

**THE CHOICE OF APPLICABLE LAW IN
INTERNATIONAL ARBITRATION**

VITEK DANILOWICZ

Reprinted from
HASTINGS INTERNATIONAL AND
COMPARATIVE LAW REVIEW
Volume 9—Winter 1986—No. 2
© Copyright 1986, Hastings College of the Law

The Choice of Applicable Law in International Arbitration

By VITEK DANILOWICZ

LL.M. with Distinction, Uniwersytet Wroclawski (Poland), 1977; Diploma in International Law and Development with Distinction, Institute of Social Studies (The Netherlands), 1982; J.D., Louisiana State University, 1985; LL.M., Louisiana State University, 1985; Associate, Vinson & Elkins, Houston, Texas.

TABLE OF CONTENTS

INTRODUCTION	236
PART I: THE CHOICE OF THE LAW GOVERNING THE ARBITRATION PROCEEDINGS	238
A. The Scope of the <i>Lex Arbitri</i>	238
B. The Distinction between Substance and Procedure in International Arbitration	240
C. The State Interest in the Choice of the <i>Lex Arbitri</i>	243
D. The Choice of the <i>Lex Arbitri</i> by the Arbitrator	251
1. <i>Lex Fori</i>	251
2. The Legal System "Significantly Related" to the Dispute	253
3. Denationalized <i>Lex Arbitri</i>	254
Conclusions	257
PART II: THE CHOICE OF THE SUBSTANTIVE LAW	258
A. Determination of the Substantive Law on the Basis of the Rules of Conflict of Laws	259
1. Application of the Conflict Rules of the Seat of the Arbitration	259
2. Application of the Conflict Rules Other than Those of the Seat of the Arbitration	261
a. The Conflict Rules of the Arbitrator's Home State ...	261
b. The Conflict Rules of the State Which Would Have Had Jurisdiction in the Absence of the Arbitration Clause	262
c. The Conflict Rules of a State Where the Award Will Be Enforced	263

d. The Conflict Rules of a State Most Closely Connected to the Dispute	263
3. Cumulative Application of the Conflict Rules Related to the Dispute	265
4. General Principles of Conflicts of Laws	267
B. The Determination of the Substantive Law without Resorting to Conflict Rules	268
1. Direct Application of the Substantive Rules of a National Law	268
2. Application of the Terms of the Contract	270
3. Application of Non-National Substantive Rules	272
a. Rules of International Trade	272
i. Customs, Usage, and General Principles of Law ..	272
ii. Transnational Rules	274
b. Public International Law	276
Conclusions	278
OBSERVATIONS	282

INTRODUCTION

The past few decades have witnessed an unprecedented growth of international trade and commerce which has generated the need for more efficient methods of dispute resolution. Initially, arbitration was considered the best way of satisfying this need. Compared to court litigation, arbitration was cheaper and faster. Arbitration also offered secrecy, procedural simplicity, and technically competent decision makers. Today, however, many of the original reasons for using arbitration in international disputes have disappeared. Arbitration is no longer necessarily less expensive than court litigation; nor is it faster. Moreover, resort to arbitration may deprive the parties of summary procedures available in courts of law. Finally, the use of so-called "professional" arbitrators—often lawyers with no business experience—casts doubts on the technical competence of arbitrators.¹ Nevertheless, arbitration remains an attractive alternative to national courts, primarily because it allows the parties to avoid the uncertainties and complexities of foreign litigation.² Also, arbitration serves as a means of obtaining jurisdiction over foreign parties

1. Park, *Judicial Supervision of Transnational Commercial Arbitration: The English Arbitration Act of 1979*, 21 HARV. INT'L L.J. 87, 116-17 (1980); see also Branson & Tupman, *Selecting an Arbitral Forum: A Guide to Cost-Effective International Arbitration*, 24 VA. J. INT'L L. 917, 918 (1984).

2. Asken, *The Need to Utilize International Arbitration*, 17 VAND. J. TRANSNAT'L L. 11 (1984).

which, though unwilling to submit to the jurisdiction of foreign courts, might agree to international arbitration. Equally important is the fact that arbitration provides a certain and neutral forum.³ Finally, in arbitration parties have more influence in determining applicable law than they do in court litigation.

A carefully drafted arbitration clause is the prerequisite for taking advantage of all the benefits of international arbitration. Indeed, "[i]nsertion of an apparently simple arbitration clause in the contract can seem an easy way to provide a cheap, quick and fair way of judging any eventual contractual disputes With an apparently innocuous arbitration clause in place, the parties can get on to the 'important' parts of their negotiations and avoid haggling over details of the proceeding which they believe will never occur."⁴ Unfortunately, however, this basic fact is often forgotten by those negotiating international contracts. For instance, rarely do the contracting parties take advantage of the power to designate the applicable law. Even when they do, they often fail to specify whether the designated law should govern the substance of the dispute, the arbitration procedure, or the arbitration clause itself. It is then left to the arbitrator to resolve the choice of law questions left open by the parties.

This study examines ways in which arbitrators choose the applicable law. Several approaches adopted by international arbitrators are presented and juxtaposed with the major theories on the juridical nature of international commercial arbitration. The author also submits his own views on the question of determining the applicable law in international commercial arbitration. Although the author's views do not aspire to be a comprehensive theory, it is hoped they might prove useful to arbitrators facing choice of law problems.

An analysis of international arbitration must take two factors into account: the sovereign's power to control arbitration and the needs of the international business community. Significantly, the sovereign's power to control arbitration includes the power to determine whether an arbitration decision will be given effect. For example, by refusing to enforce the arbitral award, the sovereign can deprive the arbitration of any practical importance. The sovereign also has an interest in the development of international arbitration as a means of promoting trade and commerce. Usually, the business community has a similar interest. Since

3. Park, *supra* note 1, at 117.

4. Higgins, Brown & Roach, *Pitfalls in International Commercial Arbitration*, 35 BUS. LAW. 1035, 1035-36 (1980).

promoting the state's interests and honoring the parties' intentions are not necessarily antithetical goals, an arbitrator who balances these goals can produce enforceable awards that satisfy the parties' expectations.

This study is confined to the question of the choice of the law governing the arbitration proceedings (*lex arbitri*) and the choice of the substantive law (*lex causae*). It does not address the problems of the choice of law governing the arbitration clause itself.

PART I

THE CHOICE OF THE LAW GOVERNING THE ARBITRATION PROCEEDINGS

Unlike a judge, an arbitrator in any international arbitration faces the threshold question of which procedural law should govern the arbitration process. This question does not arise in judicial proceedings because of the universally recognized principle that procedural issues are governed by the *lex fori*, law of the forum, whereas substantive issues may be governed by either forum or foreign law. Although the line between substance and procedure is not always clear, the distinction between the two categories is as old as the law of conflict of laws. One consequence of this distinction is that matters falling into the procedural category are not subject to the choice-of-law process because of the automatic application of forum law.

Assuming that in international arbitration the *lex causae* may, or should be, segregated from the *lex arbitri*, the second question that an arbitrator faces is which law should govern the proceedings: the law of the situs of arbitration, the law of the country of which the arbitrator is a national, or another law. Commentators and arbitrators have responded to this question differently, and their responses are discussed next.

A. The Scope of the *Lex Arbitri*

Although the problem of the scope of the law of the proceedings has been addressed in numerous legal writings, there is no generally accepted catalogue of the issues governed by the *lex arbitri*. According to Wilner, the issues governed by the *lex arbitri* include the conflicts rules which determine the *lex causae*, the need to give reasons for the award, the need to base an award upon substantive rules of law, and judicial review of the arbitrator's decision.⁵ According to Metzger, the *lex arbitri* governs the first two issues submitted by Wilner, as well as the nationality of the

5. Wilner, *Determining the Law Governing Performance in International Commercial Arbitration: A Comparative Study*, 19 RUTGERS L. REV. 646, 648 (1965).

award and the law applicable to the arbitration agreement.⁶ The scope of the *lex arbitri* was broadened by Hirsch, who added the following to Wilner's and Metzger's lists: The ability to arbitrate a given issue; the court's power to stay judicial proceedings and order arbitration; the methods by which arbitrators are appointed and the opportunities for challenging their mandate; the possibility of resorting to a court during the arbitration; and, finally, whether, and to what extent, the parties determine the procedural rules to be applied by the arbitrator.⁷ Recently, Smedresman criticized these lists as overly inclusive. He proposed that the scope of the *lex arbitri* should be limited to all aspects of procedure in arbitration, including the conduct of the arbitrator, and, crucially, the extent of judicial supervision of the arbitration.⁸

Wilner's, Metzger's, and Smedresman's definitions of the *lex arbitri* were formulated without reference to any particular legal order. It is axiomatic that each legal system decides for itself which issues are substantive and which are procedural.⁹ Certainly, if the parties to the arbitration are free to choose the *lex arbitri*, its scope may be discussed without regard to national law. If, however, the choice of the *lex arbitri* is determined by national law, its scope is also fixed by national law. The classification of a given issue as substantive or procedural is, therefore, of particular importance in those legal systems which limit the parties' freedom to choose the *lex arbitri*.

6. Metzger, *The Arbitrator and Private International Law*, in INTERNATIONAL TRADE ARBITRATION 233 (M. Domke ed. 1958). The difference between Metzger's and Wilner's definitions of the *lex arbitri* is less significant in light of Wilner's definition of the law of the proceedings as "the legal system of the country in which the award is considered domestic for purposes of obtaining confirmation." Wilner, *supra* note 5, at 648.

7. Hirsch, *The Place of Arbitration and the Lex Arbitri*, 34 ARB. J. 43, 44-45 (1979). According to Ehrenhaft, rules of procedure, as opposed to the law governing the proceedings (law of the proceedings), govern the following issues: The arbitrator's general authority over the proceedings, the service of process, the method each party may use to present its case, the rebuttal rights of each party, the basic rules governing the reception of evidence, the use of subpoenas, the close of hearings, the times for submitting briefs and announcing the final award, and the form the award must take. Ehrenhaft, *Effective International Commercial Arbitration*, 9 LAW & POL'Y INT'L BUS. 1191, 1205 (1977).

8. Smedresman, *Conflict of Laws in International Commercial Arbitration*, 7 CAL. W. INT'L L.J. 263, 268 (1977). Smedresman noted that a "mere definition of the law of the proceedings . . . accomplishes little; the significant questions are whether the law of the proceedings has an independent existence for conflict purposes, and how useful it is as an analytic tool." *Id.*

9. Wetter, *The Legal Framework of International Arbitral Tribunals — Five Tentative Markings*, in INTERNATIONAL CONTRACTS 278 (1981). The author admits, however, that some jurisdictions "expressly or impliedly permit the parties to subject their proceedings in large measure to a foreign procedural law." *Id.*

B. The Distinction between Substance and Procedure in International Arbitration

The dichotomy between substance and procedure has not always been recognized in the law of arbitration. For a long time it was assumed that the law applicable to the merits of a dispute should also govern the proceedings. Consequently, the choice of the *lex arbitri* did not present an independent problem for purposes of conflict of laws.

The independence of the *lex arbitri* in international arbitration for conflict purposes was first recognized by the English courts in *James Miller & Partners, Ltd. v. Withworth Street Estates (Manchester) Ltd.*¹⁰ There, the parties entered into a contract whereby a Scottish company agreed to remodel an English company's factory in Scotland. The arbitration clause in the contract did not specify the applicable substantive law, place of arbitration, or procedural law. Because the parties were unable to agree on an arbitrator, the president of the Royal Institute of British Architects appointed a Scottish architect, practicing in Scotland, to serve as arbitrator. The arbitration proceedings were held in Scotland based on Scottish procedure. During the proceedings, the respondent, the English company, asked the arbitrator to state the award in the form of a "case stated."¹¹ Relying on Scottish law, which did not provide for the "case stated" procedure, the arbitrator refused. The English company petitioned an English court to order the arbitrator to satisfy the demand. In the meantime, the arbitrator rendered an award for the Scottish claimant.

In the proceedings before the English court, the respondent company argued that the contract was governed by the law of England, and, therefore, English law should govern the procedure as well.¹² The majority of the Law Lords agreed with the respondent's contention that the contract was governed by English law. Nevertheless, the Lords unanimously held that the *lex arbitri* could differ from the law governing the merits, and Scottish procedural law was properly applied to the proceedings. The Lords' holding was based on the finding that "the conduct of the parties after the appointment of the arbitrator sufficiently showed an agreement or acceptance on the part of the English company that the arbitration proceedings should be governed by the law of Scotland

10. 1970 A.C. 583 [hereinafter *James Miller*].

