of English law relating to arbitral procedure. Arbitrators cannot avoid these rules simply by applying the *lex mercatoria* rules,¹²¹ even if the arbitration is held under the auspices of international arbitration. Under English law, foreign arbitration is subject to the law of the seat¹²², and any foreign award which is not made in conformity with the law governing the arbitration procedure may be refused

119. [1984] 1 Lloyds Rep. 652 at 655.

120. Arbitration in England is subject to the review procedures of Arbitration Act 1979 except to the extent that they have been validly excluded by an "exclusion agreement" Dicey & Morris op. cit Rule 58 p. 542

121. Lawrence Collins supra

122. Whitworth Street Estates (Manchester) Ltd. v. James Miller & Partners Ltd, supra.

enforcement.¹²³

The "delocalisation " of the procedure in order to avoid the mandatory rules in the country where the arbitration takes place is considered to be a violation of public policy. English law is not bound by the parties choice of law of procedure but rather give them this right: parties may choose the place of arbitration and thereby choose the procedure prevailing in that place.

The choice of place, however, must not affect the parties. Lord Wilberforce said in Whitworth Street Estates.¹²⁴

...the place might be chosen for many reasons of convenience or be purely accidental; a choice so made should not affect the parties rights.

The choice of law governing the procedure must not violate public law and the choice of law must not affect the parties rights. But, under the 1979 Act, What may arise here is that parties can,by agreement in writing, exclude the right to bring a question of law before the court, if the parties to an arbitration agreement allow the enclosure of such a clause. The parties to an international agreement may also do this before a dispute has arisen if they expressly agree to exclude court power.¹²⁵ In theory this might be possible if the requirement needed to be fulfilled. However, what will be facing this kind of contract, in the case where the parties add this clause in order to avoid mandatory rules, or their implementation, may affect the parties' rights. In this situation the exclusion agreement will not limit the court's jurisdiction.

123. See Lawrence Collins, *supra*.

124. *Supra*.

125. Ole Lando, "The Lex mercatoria In International Commercial Arbitration", (1985) 34 ICLQ 747-768.

7 .Conclusion

Notwithstanding the quantity of theories regarding the proper law which propose solutions to the problems arising when considering the applicable law, arbitrators still are faced with this problem in their choice of proper law. The parties can avoid this difficulty if they have been wise enough to choose expressly which law is to apply to their agreement.

This situation encourages the writer to look for new rules for determining the proper law . One trend which has come to the fore is support for the denationalization of arbitration, decoupling arbitration from municipal law. Writers supporting this delocalisation are trying to unlink the last connection between arbitration and municipal law, and they have succeeded to some extent. The system succeeds in that a number of conflict problems are eliminated by the use of these rules. Further, this system fills a gap in the municipal law system. Yet this should not be taken as a replacement for the municipal law system.

The *lex mercatoria* rules do not derive their binding force from any state authority, and therefore they do not provide a sufficiently substantial and solid system. An award based on this principle cannot be enforced by itself alone, it needs a system which can enforce it, otherwise it will be no more than a piece of paper with no value.

The system of *lex mercatoria* may be used in co-existence with, and may supplement whenever appropriate, rules of domestic law, where the issue or salient point in question is not regulated by it. This latter point applies especially to transnational agreements, for which states tend not to regulate. By this reunion, arbitrators and parties will avoid conflicts of law, reduce the chances of a dispute, and if a dispute arises they will be of considerable assistance in finding the right solution between the arbitral tribunal and the state court where the arbitration took place.