11. Under the English Arbitration Act of 1950 the "case stated" (or "special case") procedure allowed the English court to decide issues of law involved in the arbitration. This procedure was abrogated by the new Arbitration Act of 1979. See *infra* text accompanying notes 41.

12. 1970 A.C. 583, 584.

...¹³

A few years after *James Miller* was decided, the Paris Court of Appeals considered the dichotomy between the *lex causae* and the *lex arbitri*. The issue arose in two combined cases, *Société O.C.P.C. v. la Société K.G. Wilhelm Diefenbacher* and *Société O.C.P.C. v. M. Wilhelm Godfried Diefenbacher*.¹⁴ Under the terms of the contract which gave rise to these disputes, the respondents' (a German company, K.G. Wilhelm Diefenbacher, and Mr. Diefenbacher in his individual capacity) granted to the claimant (a Belgian company) an exclusive license for the exploitation of the respondents' patents. The contract contained an arbitration clause providing for arbitration under the rules of the International Chamber of Commerce (I.C.C.) and a choice of law clause providing for application of Belgian substantive law to the merits of the dispute. The I.C.C.-appointed arbitrator, sitting in Paris, found for the respondents and the award was challenged by the Belgian claimant in the Paris Court of Appeals. In its opinion the court noted that the parties submitted their dispute to arbitration under the rules of the I.C.C., an international institution based in France. The parties also agreed to the appointment of a French arbitrator and to his choice of Paris as the seat of the tribunal. Considering these facts, the Paris Court of Appeals held that the parties implicitly had chosen French law to govern the arbitration proceedings.¹⁵ The choice of Belgian law to govern the merits did not, in the court's opinion, mandate the conclusion that Belgian law also should govern the procedure.¹⁶ The court's decision was based on Rule 16 of the Rules of Conciliation and Arbitration of the I.C.C. as it then stood and which read as follows:

The rules by which the arbitration proceedings shall be governed shall be these [I.C.C.] Rules and, in the event of no provision being made in these Rules, those of the law of procedure chosen by the parties or, failing such choice, those of the law of the country in which the arbitrator holds the proceedings.¹⁷

From the parties' choice of the I.C.C. Rules, among which was article 16, the court implied an intent to have the procedure governed by the

13. *Id.*

14. Judgment of June 18, 1974, Cour d'appel, Paris, 1975 REVUE D'ARBITRAGE [R.A.] 179 [hereinafter Diefenbacher]. The resolution of this question was the same in both cases.

15. *Id.*

16. *Id.*

17. International Chamber of Commerce, Rules of Conciliation and Arbitration in force on June 1, 1955 (1964) (emphasis added). Rule 16 was amended in 1975 and the reference to the law of the seat of arbitration was deleted. See *infra* text accompanying note 26.

laws of the place of arbitration, rather than the law chosen to govern the merits.

The segregation of the *lex arbitri* from *lex causae* by the English court in *James Miller* and the French court in *Diefenbacher* was an important breakthrough because it recognized that the choices of the *lex arbitri* and the substantive law may be influenced by different considerations. For example, parties to a dispute may choose English Maritime Law based on its completeness and sophistication. Without more, however, the choice of English substantive law does not imply a choice of English procedure and the parties may prefer another procedural law which permits greater autonomy.

Although *James Miller* and *Diefenbacher* recognized the distinction between the *lex arbitri* and the *lex causae*, neither case decided how the *lex arbitri* should be chosen. In both cases the courts applied the law of the country in which the proceedings were conducted. The soundness of this approach will now be discussed.

In judicial proceedings, convenience and judicial economy justify the application of the *lex fori* to procedural issues. Applying foreign substantive law, as well as procedure, would place too great a burden on local judges.¹⁸ The same considerations do not apply in the field of international arbitration. Unlike a judge, an arbitrator often conducts proceedings in a country other than his or her own. Often, the parties choose one country as the place of arbitration and then nominate an arbitrator from a different country; on other occasions the arbitrator may choose an arbitration seat not located in his or her home country. In either situation, the arbitrator may not be familiar with the procedural law of the place of arbitration; therefore, the rationale for applying the *lex fori* is not compelling. In fact, considerations of convenience suggest the opposite result: that the arbitrator or the parties should have the freedom to choose a procedural law other than the law of the place of arbitration.

Of course, it could be argued that what is at stake is not the arbitrator's convenience and familiarity with the applicable *lex arbitri*, but the convenience of the local judge who eventually may review the arbitration. Even if a court reviews the arbitration proceedings, however, the

18. "[I]t would obviously be quite inconvenient for the court of the forum . . . to take over all the machinery of the foreign court for the 'enforcement,' as we say, of the 'substantive rights.'" Cook, "Substance" and "Procedure" in the Conflict of Laws, 42 YALE L.J. 333, 343-44 (1933). See also DICEY AND MORRIS ON THE CONFLICT OF LAWS 1177 (10th ed. 1980) [hereinafter DICEY & MORRIS]; P. NORTH, CHESHIRE'S PRIVATE INTERNATIONAL LAW 686 (9th ed. 1974); R. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS 46 (1971); R. LEFLAR, AMERICAN CONFLICTS OF LAWS 239 (3d ed. 1977).

judicial convenience argument has little merit because it is always possible that court proceedings will be instituted in a jurisdiction other than where the arbitration was conducted.¹⁹ Because considerations of convenience and ease of administration do not always justify application of local law, the question is whether other considerations support the application of local law.

C. The State Interest in the Choice of the *Lex Arbitri*

According to the territorial (or jurisdictional) approach to international arbitration, arbitration operates within the framework of a national legal order. Thus, although arbitrators are free to apply foreign substantive law, they are required to abide by local procedural law.²⁰ The territorial approach can be found in the civil procedure codes of some nations. For example, under article 2 of the Italian Code of Civil Procedure, Italian nationals are not allowed to exclude the competence of Italian courts.²¹ Under German law, parties can choose only the procedural law of those states whose courts have jurisdiction under internationally recognized principles.²²

The justification for limiting the parties' freedom to choose procedural law is the sovereign's interest in administering justice within its territory. From this standpoint arbitration is sometimes perceived as an attempt to circumvent the jurisdiction of local courts and bypass the sovereign's rules regulating the administration of justice.

The critics of the territorial theory argue it is incompatible with the needs of the international business community. As pointed out by one commentator, "[t]he wishes of the international business communities undoubtedly go towards denationalisation The parties . . . want their dispute, as far as possible, to be dealt with regardless of any specific

19. On the multiple-jurisdiction phenomenon in international arbitration, see *infra* text accompanying note 60.

20. For the description of the territorial theory, see J. LEW, *APPLICABLE LAW IN INTERNATIONAL COMMERCIAL ARBITRATION* 52 (1978). When taken to its extreme, the territorial theory leads to the conclusion that there may be no international arbitration:

Although, where international aspects of some kind arise, it is not uncommon and, on the whole, harmless to speak, somewhat colloquially, of the international arbitration, the phrase is a misnomer. In the legal sense no international commercial arbitration exists . . . [E]very arbitration is a national arbitration, that is to say, subject to a specific system of national law.

Mann, *Lex Facit Arbitrum*, in *INTERNATIONAL ARBITRATION* 159-60 (P. Sanders ed. 1967).

21. Coing, *The Substantive Law and the Law of Arbitration Procedure* in *INTERNATIONAL COMMERCIAL ARBITRATION* 96, 107 (C. Schmitthoff ed. 1975).

22. *Id.* at 105.

national law."²³ Important as the business community's needs may be, however, they cannot abrogate the sovereign's power to regulate arbitration held within its territory. Nevertheless, the sovereign may have no interest in some arbitration proceedings, and in these cases there is no reason to apply local procedural law.²⁴ The increasing internationalization of commercial arbitration has produced situations in which the sovereign has no interest in regulating the dispensation of justice within its territory. This occurs when a given locality has no contacts with the dispute and is chosen as the seat of arbitration solely for its neutrality.

The recent French decision, *Götaverken Arendal A.B. v. Libyan General National Maritime Co.*,²⁵ is a good example of an arbitration which took place in a disinterested forum. The dispute arose from the purchase of vessels by a Libyan company from the Götaverken shipyard in Sweden. Throughout the arbitral proceedings and the subsequent litigation, the vessels were located in Sweden and none of the parties owned property related to the dispute in France. The arbitration took place in Paris under the I.C.C. Rules. The arbitral tribunal was composed of three arbitrators — a French chairman, a Norwegian, and a Libyan. The parties did not designate the *lex arbitri*, nor was it designated by the arbitrators. The revised I.C.C. Rules in force at the time provided that:

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, and whether or not reference is thereby made to a municipal procedural law to be applied to the arbitration.²⁶

The arbitration panel decided in favor of the Swedish claimant and the Libyan company appealed to the Paris Court of Appeals. The Paris court recognized that France's only contact with the dispute was as the site of the arbitration, and that Paris had been chosen solely for its neutrality.²⁷ Under these circumstances, the court found that the choice of

23. Sanders, *Trends in the Field of International Commercial Arbitration*, 145 RECEUIL DES COURS D'ACADEMIE DU DROIT INTERNATIONAL [R.C.A.D.I.] 205, 262 (1975).

24. Metzger, *supra* note 6, at 235.

25. 107 JOURNAL DU DROIT INTERNATIONAL [CLUNET] 660 (1980) [hereinafter *Götaverken*]. For a thorough analysis of this case and an English translation of the operative part of the judgment, see Paulsson, *Arbitration Unbound: Award Detached from the Law of its Country of Origin*, 30 INT'L & COMP. L.Q. 358, 385-87 (1981).

26. 2 INTERNATIONAL COMMERCIAL ARBITRATION, INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION 1, 8 app. II, art. 11 (W. Craig, W. Park & J. Paulsson eds. 1984) (emphasis added).

27. The court apparently did not regard the French nationality of the chairman of the arbitration tribunal as a relevant contact. See *Götaverken*, 107 CLUNET at 660.

France as the seat of arbitration could not be considered "an implicit expression of the parties' intent to subject themselves, even subsidiarily, to [French procedural law]." ²⁸ Consequently, the Paris Court of Appeals refused to exercise jurisdiction over the case on the ground that the award "rendered in accordance with proceedings which are not those of French law and which have no attachment whatsoever to the French legal order . . . may not be considered French." ²⁹

As in *Diefenbacher*, the arbitral proceedings in *Götaverken* were held in Paris between non-French parties, and arose from contracts which had no connection with France and did not designate the *lex arbitri*. Despite these similarities, however, the Paris Court of Appeals decided the two cases differently. The reason for the difference may be attributed to an amendment of the Arbitration and Conciliation Rules of the I.C.C. In *Diefenbacher*, the court was interpreting the old Rule 16, mandating the application of the *lex fori* unless the parties chose some other *lex arbitri*. Since the parties in *Diefenbacher* voluntarily agreed to have their arbitration bound by the I.C.C. Rules, the court implied an intent to have French law govern the proceedings. When the *Götaverken* case reached the Paris Court of Appeals, the reference to the *lex fori* had been deleted from the I.C.C. Rules. Consequently, the court could not have applied French law on the basis of the implied intent of the parties. The only other rationale for applying French law would have been the territorial principle that calls for the application of the law of the seat of arbitration. The court, however, declined to adopt this approach.

Despite different outcomes on the application of French law, *Diefenbacher* and *Götaverken* represent a departure from the territorial approach and a willingness to determine the *lex arbitri* on the basis of the parties' intent. These cases indicate that when the local sovereign is disinterested, it might yield to the business community's wishes, rather than insist on application of its own law. Nevertheless, it is for the sovereign to decide whether it has an interest in the arbitration.

Some nations are particularly sensitive about their territorial sovereignty and regulate all arbitral proceedings within their territories.³⁰ It is conceivable, therefore, that when confronted with a factual situation like *Götaverken* or *Diefenbacher*, courts in these jurisdictions might refuse to sanction the application of foreign procedural law. On the other hand, in

28. Quoted from the English translation of the decision, *supra* note 25, at 386.

29. *Id.*

30. According to Lew, the territorial approach is most clearly reflected in the East European attitude to arbitration: "the socialist tribunals of Eastern Europe are generally considered to be bound to 'their own' procedural . . . rules." J. LEW, *supra* note 20, at 54.

at least one case, a French court upheld the parties' choice of a foreign *lex arbitri* for an arbitration in France, even though the dispute had significant contacts with the forum. In *Monier v. S.A.R.L. Scali Frères*,³¹ the Paris Court of Appeals upheld an award rendered in France under the English law of the proceedings. The dispute in *Monier* involved two French companies whose principal places of business were in France. The arbitration was conducted under a contractual clause providing for arbitration in Paris and directing the arbitrator to apply English substantive and procedural law.

The liberal approach of the French courts was codified in the new French Code of Civil Procedure which provides that the parties to an arbitration are free to choose the law governing the proceedings.³² Because of its liberal position, France has become one of the most popular centers of international arbitration. The reasons France adopted this approach may range from recognition of the needs and customs of international commerce³³ to promotion of national economic and commercial interests.³⁴

France is not the only country that has adopted a liberal approach towards international arbitration. Other traditional centers of arbitration, such as Switzerland, have also become more liberal in this respect. One example of this trend is the *LIAMCO* arbitration,³⁵ which involved a dispute between a United States oil company and the Libyan government. The arbitrator awarded the United States claimant a substantial amount in damages. To secure execution of the award, the company attached Libyan property in Switzerland. The attachment was challenged by Libya in a Swiss court. Although it found the award enforceable in Switzerland, the court dissolved the attachment because the Swiss forum

31. Judgment of July 5, 1955, Cour d'appel, Paris, 45 REVUE CRITIQUE DE DROIT INTERNATIONAL PRIVÉ [R.C.D.I.P.] 79 (1956), with note by Metzger.

32. Cf. Delaume, *International Arbitration Under French Law*, 37 ARB. J. 335, 341 (1982).

33. This reason is typically stated by the French Cour de Cassation. See Batifol, *Arbitration Clauses Concluded between French Government-Owned Enterprises and Foreign Private Parties*, 7 COLUM. J. TRANSNAT'L L. 32, 35 (1968). See also *Scherk v. Alberto Culver Co.*, 417 U.S. 506 (1974).

34. Cf. Carboneau, *The Elaboration of a French Court Doctrine on International Commercial Arbitration: A Study in Liberal Civilian Judicial Creativity*, 55 TUL. L. REV. 1, 15 (1980). Carboneau suggests that, by adopting a liberal attitude towards international commercial arbitration, the French courts "emphasized — at least impliedly — their view that France should respond positively to the modifications in the international economic order and, thereby, make its contribution to a stable and viable world community." *Id.* at 6.

35. *Libyan American Oil Co. (LIAMCO) v. Government of the Libyan Arab Republic*, Award of Apr. 12, 1977, 62 I.L.R. 141 (1982).

was not sufficiently connected to the dispute.³⁶ Because the arbitration involved two non-Swiss parties and property located outside Switzerland, the seat of arbitration was Switzerland's only contact with the dispute. Without more, this contact did not justify the attachment. The Swiss court emphasized that the decision regarding the seat of the arbitral tribunal was made by the arbitrator and not by the parties.³⁷ In the *LIAMCO* case, therefore, the Swiss court adopted the approach of the French court in *Götaverken* and recognized that the mere fact that an arbitration takes place in a certain jurisdiction does not automatically give the sovereign an interest in regulating the proceedings.

In England, the rule that arbitration taking place there must be governed by English procedural law is well-established. In *dictum* in the *James Miller* case, however, Lord Wilberforce suggested that this rule might not apply to arbitral proceedings conducted under the I.C.C. Rules.³⁸ Although Lord Wilberforce did not explain why an I.C.C. arbitration should receive this special treatment, one commentator suggested the reason might be that many I.C.C. proceedings are conducted in places unrelated to the disputes. Furthermore, I.C.C. rules are well-developed and adequately protect the rights of the parties.³⁹ Assuming these were the reasons that Lord Wilberforce had in mind, one might ask why the more liberal approach should be limited to proceedings conducted under the I.C.C. Rules. Why should a case in which the parties arbitrate their dispute in London under French procedural law be treated differently from a case in which the parties arbitrate in London under the I.C.C. Rules? If England had no connection to the dispute other than as the seat of the tribunal, it would be a completely disinterested forum. Moreover, French law would protect the rights of the parties in the same manner as the I.C.C. Rules. There is no rational explanation, therefore, for treating these two situations differently. In sum, Lord Wilberforce's *dictum* in *James Miller* seemed to reflect the uncertainty of the English courts to expanding I.C.C. arbitration, rather than a change of attitude towards the application of English procedural law to arbitration proceedings conducted in England.

In 1979, the British Parliament enacted a new Arbitration Act. Among other things, the Act permits parties to a contract to stipulate

36. *Socialist Libyan Arab Popular Jamahiriya v. Libyan American Oil Co (LIAMCO)*, Judgment of June 19, 1980, BGE I, Switz., 62 I.L.R. 228, 236 (1982).

37. *Id.* at 235.

38. 1970 A.C. 583, 616.

39. See Smedresman, *supra* note 8, at 282.

that the courts will not have power to review the arbitration award.⁴⁰ Thus, the Act abolished the "case stated" procedure which gave English courts the power to review the arbitrator's determination of legal issues.⁴¹ Several factors prompted the British Parliament to enact the Arbitration Act. According to one author, "the parliamentary debate on the Act reveals that its architects were concerned with commercial as well as legal considerations."⁴² Furthermore, the "stated case" procedure was blamed for the relative unpopularity of London as a seat of international arbitration.⁴³ It was suggested that abolition of that procedure would revive interest in London as a seat for arbitral panels.⁴⁴

The United States Supreme Court analyzed the nature and needs of international arbitration in the case of *Scherk v. Alberto Culver Co.*⁴⁵ *Scherk* was a dispute between a United States plaintiff and a German defendant, arising out of a contract under which the plaintiff purchased cosmetic companies and their trademark rights from the defendant. The companies were organized under the laws of Germany and Lichtenstein. The contract contained an arbitration clause providing for arbitration under the I.C.C. Rules. The contract itself was to be governed by Illinois law. The plaintiff brought the suit upon discovering that the trademarks were subject to serious encumbrances. Rather than invoke the arbitration clause, the plaintiff prosecuted his case under the Securities Exchange Act of 1934. In a motion to dismiss, the defendant asserted that the arbitration clause in the contract precluded the plaintiff from seeking redress in the courts.

One of the issues in *Scherk* concerned the application of section 14 of the Securities Exchange Act to void all agreements purporting to waive compliance with the Act. In an earlier case, *Wilko v. Swan*,⁴⁶ the Supreme Court had decided that section 14 was applicable to arbitration agreements and refused to enforce an arbitration clause. The *Scherk* Court distinguished *Wilko*, emphasizing that the contract between the parties in *Scherk* was a "truly international agreement." The parties in

40. The Act does not permit the parties to make this stipulation in contracts concerning maritime, insurance, or commodities matters. Arbitration Act, 1979, ch. 42.

41. Park, *supra* note 1, at 87; Schmitthoff, *The United Kingdom Arbitration Act of 1979*, 5 Y.B. COM. ARB. 231, 231-39 (1980).

42. Park, *supra* note 1, at 95.

43. Schmitthoff, *supra* note 41, at 232.

44. Lord Cullen of Ashborne estimated that a new arbitration law might attract to England as much as 500 million pounds per year in "invisible exports" in the form of fees for arbitrators, barristers, solicitors, and expert witnesses. Park, *supra* note 1, at 95. See also Rippon, *Recent Trends in International Law*, 15 INT'L LAW. 287, 291-92 (1981).

45. 417 U.S. 506 (1974).

46. *Wilko v. Swan*, 346 U.S. 427 (1953).

Scherk were of different nationalities, negotiations took place in five countries, and the purpose of the contract was to sell companies incorporated in Europe whose activities were predominantly directed to European markets.⁴⁷ According to the Court, the international character of the contract brought to light new interests which required protection.⁴⁸ The Court pointed out that a "parochial refusal by the courts of one country to enforce an international arbitration agreement" might have an adverse effect on international trade by "hampering the willingness and ability of businessmen to enter into international agreements."⁴⁹ The Court's underlying concern was that a hostile attitude towards international arbitration could have an adverse effect on United States economic interests. Consequently, the Court subordinated the national interest in regulating securities transactions to the national interest in promoting international trade. From the perspective of this study, the importance of *Scherk* is that it acknowledged that international arbitration calls for a different analysis of state interests than do local arbitrations.

With regard to the choice of the *lex arbitri*, the *Scherk* Court said that "[a]n agreement to arbitrate before a specified tribunal is, in effect, a specialized kind of forum-selection clause that posits not only the situs of the suit but also the procedure to be used in resolving the dispute."⁵⁰ This language seems to suggest that the Court would allow the parties to choose the applicable procedural law. In analyzing this part of the opinion, however, it is significant that the arbitration clause in *Scherk* provided for application of the I.C.C. Rules, including the old Rule 16 which provided for the subsidiary application of the *lex fori*. The reference to the law of the forum since has been deleted from Rule 16, and it is unclear how this change would have affected the *Scherk* Court's conclusion. For example, will the Court enforce arbitration awards rendered

47. See *Scherk*, 417 U.S. 506.

48. *Id.*

49. This language was quoted with approval by the United States Supreme Court in *Mitsubishi Motors Corp. v. Soler-Chrysler-Plymouth*, 105 S.Ct. 3346, 3359 (1985). In that case, the Supreme Court reaffirmed its policy supporting international commercial arbitration and observed that:

[T]he potential of [arbitral] tribunals for efficient disposition of legal disagreements arising from commercial relations has not yet been tested. If they are to take a central place in the international legal order, national courts will need to "shake off the old judicial hostility to arbitration," and also their customary and understandable unwillingness to cede jurisdiction of a claim arising under domestic law to a foreign or transnational tribunal. To this extent, at least, it will be necessary for national courts to subordinate domestic notions of arbitrability to the international policy favoring international arbitration.

Id. at 3360 (footnotes omitted).

50. *Scherk*, 417 U.S. at 519.

in proceedings conducted in the United States under a foreign *lex arbitri*, or under procedural rules drawn by the parties themselves? If the Court were influenced by the same considerations which led it to uphold the arbitration clause in *Scherk* it might approve arbitration conducted under a foreign *lex arbitri*.⁵¹

The cases discussed above suggest that, at least in situations where the forum has no significant contacts with the dispute, the courts are willing to allow parties and arbitrators to choose a *lex arbitri* other than the law of the forum. Cases in which a dispute has some significant connection with a forum pose a more difficult problem because the local sovereign has a genuine interest in regulating the proceedings. Under the traditional approach, if the sovereign decides to protect its interest the parties are obligated to yield to its will. An alternative view was first suggested by Sauser-Hall in his so-called "mixed-theory" of the juridical nature of arbitration. In his 1957 report to the Institute of International Law, Sauser-Hall suggested that arbitration should be defined as a "juridical institution of a mixed character, *sui generis*, which has its origin in the agreement and which draws its jurisdictional effects from the law governing the proceedings."⁵² Other authors have gone further and developed a contractual theory of arbitration, according to which all essential elements of arbitration, including submission, proceedings and award, are contractual. Under this latter view, arbitration is merely a series of contractual relations between parties who have agreed to submit disputes to arbitration and abide by an award.⁵³ Accordingly, arbitration would function independent of any national legal order, and arbitrators would be free to choose any procedural law.

There is little doubt that arbitration is derived from and based on the agreement of the parties. As long as the parties fulfill their contractual obligations, the agreement provides a sufficient basis for the arbitral proceedings. A problem arises when the parties interpret the agreement differently, or when one party refuses to fulfill its obligations.⁵⁴ In this

51. The following language from *Bremen v. Zapata Off-Shore Oil Co.*, 407 U.S. 1 (1971), quoted with approval in *Scherk*, reveals the court's concerns: "The expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts." *Id.* at 9.

52. Sauser-Hall, *L'arbitrage en droit international*, 47-II ANNUAIRE DE L'INSTITUTE DE DROIT INTERNATIONAL 394, 399 (1957) (Author's translation).

53. See generally J. LEW, *supra* note 20, at 54-56; P. FOUCHARD, *L'ARBITRAGE COMMERCIAL INTERNATIONAL* 320-21 (1965).

54. Hirsch, *supra* note 7, at 45. See also de Vries, *International Commercial Arbitration: A Contractual Substitute for National Courts*, 57 TUL. L. REV. 42, 47 (1982); see generally Wilner, *supra* note 5, at 649.

situation, the only remedy available is to seek judicial assistance. At this point, a court applying national law would have the opportunity to examine the choice of the *lex arbitri*.

The attitude taken by national law with respect to the parties' choice of the *lex arbitri* reflects the sovereign's understanding of its interests in regulating arbitration proceedings. The crucial question is not whether the arbitration is jurisdictional or contractual in nature, but to what extent the sovereign controls, or should control, the proceedings. Recent developments in international arbitration indicate that, at least in the most developed countries, the state's interest in promoting commerce prevails over its interest in subjecting arbitral proceedings to national law. As a result, parties and arbitrators are given more freedom to choose the *lex arbitri*. Nevertheless, some authors still argue that the state where the arbitration proceedings takes place should be able to control these proceedings to ensure respect for traditional standards of fairness, as well as the "limits of the arbitral mission" and the rights of third parties.⁵⁵

D. The Choice of the *Lex Arbitri* by the Arbitrator

If the parties to the arbitration choose the *lex arbitri*, whether in the arbitration clause or in the compromise, the arbitrator should abide by this decision. In many instances, however, the parties either neglect to choose the law governing the arbitral proceedings or are unable to agree on the applicable law. In these cases, the *lex arbitri* must be determined by the arbitrator who may approach the problem by inquiring into the implied intent of the parties.⁵⁶ The arbitrator cannot always follow this approach, however. For example, when the parties cannot agree on the applicable law, it would be senseless for the arbitrator to inquire into the parties' intent. The arbitrator also faces a difficult task when there is no evidence of the parties' intent. The ensuing question of which law should govern the proceedings in the absence of any explicit or implied choice by the parties is considered next.

1. *Lex Fori*

In discharging his or her duties, an international arbitrator must be

55. Parte, *The Lex Loci Arbitri and International Commercial Arbitration*, INT'L & COMP. L.Q., 31, 51 (1983).

56. "[W]hen the arbitration clause does not specify the *lex arbitri* or the place of arbitration, the *lex arbitri* has to be determined in conformity with the general principles of the conflict of laws, that is, in accordance with the implied will of the parties." Hirsch, *supra* note 7, at 47.

guided by the objective of producing an enforceable award⁵⁷ and consequently the *lex arbitri* must be chosen with this objective in mind. This consideration led the arbitrator in the *B.P. v. Libyan Arab Republic* arbitration⁵⁸ to adopt Danish law to govern the arbitration proceedings:

By providing for arbitration as an exclusive mechanism for resolving contractual disputes, the parties to an agreement . . . must . . . be presumed to have intended to create an effective remedy. The effectiveness of an arbitral award that lacks nationality . . . generally is smaller than that of an award founded on the procedural law of a specific legal system and partaking of its nationality. Moreover, even where the arbitrators do, as the Tribunal does in this instance, have full authority to determine the procedural law of the arbitration, the attachment to a developed legal system is both convenient and constructive.⁵⁹

This language is based on the premise that, unless the parties chose the *lex arbitri*, the arbitrator is not compelled to adopt the procedural law of any particular country and need not adopt the procedural law of the forum. Although the arbitrator in the *B.P.* arbitration did apply forum law, his choice was dictated by convenience and effectiveness rather than by a legal norm.

The *B.P.* arbitration award should not be interpreted to mean that considerations of convenience and effectiveness always will lead to application of the *lex fori*. One of the main characteristics of international arbitration is its multijurisdictional character. An international arbitration usually involves at least two jurisdictions: The forum state and the state in which the award will be enforced. Legal proceedings may be instituted in a third jurisdiction, for example, the home state of one of the parties. It is also possible that a party might seek redress in the courts of the state whose law governs the merits of the dispute.⁶⁰ The legal system of any of these jurisdictions could serve as the *lex arbitri*. Perhaps the main reason that arbitrators choose the *lex fori* more often than another law is that the place of arbitration is the most likely forum for court proceedings concerning the arbitration.

In *James Miller*, a majority of the four Lords held that when the parties fail to choose the *lex arbitri*, the proceedings should be governed by the law of the state where the arbitration is held because that law

57. Paulsson, *supra* note 25, at 376.

58. Arbitral Award of Oct. 10, 1973, 53 I.L.R. 297 (1979) [hereinafter *B.P. arbitration*].

59. *Id.* at 309.

60. See, e.g., *Int'l Tank & Pipe S.A.K. v. Kuwait Aviation Fueling Co.* K.S.C., 1975 Q.B. 224.

usually is most closely connected to the proceedings.⁶¹ Where the arbitration has no substantial contacts with the forum, however, local courts might decline to assert jurisdiction, as in *Götaverken*; therefore, adopting forum law to govern the arbitral proceedings would serve no purpose.

2. The Legal System "Significantly Related" to the Dispute

The application of local procedural law is justified when the forum has significant connections to the dispute. An important question is which contacts between the forum and the arbitration justify the choice of the *lex fori*. In the *Sapphire* arbitration⁶² the arbitrator declared that the proceedings were governed by the *lex fori* on the basis of the implied intent of the parties. As an alternative reason for adopting the *lex fori*, the arbitrator referred to a "general rule" which, according to the arbitrator, provides that in the absence of a choice by the parties, the arbitration is to be governed by the law of the place where the tribunal has its seat. As if to justify this rule, the arbitrator enumerated the contacts which the proceedings had with the Swiss canton of Vaud, where the arbitration took place: Lausanne was the headquarters of the judicial authority which would nominate the arbitrator if the parties were unable to agree; the arbitrator was domiciled in Lausanne; and the proceedings, including rendering of the award, took place there.⁶³

None of the contacts present in the *Sapphire* arbitration, however, related to the forum's interest in regulating the proceedings. Consequently, these contacts may not create a nexus between the proceedings and the forum sufficient to justify application of the *lex fori*.

The *Götaverken* court held that the choice of a given place to serve as the seat of a tribunal solely because of its neutral character does not implicate the sovereign's interest in regulating the arbitral proceedings.⁶⁴ If, on the other hand, the seat of the tribunal is chosen because of the local law, and this law is also designated as the applicable law, the result might be different. Thus, in the *B.P.* arbitration the arbitrator chose Copenhagen as the seat of the tribunal because of the "wide scope of freedom and independence enjoyed by arbitration tribunals under Danish

61. Lords Hudson, Guest, Wilberforce, and Viscount Dilhorne are quoted in support of this proposition in DICEY & MORRIS, *supra* note 18. *James Miller*, 1970 A.C. at 612, 616, 687, 689.

62. *Sapphire Int'l Petroleum Ltd. v. National Iranian Oil Co.*, Award of Mar. 15, 1963, 35 I.L.R. 136 (1967) [hereinafter *Sapphire* arbitration].

63. *Id.* at 169. It is to be noted that the arbitrator's choice of the *lex arbitri* in the *Sapphire* arbitration was challenged by the parties. The case ended, however, with an amicable settlement, so this issue remained unsolved. Hirsch, *supra* note 7, at 47.

64. 107 CLUNET 660 (1980).

law."⁶⁵

Even when the domicile of the arbitrator and the seat of the tribunal coincide, these contacts are not sufficient to implicate the sovereign's interest if neutrality was the sole reason for choosing the arbitrator. Again, the result might be different if the arbitrator was chosen because of expertise in the forum's legal system.

The state's interest usually would be involved in cases where the forum is the domicile of one or both of the parties, the place where the contract is to be performed, or the location of disputed property. As the *Monier* case indicates, however, the fact that both parties to the dispute are nationals of the forum, without more, might not be sufficient to mandate application of the *lex fori*.⁶⁶

When sitting in a forum unrelated to the proceedings, the arbitrator is advised to adopt the *lex arbitri* of one of the jurisdictions having a significant relationship with the arbitration. Alternatively, an arbitrator could conduct the proceedings under the law governing the merits of the dispute⁶⁷ so that all aspects of the dispute would be governed by a single legal system.

In some circumstances, the choice of a *lex arbitri* unrelated to the dispute is justified. For example, if a legal system is exceptionally well-developed or particularly suited to the arbitration proceedings for some other reason such a choice may be warranted. The choice of an unrelated *lex arbitri*, however, might render the award unenforceable since a court might refuse, on jurisdictional grounds, to entertain an appeal or execute the award. The *LIAMCO* arbitration is an example of such a situation.⁶⁸

Some jurisdictions permit an arbitrator to adopt a foreign *lex arbitri*;⁶⁹ others do not. As a result, an arbitrator who defies local law and applies foreign procedural law faces the risk that the proceedings will be found invalid under the *lex fori* and that the award will be unenforceable not only in the forum state but possibly also in other jurisdictions.

3. Denationalized *Lex Arbitri*

Finally, an arbitrator might decide not to follow any particular *lex arbitri* but to conduct the proceedings under general principles of proce-

65. *B.P. arbitration*, 53 I.L.R. at 309.

66. See *supra* text accompanying note 31.

67. Provided that the legal system governing the merits permits the arbitrator to hold the proceedings abroad.

68. See *supra* text accompanying note 36.

69. France is one such nation.

ture or international rules prepared by one of the international institutions such as the I.C.C. or the United Nations Conference for International Trade Law (UNCITRAL). If one of the parties is a sovereign state, the arbitrator also may have the option of conducting the proceedings based on principles of public international law. In all these cases, the arbitrator would render an award unattached to any national legal system, a so-called "floating" or "drifting" award.⁷⁰ An example of a floating award is found in the *Texaco Overseas Oil Co. v. Libya* arbitration.⁷¹ The seat of the tribunal was Geneva. The arbitrator specifically rejected Swiss *lex arbitri* and declared that the proceedings would be governed by public international law. Another floating award was rendered in the *Götaverken* arbitration,⁷² in which the proceedings were conducted under the I.C.C. Rules.

The effectiveness of floating arbitral awards can be tested in the national courts when one party challenges the award or petitions a court to enforce it.⁷³ Of course, when the parties implement the award voluntarily, the courts have no opportunity to pass on the validity or enforceability of the award.

A court called upon to exercise its supervisory function over the arbitration is not bound by the arbitrator's decision on the law governing the proceedings. In particular, the court is not bound by the arbitrator's exclusion of the local law. The court could, therefore, disregard the arbitrator's decision and declare the nationality of the award itself. The court could also find that the arbitrator violated the forum's mandatory rules by applying foreign rules of procedure, and, consequently, refuse to recognize the award. The court's decision always will be based on national law, even if the arbitrator intended to make the arbitration international and detached from any national legal system.

The denationalization of arbitration proceedings is further complicated by the multijurisdictional character of international arbitration.

70. See Paulsson, *Delocalization of International Commercial Arbitration: When and Why It Matters*, 32 INT'L & COMP. L.Q. 53, 57 (1983). Responding to the argument of the opponents of delocalized arbitration who argue that there can be no legal obligation independent of a legal order, Paulsson explains: "What this critique misses is that the delocalized award is *not* thought to be independent of any legal order. Rather, the point is that the delocalized award may be accepted by the legal order of an enforcement jurisdiction although it is independent from the legal order of its country of origin." *Id.*

71. Award of Jan. 19, 1973, 53 I.L.R. 389 (1979) [hereinafter *Texaco* arbitration].

72. See *supra* notes 25-31 and accompanying text; Cases No. 2977, 2978 & 3033, 1978; I.C.C. Arbitration Tribunal, 6 Y.B. COM. ARB. 133 (1981).

73. The *Texaco* award never was tested in a court due to the settlement arrived at by the parties. The *Götaverken* award was enforced in Sweden. See Paulsson, *supra* note 25, at 380. See generally Wilner, *supra* note 5, at 649.

While some jurisdictions recognize floating awards, others do not. Because the arbitrator cannot foresee where the prevailing party will seek to enforce the award, detaching the proceedings from national law might result in an unenforceable award. For this reason, some scholars strongly criticize the concept of proceedings based on non-national rules.⁷⁴

In support of arbitration proceedings detached from national law, it is argued that "it is both pointless and misleading to create a link between the arbitrator and some national law just in case . . . one of the parties wishes to resort to the courts."⁷⁵ Also, in support of detached proceedings is the experience of the international business community which has successfully carried on arbitral proceedings detached from national legal systems.⁷⁶

A substantial number of arbitration proceedings are governed by a *lex arbitri* other than the *lex fori*. One commentator notes that arbitral proceedings detached from national legal systems constitute the major portion of international commercial arbitration.⁷⁷ Denationalized arbitration has been successful for two reasons. First, the majority of arbitral awards are implemented voluntarily so their validity and enforceability is never litigated. Second, a number of states, recognizing the needs of the international business community, permit enforcement of floating awards.⁷⁸

One obstacle to the development of the denationalized arbitration, however, is lack of uniformity in national arbitration rules. This difficulty might be overcome by an international convention confirming the parties' right to choose the *lex arbitri*.⁷⁹ A more urgent subject for an international convention, however, is the need to ensure that proceedings conducted outside the national legal systems will be recognized and floating awards will be enforced.

74. See, e.g., Wetter, *supra* note 9, at 273, who regards the concept of proceedings based on non-national rules as "excessive and without support in law."

75. J. LEW, *supra* note 20, at 253.

76. *Id.*

77. *Id.* at 17. The author notes, however, that the detachment of the arbitration from a national legal system might not always be recognized by national legal orders. *Id.* at 40 n. 25.2. See also Luzzatto, *International Commercial Arbitration and the Municipal Law of States*, 157 R.C.A.D.I. 49-50 (1977).

78. See Delaume, *L'Arbitrage Transnational et les Tribunaux Nationaux*, 111 CLUNET 521, 546 (1984).

79. McClelland, *Towards a More Mature System of International Arbitration: The Establishment of Uniform Rules of Procedure and the Elimination of the Conflict of Laws Question*, 5 N.C.J. INT'L & COM. REG. 186 (1980).

CONCLUSIONS

In the past it has been assumed that the state always has an interest in regulating the administration of justice within its territory. This assumption explains why arbitrators, while permitted to apply foreign substantive law, have been required to apply the procedural law of the forum. In recent decades, however, the development of international trade and the recognition that national intervention hampers business transactions, have led to a softening of the territorial approach. It has been recognized that foreign trade, a substantial source of revenue for most nations, is incompatible with a policy of strict supervision over international arbitration. On this issue, the interests of the business community and states coincide. Thus, the question, whether and to what extent states should regulate international arbitration, must be answered by balancing two competing state interests: Regulating the administration of justice and promoting foreign trade. The importance of these two interests differs from state to state and from case to case. Nonetheless, an analysis of recent jurisprudence and legislation in a few industrialized nations permits some generalizations.

The major trading nations have recognized the business community's need for international arbitration detached from the *lex arbitri* of the forum. Where local fora have no interest in the proceedings, national courts are willing to allow arbitrators to conduct proceedings under foreign or non-national rules of procedure. On the other hand, when the dispute has substantial connections with the forum, national courts are more reluctant, with the exception of France, to permit application of foreign procedural law. In the future, however, this reluctance might diminish. Developments in the last twenty years indicate that in many instances the state's interest in regulating arbitration has been subordinated to its interest in promoting international trade. It is possible, therefore, that a fully detached international arbitration universally will be recognized in the future.

The arbitrator who approaches the problem of the choice of *lex arbitri* should inquire into the forum law governing the arbitration. If awards based on foreign or non-national rules of procedure are considered invalid under forum law, the arbitrator would be advised to follow the forum's procedural law. If *lex fori* requires application of its own procedure only when the arbitrated dispute has substantial contacts with the forum, the arbitrator must determine whether such contacts exist. When the dispute has no significant contacts with the forum or when the

forum permits application of foreign law even when significant contacts exist, the arbitrator may choose a *lex arbitri* other than forum law.

Given the basically contractual nature of arbitration, the arbitrator should decide which procedural law to apply based on the intent and interests of the parties. Thus, when the intent of the parties with regard to the *lex arbitri* can be established, that law giving effect to the parties' intentions should be applied. When the parties' intent cannot be established, the arbitrator should choose suitable rules for the proceedings. This could be either the *lex arbitri* of the place most closely related to the dispute or procedural rules prepared by an international organization.

The application of non-national rules of procedure is probably the most desirable choice because these rules are supported by the international business community and reflect its needs and expectations. Since the concept of a truly international arbitration, detached from every national legal system, is not yet universally recognized, application of non-national rules is sometimes impractical. Nevertheless, growing support for denationalized arbitrations will make non-national rules of procedure a more attractive alternative in the future.

II. THE CHOICE OF THE SUBSTANTIVE LAW

The choice of the substantive law is a critical issue in international arbitration. Nevertheless, this issue is often disregarded by the parties and the arbitrators.⁸⁰ This part of the study considers the choice of the *lex causae* by an arbitrator when the parties did not specify their choice of law.

To choose the substantive law, an arbitrator may rely on the conflict of laws rules or choose the substantive law directly. The former approach leads to a double conflict of laws: The first is the selection of a national system of conflict rules and the second is application of the substantive law indicated by the conflict rules. At this point, the difference in the tasks of a judge and an arbitrator again becomes apparent. A judge is concerned only with a conflict between substantive laws, the so-called conflict "au premier degré". Unlike an arbitrator, a judge is never confronted with the conflict "au deuxième degré", the choice of the applicable system of conflict rules, because a judge will always apply the forum's conflict of laws rules.

80. "Arbitrators, as well as judges, may be faced with the problem of determining which one of several legal systems should be applied in a given dispute. This problem cannot be disregarded, albeit parties and arbitrators often pretend that it does not exist." Metzger, *supra* note 6, at 229.

The international and multijurisdictional character of international arbitration makes the conflict "au deuxième degré" difficult to resolve. Initially, commentators suggested that an arbitrator must apply the conflict rules of one of the jurisdictions related to the dispute.⁸¹ Later, it was proposed that an arbitrator should determine the *lex causae* on the basis of a comparative analysis of all the conflict rules involved. The modern approach takes the position that an arbitrator can determine the applicable substantive law without resorting to conflict rules at all. According to this approach, an arbitrator should choose the law applicable to the merits either by examining the substantive laws involved in the dispute or by rendering an award based on non-national rules, such as the *lex mercatoria*, international or transnational law.⁸²

All these solutions have been applied by international arbitrators. This section will discuss the practical application and value of these solutions.

A. Determination of the Substantive Law on the Basis of the Rules of Conflict of Laws.

1. Application of the Conflict Rules of the Seat of the Arbitration.

One theory for determining the *lex causae*, proposed by supporters of the territorial theory, is that the conflict rules of the seat of arbitration should apply.⁸³ In practice, the conflict rules of the seat of the arbitral tribunal often are applied by international arbitrators, especially those sitting in Eastern European countries. This fact is not surprising since the Eastern European states staunchly adhere to the territorial theory of arbitration. For example, in a dispute between a Soviet claimant and a Sri Lankan respondent, the arbitrator of the Foreign Trade Arbitration Commission at the U.S.S.R. Chamber of Commerce and Industry in Moscow stated that "[s]ince the contract did not contain a reference to the law to be applied, this question had to be determined in accordance with Art. 126 of the Fundamentals of Civil Legislation of the U.S.S.R. and the Union Republics."⁸⁴ Unfortunately, the arbitrator did not explain why it was necessary to apply Soviet conflict rules.

81. See Croff, *The Applicable Law in International Commercial Arbitration: Is It Still a Conflict of Laws Problem?*, 16 INT'L LAW. 613, 632-33 (1982).

82. See *id.*; see also *Sapphire* arbitration, 35 I.L.R. at 170-71.

83. Mann, *supra* note 20, at 167; Wetter, *supra* note 9, at 231, 239.

84. Art. 126 of the Fundamentals of Civil Legislation is a conflict of laws rule. Award of Oct. 6, 1977, Foreign Trade Arbitration Commission of the U.S.S.R. Chamber of Commerce and Industry, Moscow, 5 Y.B. COM. ARB. 209 (1980).

Similarly, in an arbitration concerning truck leases between Austrian and Czechoslovakian parties,⁸⁵ the Arbitration Court at the Czechoslovakian Chamber of Commerce in Prague applied a Czechoslovakian statute. The statute provided for the application of the law most closely related to the contractual relationship. Since the lease was negotiated in Austria, the trucks were used there, the respondent was an Austrian company, and the disputed rent was to be paid in Austrian currency, the arbitrators applied Austrian substantive law.

Of course, the application of the forum's conflict rules is not limited to Eastern European arbitrations. In the *Götaverken* arbitration,⁸⁶ a dispute between Swedish sellers and Libyan buyers concerning the unpaid balance on three ships built and located in Sweden was submitted to I.C.C. arbitration in Paris. With regard to the applicable substantive law, the arbitrators declared that the "applicable law to the contracts is determined either by an international convention or by the conflicts of laws rules of France, as the country of the place of arbitration."⁸⁷ Since the arbitrators did not believe that the Hague Convention on the Law Applicable to International Sales of Goods of 1955 applied to ships, their decision was primarily based on French conflict of laws rules.⁸⁸ This territorially-oriented reasoning is based on two assumptions: a) that an arbitral tribunal exercises the same functions as a court of law, and b) that the conflict rules of a given jurisdiction apply not only to judicial proceedings but also to international arbitration proceedings.

One should not lose sight of the fact, however, that the functions of an arbitrator differ substantially from those of a judge. Arbitration is based upon a private agreement, and not a sovereign compulsion, and consequently an arbitrator does not render an award in the name of a state.⁸⁹ Thus, the argument that arbitrators must abide by all the rules which bind a judge is not well-founded. Furthermore, although the conflict of laws rules reflect the sovereign's "political and judicial concept of the delimitation of the legislative competence of the State,"⁹⁰ the state

85. Award of Jan. 9, 1975, Arbitration Court of the Czechoslovakian Chamber of Commerce, Prague, 2 Y.B. COM. ARB. 143 (1976).

86. See *Götaverken*, 107 CLUNET 660 (1980).

87. *Id.* at 136.

88. *Id.* at 137. The question of the applicability of the Hague Convention was left undecided.

89. "[The arbitrator] draws his power from the arbitration clause and does not, in any manner, render justice in the name of a given state, whether a state of the seat [of the arbitration] or any other state." Lalive, *Les règles du conflit de lois appliquées au fond du litige par l'arbitre international siegeant en Suisse*, 1976 R.A. 155, 159. (Author's translation).

90. "[The national judge] applies the rules of his own private international law, by means of which the state, whose authority he exercises, expresses certain political-juridical visions or

did not necessarily intend to impose these rules on arbitrators. The holding of the Paris Court of Appeals in the *Götaverken* case supports this position. There, the Court held that French procedural law did not apply in the arbitration because the nexus between the dispute and the forum was insufficient. For similar reasons, an arbitrator should not be bound by the French conflict rules. If a state has no interest in regulating the arbitration procedure, it probably has even less interest in determining the substantive law applied by the arbitrator. In the *Götaverken* arbitration, the dispute had absolutely no contacts with the forum; this fact made the interest analysis relatively simple. A case involving a forum which has significant contacts with a dispute might pose a more difficult problem. Even if a forum is significantly related to the dispute, however, the sovereign may have no interest in applying its conflict rules.

The existence of significant contacts between the forum and the dispute warrants the assumption that the forum has an interest in regulating the arbitration. Hence, the state may bind the arbitrator with its own *lex arbitri*. These contacts may or may not justify the application of the forum's rules of conflict of laws, however. The purpose of the conflict rules is to regulate the scope of the state's legislative competence. This purpose would not be advanced by requiring an international arbitrator, who is not an organ of the state, to apply the conflicts rules.

2. Application of the Conflict Rules Other than Those of the Seat of Arbitration

a. *The Conflict Rules of the Arbitrator's Home State.*

One method of determining the applicable *lex causae* is application of the conflict rules of the arbitrator's home state. This approach is based on the assumption that the arbitrator is most familiar with the home state's conflict rules. This method is flawed for several reasons. First, if the arbitrator's familiarity with a legal system plays a role in choosing the applicable law, it should influence the choice of substantive rather than conflict law,⁹¹ because the substantive law determines the rights and obligations of the parties. Second, the proposition that the conflict rules of the arbitrator's home state should apply underestimates the arbitrator's intellectual capacities.⁹² Third, this approach runs into the practical problem of determining the arbitrator's home state, namely

concepts concerning the delimitation of its own legislative competences." *Id.* (Author's translation).

91. Lalive, *supra* note 89, at 160.

92. "[The proposition that an arbitrator should apply his own conflict law] would unjustly underestimate the intellectual capacities and resources of the majority of international arbitra-

whether it is the place of the arbitrator's nationality, citizenship, domicile, or residence.⁹³ Finally, application of the conflict rules of the arbitrator's home state implies a nexus between that state and the dispute. In most cases, however, such a nexus does not exist. Unless the arbitrator was chosen specifically for knowledge of the legal system governing the arbitration, the arbitrator's nationality, domicile, or residence are irrelevant for the purposes of conflict of laws.

b. *The Conflict Rules of the State Which Would Have Had Jurisdiction in the Absence of the Arbitration Clause*

Eighty years ago, Anzilotti advanced the view that arbitrators should apply the conflict of laws rules of the state which would have had jurisdiction over the dispute in the absence of the arbitration clause. Anzilotti based his argument on the theory that an arbitration clause deprives national courts of jurisdiction over the case.⁹⁴ As pointed out by Anzilotti's critics, however, this theory is based on circular reasoning. To determine the applicable conflict rules, an arbitrator must first determine which state would have had jurisdiction in the absence of the arbitration clause, a determination that can be made only by applying the conflict of laws rules.⁹⁵ The criticism of Anzilotti's theory, however, might not be correct. The critics assume that the jurisdictional and conflict rules are the same, a proposition which is at least debatable. Certain contacts between the dispute and the forum, while sufficient to confer jurisdiction on the forum's courts, might not justify application of forum law. Thus, when one of the parties is a national of the forum but all other contacts are with another jurisdiction, the application of forum law might not be warranted, despite the fact that local courts would have jurisdiction because one party is a national.

The main reason why Anzilotti's theory is of only historic interest today is that international arbitration is no longer considered an attempt to deprive national courts of jurisdiction over the case. Today, arbitration is considered a convenient way of resolving international commercial disputes and is supported not only by the international business community but also by states themselves.

tors since in effect it suggests that they are incapable of resorting to a system of private international law other than their own." *Id.* (Author's translation).

93. *Id.*

94. Croff, *supra* note 81, at 624.

95. Lalive, *supra* note 89, at 161.

c. *The Conflict Rules of a State Where the Award Will Be Enforced.*

Another theory is that, to ensure enforceability of the award, the arbitrator should apply the conflict rules of a state where an arbitral award will be enforced. For example, under Article V of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards,⁹⁶ a state can refuse to recognize a foreign arbitral award if the award violates public policy. If the application of foreign conflict rules were viewed as a violation of the public policy of the state where enforcement is sought, the award would be unenforceable. The narrow interpretation the courts give to the public policy exception in the New York Convention⁹⁷ makes it unlikely that a state would refuse to recognize an award on this ground.

Furthermore, practical considerations reinforce the conclusion that application of the conflict rules of a state where the award will be enforced is not a viable alternative. In most cases, when the arbitrator makes a decision concerning the applicable conflict rules, the state where execution of the award will be sought is unknown.⁹⁸ Moreover, enforcement of the award might be sought in more than one jurisdiction.

d. *The Conflict Rules of a State Most Closely Connected to the Dispute.*

Under the influence of modern United States approaches to choice-of-law problems, some arbitrators apply the conflict rules of the state most closely connected with the dispute. Although this approach has proved successful with respect to the choice of substantive law by the courts, it is debatable whether the same analysis can be applied in determining the applicable conflict rules in international arbitration.

In a case arbitrated in Paris under the I.C.C. Rules, the arbitrator applied Italian conflict rules because the Italian legal system was most closely connected to the dispute.⁹⁹ In that case, a Swiss company was distributing products of its Italian partner in Mexico and the United States. The contract was signed in Italy, and the contract was to be executed in Italy (the Italian company was delivering the goods to the Italian port of Genoa where the property rights passed to the Swiss

96. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, art. V, 21 U.S.T. 2517, 2520, T.I.A.S. No. 6997 (entered into force with respect to the U.S. Dec. 19, 1970).

97. See *id.*

98. Lalive, *supra* note 89, at 162.

99. Case No. 1422, 1966, I.C.C. Arbitration Tribunal, 101 CLUNET 884 (1974).

company).¹⁰⁰ Although Italy's contacts with the dispute were significant, their existence justified the application of Italian substantive law rather than Italian rules of conflict of laws.

In some cases, application of the conflict rules of the most closely related jurisdiction may also result in the application of that state's substantive law. This was the result in the I.C.C. arbitration between the Italian and Swiss parties described above.¹⁰¹ Since under Italian law contracts are governed by the *lex loci contractus*, the arbitrator applied Italian substantive law. Very often, however, determination of the *lex causae* through the conflict rules of the most closely related jurisdiction does not ensure that the substantive law of the state most closely related to the dispute will be applied. The following hypothetical illustrates this situation. A contract between Italian and Swiss parties is signed in Paris. Under the terms of the contract the Italian party is to deliver machinery to the Swiss party's plant located in Italy. The machinery will be used to manufacture goods for the Italian market. Undoubtedly, the Italian legal system is most closely related to the dispute. Under the Italian *lex loci contractus* rule, however, an arbitrator would have to apply French substantive law. Since France has no meaningful contacts with the dispute it has no interest in having its law applied. Consequently, the application of French law in this situation is not justified. Although courts have used the closest-connection approach successfully to choose substantive law, it is debatable whether arbitrators should use the same analysis to determine the applicable conflict rules.

By applying the conflict rules of the state most closely related to the dispute, an arbitrator relinquishes to the state the power to determine applicable law. In doing so, the arbitrator furthers the state's interests and policies, as expressed in its conflict rules. When the state's interests are of a fundamental nature, for example, when a personal status of a citizen is involved, the arbitrator is justified in yielding to the state. Cases of this nature, however, are rare in international arbitration. Typically, disputes submitted to international arbitration are commercial. When commercial matters are involved, there is no justification for an international arbitrator, who is appointed by the parties and does not represent a state, to further the state's interests embodied in its conflict rules. The following observations by the arbitrator in the *Sapphire* arbitration illustrate this point:

Since the arbitration has its seat in Switzerland, Swiss Private Interna-

100. *Id.* at 885.

101. *See supra* text accompanying note 100.

tional Law might be applicable, as the *lex fori*, for determining the substantive law applicable to the interpretation and performance of the agreement. However, in the view of some eminent specialists in Private International Law, since the arbitrator has been invested with his powers as a result of the common intention of the parties he is not bound by the rules of conflict in force at the forum of arbitration. Contrary to a state judge, who is bound to conform to the conflict law rules of the state in whose name he metes out justice, the arbitrator is not bound by such rules. He must look for the common intention of the parties, and use the connecting factors generally used in doctrine and in case law and must disregard national peculiarities . . . For these reasons, since the agreement contains no express choice of law, the arbitrator will determine which system of law should best be applied according to the evidence of the parties' intention and in particular the evidence to be found in the contract.¹⁰²

3. Cumulative Application of the Conflict Rules Related to the Dispute.

A cumulative analysis of the conflict rules of all related jurisdictions is another method of determining the *lex causae*. This approach developed from the modern United States conflict of laws analysis which looks directly to the substantive laws involved in the dispute. In international arbitration, arbitrators have used this approach to find the solution for conflicts *au deuxième degré*. Arbitrators usually have adopted this approach to avoid choosing any single system of conflict rules.

When the conflict rules of all the jurisdictions related to the dispute point to the same substantive law (the so-called "false conflict situation"),¹⁰³ it is not necessary to determine the applicable legal system. If satisfied that all conflict rules lead to the same conclusion, the arbitrator may proceed to apply the substantive law directly.

A good illustration of this approach can be found in an I.C.C. arbitration between a German claimant and a Greek respondent.¹⁰⁴ The dispute arose when the Greek party refused to accept or pay for the goods it agreed to purchase from the German party. The Swiss arbitrator considered which law to apply and noted that "the answer to the question is much facilitated by the fact that the principles of private international law, as they are developed under German law and Greek law (as well as

102. See *supra* note 62, at 170-71.

103. R. LEFLAR, *AMERICAN CONFLICTS LAW* 187 (3d. ed. 1977).

104. Case No. 953, 1956, I.C.C. Arbitration Tribunal, 3 Y.B. COM. ARB. 214 (1978).

under Swiss law) lead to the same result."¹⁰⁵

A similar approach was adopted by an arbitrator in a dispute between an Italian claimant and a Spanish respondent concerning an allegation of unfair competition.¹⁰⁶ In determining the law applicable to the tort, the arbitrator stated:

In this respect mention should be made of the conflict of laws rules contained in Art. 25, para. 2 of the Preliminary Provisions of the Italian Civil Code, which confer the legislative competence governing the extra-contractual obligations to the law of the place where the facts, from which these obligations derive, have occurred. This solution is also in conformity with the general principles of Spanish private international law.¹⁰⁷

For the arbitrator to apply the cumulative-application approach the conflict rules involved need not be identical. For example, a false conflict could exist even if one of the jurisdictions adheres to the principle of *lex loci contractus* and the other to the *lex loci solutionis* principle, if the contract was concluded and was to be performed in the same place.¹⁰⁸

One difficult issue arising in the cumulative-application approach is whether the country in which the arbitration is conducted is a related jurisdiction. While some arbitrators consider the law of the forum an indispensable element of the cumulative-application analysis, others exclude it altogether. These two approaches reflect the doctrinal controversy between supporters of the territorial and contractual theories of international arbitration. Those who view the arbitration as an extension of the national judicial system consider the forum a related jurisdiction for purposes of the cumulative-application approach. Proponents of the contractual theory, on the other hand, deny it such a role.¹⁰⁹

According to one commentator, the cumulative-application approach satisfies the parties and ensures that the award will be recognized in all related jurisdictions.¹¹⁰ Moreover, by detaching the arbitration from any particular national legal system, the cumulative-application approach brings it closer to a true international award. The commentator admits, however, that this effect is relative and coincidental.¹¹¹

105. *Id.*

106. Case No. 1990, 1972, I.C.C. Arbitration Tribunal, 3 Y.B. COM. ARB. 217 (1978).

107. *Id.* at 218.

108. See Case No. 3043, 1978, I.C.C. Arbitration Tribunal, 106 CLUNET 1000 (1979). See also Comment, Case No. 3043, I.C.C. Arbitration Tribunal, 106 CLUNET 1002 (1979).

109. See Derains, *L'application cumulative par l'arbitre des systèmes de conflit de lois inter-essés au litige*, 1972 R.A. 105.

110. *Id.* at 121.

111. See *id.*

Despite its limitations, the cumulative-application approach should be welcomed as a forerunner of the new thinking in conflict of laws in international arbitration. The main contribution of the cumulative-approach is that it stresses the need to consider more than one system of conflict rules. The cumulative application approach does not, however, go far enough in its analysis of conflict issues. While recognizing the need for an analysis of all the conflict rules involved in the dispute, the proponents of the cumulative-application approach refuse to extend this analysis to the cases where the analysis is most needed—the true conflict situations.

4. General Principles of Conflict of Laws

Unlike proponents of the cumulative-application approach, arbitrators applying general principles do not limit their analysis to the rules of the jurisdictions connected with the dispute. Instead, through a comparative analysis of all conflict systems, they attempt to establish the existence of universally recognized principles of conflict of laws.

In an I.C.C. arbitration between a Pakistani bank and an Indian company the arbitrator observed that:

The international arbitrator has no *lex fori*, from which he can borrow rules of conflict of laws The problem has often been debated in doctrinal writings where various solutions are put forward However this may be, the three or four solutions . . . with regard to the various systems of private international law to be applied by the arbitrator, would, in the present case lead to the same practical result in all likelihood, since there exists a large measure of agreement and concordance, on the question of applicable law to contracts, not only between the various systems deriving from English conflict of laws, but also, more generally, between the main systems of conflict of laws in the world.¹¹²

The cumulative-application approach and the general principles approach offer solutions only to false conflict situations. The general principles approach avoids one problem of the cumulative-application approach—determining the jurisdiction to which the dispute is related. The general principles approach is limited, however, because with the exception of a few basic rules, very few conflict rules are recognized universally. The application of general principles of conflict of laws might lead to the unification and harmonization of conflict rules.¹¹³ One should

112. Case No. 1512, 1971, I.C.C. Arbitration Tribunal, 1 Y.B. COM. ARB. 128, 129 (1976).

113. P. FOUCHARD, *supra* note 53, at 319; Smedresman, *supra* note 8, at 290.

not be too optimistic about this result, however.¹¹⁴

B. The Determination of the Substantive Law without Resorting to Conflict Rules

Most business people envision arbitration as "practical proceedings wherein . . . [they] can quickly arrive at a determination of the dispute without any legal complications."¹¹⁵ Parties that agree to arbitrate expect procedural simplicity as well as certainty of applicable law. These expectations are not met when the arbitrator applies conflict of laws rules.

The application of the conflict rules limits the distributor's choices of the applicable laws to the rules of a national law and excludes application of rules of non-national origin. On the other hand, an arbitrator who determines the applicable *lex causae* without resorting to the conflict rules may apply the laws of a related national system, the terms of the contract and the trade usage, or substantive rules of non-national character.

1. Direct Application of the Substantive Rules of a National Law

An arbitrator who applies a national substantive law without resorting to conflict rules looks directly to the substantive rules of all jurisdictions involved in the dispute. When all substantive rules offer the same solution, the "false conflict" situation arises and the arbitrator's task is simple. Thus, in a dispute arising out of a contract between German and Swiss parties, the arbitrator did not find it necessary to designate the applicable law. Although the parties argued for the application of German or Swiss law, the arbitrator stated that:

It is necessary to underline from the outset that the question of the law applicable is only of interest if there exists between the systems of law to which the parties are submitted a true conflict of laws. As German and Swiss law impose similar solutions in matters of the law of obligations and of commercial law, one can thus, as a general rule, abandon the research for the applicable law.¹¹⁶

Often, arbitrators fail to perceive false conflicts of substantive laws.

114. "In theory and in court practice we are still far from harmonisation of rules of conflict, not to speak of unification. Arbitration, however, may pave the way. We should, however, not be too optimistic about the result." Sanders, *supra* note 23, at 260.

115. Abrams, *Arbitration Courts and Corporate Problems: A Semantic Approach*, 9 ARB. J. 120, 123 (1954).

116. Case No. 2172, I.C.C. Arbitration Tribunal, *cited in* J. LEW, *supra* note 20, at 376.

In a case heard by the Arbitral Tribunal of Hamburg, the arbitrator decided to apply German law for the following reason: "The agreement is concluded through the intermediary of a German broker in respect of goods warehoused in Germany and drawn up in German language. Connecting factors pointing to the application of Dutch law do not exist."¹¹⁷ From this it is apparent that the arbitrator overlooked the Dutch nationality of the respondent. Nationality of one of the parties undoubtedly is an important factor, suggesting application of Dutch law. Even if Dutch law were applied, however, the outcome would have been the same, since Dutch and German law on the issue did not differ.

When the substantive laws of the jurisdictions related to the dispute do not coincide, the arbitrator is confronted with a "true conflict." One solution to a true conflict situation was suggested in the celebrated *ARAMCO* arbitration.¹¹⁸ This case arose out of a concession agreement between a United States oil company (claimant) and Saudi Arabia (respondent). The arbitrators found that some disputed issues were governed by law of Saudi Arabia, as provided for in the contract. Then the tribunal had to decide the law governing the remaining matters:

As for the law to be applied to matters which are not governed by the law expressly chosen by the Parties . . . the Tribunal adopts the following solution. Influenced by the most progressive teachings in that part of private international law which deals with the autonomy of the will, the Tribunal . . . decides to apply the law which corresponds best to the nature of the legal relationship between the parties, without looking for the tacit or presumed intention of the contracting parties. This is the law of the country with which the contract has the closest connection Relying on objective considerations, the Tribunal believes that the governing law should coincide with the economic milieu where operation is to be carried out.¹¹⁹

Following the closest-connection approach, the arbitrator considers all aspects of a case in light of the potentially applicable legal systems.¹²⁰ This solution also guarantees that the choice of substantive law will not be fortuitous from the perspective of the parties or with respect to the disputed issues.

Although the closest-connection approach has many advantages, it also has some drawbacks. The arbitrator has great discretion in analyz-

117. Arbitral Tribunal of Hamburg, Jan. 15, 1976, 3 Y.B. COM. ARB. 212, 213 (1978).

118. Saudi Arabia v. Arabian American Oil Co. (ARAMCO), Award of Aug. 23, 1958, 27 I.L.R. 117 (1963) [hereinafter *ARAMCO* arbitration].

119. *Id.* at 167.

120. Sanders, *supra* note 23, at 265.

ing the contacts between the dispute and related legal systems because the weight attached to different factors is based on subjective criteria. The arbitrator's decision, therefore, may be criticized as arbitrary.

The application of the closest-connection approach led to a controversial result in an *ad hoc* arbitration between a Dutch seller and Swedish buyers in Sweden.¹²¹ The dispute arose from a contract to sell the motor vessel *Mare Liberum*. Although the contract did not provide for the applicable law, the parties stipulated that any arbitration would take place in Gothenburg, Sweden. Following the closest-connection analysis, the three arbitrators (a Norwegian chairman, a Dutchman, and a Swede) concluded that the choice of Sweden as the seat of arbitration outweighed the contacts with the Netherlands. Numerous factors pointed towards application of Dutch law: The vessel was registered in the Netherlands, the sellers were domiciled there,¹²² the contract was dated Rotterdam (although it was signed in Gothenburg, Sweden), the vessel was to be delivered to the Dutch port of Vlaardingen, and the purchase price was to be paid to a Rotterdam bank. In the light of these contacts with the Netherlands, the arbitrators' decision to apply Swedish law is at least debatable.

Although the closest-connection approach is only one of many theories, it is the only recent United States theory which has been applied in international arbitration. For example, other United States theories, such as the interest analysis, have never been employed by arbitrators. Possibly this can be explained by the fact that interest analysis is ill-suited to international arbitration. A judge, using an interest analysis, approaches conflicts problems from the perspective of the sovereign's interest in regulating a given activity. Unlike a judge, however, an arbitrator is answerable to the parties and not to a sovereign. Consequently, to determine the applicable law, the arbitrator should choose the legal system which best serves the interests of the parties and not those of a sovereign. Moreover, the sovereign does not usually expect arbitrators to implement policies embodied in domestic legislation.

2. Application of the Terms of the Contract

Some disputes can be resolved by arbitrators without the application of rules of substantive law. Instead, an arbitrator may base the decision

121. Award of July 1966, 1 Y.B. COM. ARB. 141 (1976).

122. See Convention on the law applicable to international sales of goods, done at the Hague June 15, 1955, art. 3, 510 U.N.T.S. 147. Due to the fact that under the Hague Convention of 1955 sales of movables in international trade are governed by the law of the seller, this connecting factor assumes particular importance.

solely on an interpretation of the parties' contract.¹²³

On many occasions, the language of the contract may provide an adequate basis for a solution to the dispute: "The contract normally sets down the relative rights and duties of the parties. It will state the subject of the transaction, what constitutes performance, and what excuses non-performance. This, for the most part, supplies the substantive 'law' against which the facts of a dispute are to be weighed."¹²⁴

For example, a dispute arose out of a license and exclusive sales agreement, under which an Italian claimant promised to provide a Spanish respondent the know-how necessary to manufacture certain products in Spain. The arbitrator found that:

In so far as the questions in dispute are regulated by the parties in their contract and this contractual regulation does not contravene the mandatory rules of the two laws in question, it is permitted to resolve them on the basis of the contract. This applies in the present case to the validity, execution, rescission or adaptation to the circumstances of the contract.¹²⁵

This Italian-Spanish arbitration also illustrates the limits of basing a decision on the contract terms. In many instances, the terms of a contract will not provide a solution for all the disputed issues because certain aspects of the parties' relationship may have been omitted from the contract, either deliberately or accidentally. Moreover, a dispute might involve a question which is non-contractual in nature. The arbitrator in the Italian-Spanish arbitration was confronted by both of these problems. There, the parties failed to determine the rate of interest on damages for non-performance. Furthermore, the claimant asserted a claim on the grounds of unfair competition, which is clearly a non-contractual issue.¹²⁶

Where interpretation of the contract does not provide a solution for all the issues in the arbitration, the arbitrator could resort to external sources of interpretation, such as customs and practices of trade. In this context, the arbitrator should analyze general customs and trade practices, as well as customs and practices between the parties.¹²⁷

123. Sanders, *supra* note 23, at 264; J. LEW, *supra* note 20, at 493-94.

124. Ehrenhaft, *supra* note 7, at 1212.

125. Case No. 1990, 1972, I.C.C. Arbitration Tribunal, 3 Y.B. COM. ARB. 217, 217-18 (1978).

126. *See id.*

127. Ehrenhaft, *supra* note 7, at 1212.

3. Application of Non-National Substantive Rules.

The application of non-national substantive rules has been discussed widely in recent years. The departure from national law as the source of standards for international commercial relations was triggered by a combination of factors, including discontent in the international business community with the law and lawyers.¹²⁸

Traditionally, parties to an arbitration have preferred arbitrators to apply practical rather than legal principles.¹²⁹ Moreover, national legislation often does not address all the complex issues that arise from transnational commercial relations. As a result, the business community turned to rules which developed outside the realm of national legal systems.

a. *Rules of International Trade*

International arbitrators also can apply non-national substantive rules arbitrators called the "law merchant" or *lex mercatoria*.¹³⁰ The origins of these rules can be traced to the merchant law of the Middle Ages¹³¹ and English commercial and maritime principles.¹³² Among the sources of the modern *lex mercatoria* are customs and usages of trade, general principles of law, international conventions, acts of international organizations, and codes of conduct.

i. Customs, Usage, and General Principles of Law

Writers do not agree whether the customs of trade and general prin-

128. Freedom from the application of binding legal rules has been advanced by many observers, including the most fervent supporters of arbitration, as a major benefit of the process. Arbitration, which is "confidential," owes no higher duty to the evolution of a society-wide body of legal principles. It is thought sufficient that the particular controversy be fairly and equitably decided and then relegated to the private files of the arbitral institution. No precedent need be established. Such is the discontent with the law and lawyers that these ideas have a powerful appeal in the international business community.

Higgins, Brown & Roach, *supra* note 4, at 1040 (footnote omitted).

129. In the absence of an express intent, it seems more in keeping with what the everyday businessman actually had in mind to presume that they intended practical rather than technical and legal principles to form the criteria for the arbitrator. Indeed, how can an arbitrator who is not trained in the law possibly be expected to apply legal principles?

Abrams, *supra* note 115, at 135.

130. See generally J. LEW, *supra* note 20, at 346, and sources cited therein. The law merchant does not include public international law.

131. Sanders, *supra* note 23, at 263.

132. Smedresman, *supra* note 8, at 299.

ciples of law constitute one¹³³ or two independent¹³⁴ sources of *lex mercatoria*. Customs of trade are widely accepted and applied in international trade and commerce. While some customs might apply to a particular type of commercial activity, others represent more general principles.

The general principles of law are universally recognized rules, at least in the major legal systems. Unlike customs and usages which need not conform to the national rules, the general principles of law, by their nature, are deeply rooted in national laws. It could be argued that the general principles of law also form part of the trade customs. For example, basic principles like *pacta sunt servanda* and *force majeure* are widely recognized by the business community.

Arbitrators often turn to general principles of law and customs of trade.¹³⁵ In many instances, arbitrators invoke the general principles and customs of trade to support their interpretation of a contract. In other cases, arbitrators use these rules and principles to avoid application of national laws: "[I]n contract cases national laws can be escaped by labelling an issue as one of contract construction. Trade usage and custom clearly have an important role in this technique, and indeed it may be difficult to maintain a precisely defined distinction between law and custom."¹³⁶ Finally, on some occasions arbitrators rely on customs of trade and general principles of law as the only source of substantive rules. An example of an arbitral decision based solely on trade customs is the award rendered by the Arbitral Tribunal of the Coffee Trade.¹³⁷ The dispute arose when the seller of coffee¹³⁸ invoked Article 4 of the Conditions of Trade in Indonesian Coffee. This article provides that the increase or reduction of freight after the conclusion of the contract was for the benefit or account of the buyer. Based on this provisions, the seller demanded an additional payment from the buyer. The seller's claim was rejected by the arbitrator who noted that sellers in the coffee trade customarily include in the price any freight increases applicable at the time of shipment.

The *Sapphire* arbitration is one of the best examples of an award based on general principles of law. The arbitrator concluded that the par-

133. See P. FOUCHARD, *supra* note 53, at 402.

134. See Sanders, *supra* note 23, at 263.

135. See Goldman, *Les conflits de lois dans l'arbitrage international de droit privé*, 109 *R.C.A.D.I.* 366, 477 (1963).

136. Smedresman, *supra* note 8, at 299.

137. Award of May 19, 1971, 1 *Y.B. COM. ARB.* 136 (1976).

138. The nationalities of the parties were not reported by the editors of *Y.B. COM. ARB.*

ties intended to avoid national law and to submit the interpretation and performance of the agreement to the "general principles of law based upon the practice common to civilized countries."¹³⁹ The arbitrator gave the following grounds for the application of the general principles of law:

Article 38 of the agreement, which confirms an intention already expressed in the preamble, provides that the parties undertake to carry out its provisions according to the principles of good faith and good will, and to respect the spirit as well as the letter of the agreement

It is . . . perfectly legitimate to find in such a clause evidence of the intention of the parties not to apply the strict rules of a particular system but, rather, to rely upon the rules of law, based upon reason, which are common to civilized nations. These rules are enshrined in Article 38 of the Statute of the International Court of Justice as a source of law, and numerous decisions of international tribunals have made use of them and clarified them

The arbitrator will therefore apply these principles, by following, when necessary, the decisions taken by international tribunals. He points out that, this being so, he has no intention of deciding the case according to "equity," like an "*amiable compositeur*." On the contrary, he will try to disentangle the *rules of positive law*, common to civilized nations, such as are formulated in their statutes or are generally recognized in practice.¹⁴⁰

It should be noted that in many instances, the application of the customs of trade and general principles alone cannot resolve a dispute because these principles do not cover all issues. For example, at present there are no customs in international commerce regarding the periods of prescription. Since national rules differ on this matter, there are no general principles,¹⁴¹ and therefore the application of customs of trade and general principles would be impossible.

ii. Transnational Rules

The term "transnational rules" is used in this study to describe the substantive rules which have been created by international organizations and conferences. These rules are primarily contained in international conventions, codes of conduct, uniform laws, and other resolutions of international organizations. The common feature in these sources of international trade law is that they are created as a result of international cooperation. Unlike rules of public international law, however, transna-

139. Award of Mar. 15, 1965, 35 I.L.R. 136, 173 (1967).

140. *Id.* at 172-75.

141. Sanders, *supra* note 23, at 263.

tional rules do not govern relations between states; they regulate questions of private law in the international business arena.

International conventions regulating issues of private law play a dual role in international commercial arbitration. When ratified or accepted by a state, the rules embodied in these conventions form part of the national legal system and can be applied by arbitrators as rules of national law. These same rules, however, may also be applied by arbitrators as non-national standards. For example, an arbitrator may apply a rule embodied in an international convention without reference to any national legal system.

Codes of conduct and uniform laws usually are prepared by international intergovernmental and nongovernmental organizations¹⁴² and are aimed at universal or regional unification of substantive laws. Some of the laws contained in codes of conduct and uniform laws are adopted voluntarily by states and form part of the national legal systems. An arbitrator's willingness to apply these rules depends on their recognition by the international community. Certainly, legal instruments which have received wide recognition (as reflected by the number of ratifications and acceptances) are more likely to be applied by arbitrators.

Another group of transnational rules available to international arbitrators are the rules promulgated by international organizations. The most important rules are promulgated by two European organizations: The Council for Mutual Economic Assistance (COMECON)¹⁴³ and the European Economic Community (E.E.C.).

The legal character of non-national substantive rules has been the subject of controversy for some time. It has been argued that all rules applied by arbitrators must be derived from some legal system and supported by means of sovereign compulsion. Others have argued that arbitrators should not apply non-national rules because they are uncertain.

On the other hand, proponents maintain that the rules of international trade form an a-national legal system of merchants and people from the business world.¹⁴⁴ Others argue that the wide application of the non-national rules in international arbitration sufficiently demonstrates

142. One has to distinguish between the uniform laws contained in international conventions like the Geneva Convention Providing the Uniform Law for Cheques of 1931, Mar. 19, 1931, 143 L.N.T.S. 355, and the uniform laws discussed in this paragraph. The uniform laws of the latter type constitute merely the recommendations of international organizations, while the former are binding treaty law.

143. See, e.g., The General Conditions of Assembly and the Provisions on Other Technical Services of 1962, The General Conditions for the Technical Servicing of Machinery, Equipment and Other Items of 1968, and The General Conditions of Delivery of 1968.

144. P. FOUCHARD, *supra* note 53, at 404.

that such practice is commonly accepted.¹⁴⁵

It appears that the existence of a legal sanction is not a condition to *lex mercatoria's* application by international arbitrators. It has been submitted that "there is no reason why the rules, practices and customs of international trade cannot individually and *per se* be applied, where relevant to particular commercial arrangement."¹⁴⁶ Even if treated as "spontaneous" rules of law,¹⁴⁷ however, rules of international trade have a great role to play in promoting the development of international commercial arbitration.

b. Public International Law

Public international law governs relations between states and international organizations. For that reason, its rules are generally not applicable to international commercial transactions that are private and non-governmental. In some instances, however, a commercial dispute might involve issues requiring the application of public international law. In an arbitration between an Indian company and a Pakistani bank,¹⁴⁸ the respondent, a Pakistani bank, asserted that the arbitration clause contained in the contract was invalid as a result of a "state of war" between India and Pakistan in 1965-66. The arbitrator sitting in Switzerland decided, based on rules of public international law, whether a state of war existed.

The direct application of public international law to private or semi-private commercial relations often occurs in arbitrations between states and international corporations. For example, the arbitrator in the *Sapphire* arbitration based the award on general principles of international law recognized by the civilized nations, as defined in Article 38 of the Statute of the International Court of Justice. The arbitrator then observed that:

Their application is particularly justified in the present contract, which was concluded between a State organ and a foreign company, and depends upon public law in certain of its aspects. This contract has therefore a quasi-international character which releases it from the sovereignty of a particular legal system, and it differs fundamentally from an ordinary commercial contract [The application of the general principles of law] seems particularly suitable for giving the guarantees of protection which are indispensable for foreign companies, since these companies undergo very considerable risks in bringing

145. Goldman, *supra* note 135, at 477.

146. J. LEW, *supra* note 20, at 437.

147. Luzzatto, *supra* note 77, at 64.

148. Case No. 1512, 1971, I.C.C. Arbitration Tribunal, 1 Y.B. COM. ARB. 129, 131 (1976).

financial and technical aid to countries in the process of development. It is in the interest of both parties to such agreements that any disputes between them should be settled according to the general principles universally recognized and should not be subject to the particular rules of national laws, which are very often unsuitable for solving problems concerning the rights of the State where the contract is being carried out, and which are always subject to changes by this State and are often unknown or not fully known to one of the contracting parties.¹⁴⁹

In a more recent case dealing with the same issue, *S.P.P. (Middle East) Ltd. v. The Arab Republic of Egypt*,¹⁵⁰ the arbitrator took a different position. Although the agreement did not specify the applicable law, the parties agreed that Egyptian law should apply. The claimants argued, however, that Egyptian law could not override principles of international law applicable to international investments. The defendants maintained that Egyptian law should govern all disputed issues. The arbitrators characterized the problem in the following way:

In concrete terms the basic issue to be dealt with is whether contracts between States and private Law persons can be removed at least to a certain extent from domestic law and made subject to International Rules.

The theories which have emerged on the subject differ sometimes to a considerable extent. Some have gone so far as to invoke under certain circumstances full "denationalisation" of international contracts to the extent that they should only be governed by Rules and Principles drawn from International practice and Trade usages. Others do not discard the reference to domestic laws, provided, however, that even when placed within the legal framework of a domestic system, arbitrators are empowered to apply those principles of international law which ensure protection to the contractual rights of the private party vis-a-vis the sovereign state.

In the field of international investments the problem has been expressly dealt with in Article 42(1) of the *ICSID Convention* reading as follows:

"The Tribunal shall decide a dispute in accordance with such rules 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 of the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable."

Obviously the specific proviso of art. 42 only applies to investment agreements and disputes that may arise thereunder. However, we take

149. Award of Mar. 15, 1967, 35 I.L.R. 136, 137-76 (1967).

150. Award of Mar. 11, 1983, I.C.C. Arbitration Tribunal, 22 I.L.M. (1983).

the view that "in the world today, there is no reason why this solution should be limited to a particular category of state contracts. In other words, the rule formulated in article 42 can be considered as illustrative of a principle of wider application."

May we observe, *ad abundantiam*, that failing contractual designation of the governing law the same result (i.e., reference to the law of the host country) would also normally be achieved by applying the ordinary principles of conflict of laws.

In the case at issue the governing law is, in our opinion, the law of Egypt. The Agreements were both made in Egypt. The place of performance was almost entirely Egypt. There are numerous references to Egyptian law in the agreements.¹⁵¹

Nevertheless, the court applied the rules of international law based on the following reasoning: "We have found that International Law principles such as 'Pacta Sunt Servanda' and 'Just Compensation for Expropriatory Measures' can be deemed as part of Egyptian law."¹⁵²

CONCLUSIONS

Because of the contractual nature of arbitration, the arbitrator's choice of applicable law should be guided by the intent of the parties. If the intent of the parties cannot be ascertained, the arbitrator must decide whether to resort to conflict rules to determine the applicable substantive law. Choosing the applicable substantive law based on conflict rules, however, is impractical because the result is the double conflicts problem, which in turn leads to uncertainty of the applicable law. From a theoretical point of view, application of conflict rules often does not promote the purpose of the rules or the interests of the parties. Nevertheless, some arbitrators still consider application of the forum's conflict rules convenient and practical. Thus, in a dispute between a West German claimant and a Yugoslavian respondent concerning the exclusive right to sell and distribute claimant's goods in Yugoslavia, a Swiss arbitrator sitting in Switzerland said that:

There are no rules of conflict of laws . . . in force that could indicate to the arbitrator of a third country, which has no connection with the legal relationship existing between the parties, according to which country's private international law he should determine the law to be applied to the substance. Nor does there exist a criterion which is suitable for deciding in favor of either the private international law of Germany nor the one of Yugoslavia; such an investigation would not

151. *Id.* at 769-70 (citations omitted).

152. *Id.* at 771.

sustain criticism and the result would always have the appearance of an arbitrary preference. Therefore, the solution which is in practice the most convenient, and which is recognized as such by the most recent doctrine, consists in the reference to the conflict of law rules of the forum.¹⁵³

Although the arbitrator's contention that his position is supported by legal doctrine is debatable,¹⁵⁴ his remarks concerning the convenience of applying the forum's conflicts rules are worth considering. The arbitrator was aware that Swiss law had no relation to the dispute. At the same time, he disregarded German and Yugoslavian law, which were related to the dispute, because no criteria existed for choosing between the two. Thus, the arbitrator probably applied Swiss conflict rules because they were neutral and he was familiar with them.

The Swiss arbitrator proceeded on the assumption that applicable law must be decided on the basis of a single national conflict system.¹⁵⁵ This is the major flaw in his reasoning. The application of Swiss conflict laws created a situation where the substantive law was determined based on a legal system with no connection to the dispute and no interest in its outcome. The application of the Swiss rule did not promote the objectives of the Swiss legal system or the interests of the parties. For this reason, it must be regarded as the least sensible choice. Furthermore, the arbitrator failed to consider whether any differences existed between the German and Yugoslavian conflict rules. If the German and Yugoslavian rules were identical, but different from the Swiss rules, the application of Swiss law clearly was unjustified. If the German and Yugoslavian conflict rules led to different results, the arbitrator should have applied non-national conflict rules or he should have applied the substantive laws directly.

Sometimes the application of the forum's conflicts rules may be necessary to ensure the enforceability of the award. For example, under Article V(1) of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards,¹⁵⁶ the recognition and enforcement of an award may be refused abroad if the award is not valid under the law of the country where rendered. Thus, if a state refuses to uphold awards based on *lex causae* other than that indicated by its own conflict

153. Case No. 1455, I.C.C. Arbitration Tribunal, 3 Y.B. COM. ARB. 215, 219 (1978) (footnotes omitted).

154. See Croff, *supra* note 81, at 625.

155. See Case No. 1455, 3 Y.B. COM. ARB. 215, 219.

156. United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done June 10, 1958, 21 U.S.T. 2517, T.I.A.S. No 6997, 330 U.N.T.S. 38.

rules, an award based on non-forum rules might not be recognized or enforced abroad. For this reason, some commentators endorse the application of the forum's conflict rules, even though it leads to arbitrary results in some cases.¹⁵⁷ The present trend in international arbitration, however, is away from application of the forum's conflict rules.

The European Convention on International Commercial Arbitration of 1961 is evidence of this trend.¹⁵⁸ Article VII(1) of the Convention states:

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 rules of conflict that the arbitrators deem applicable.¹⁵⁹

Thus, the European Convention confirms the parties' autonomy to choose the substantive law and gives arbitrators freedom to determine the applicable conflicts systems. This provision was later interpreted by arbitrators and courts as permitting arbitrators to apply substantive law directly.¹⁶⁰ The 1961 European Convention codified proposals of various international bodies all of which would accord a great degree of flexibility to arbitrators in determining the applicable *lex causae*. This trend ultimately may result in universal recognition of awards in which the applicable *lex causae* was determined without the assistance of the conflict rules.

An arbitrator who determines the *lex causae* without resort to the conflict rules must choose between the law of one of the national legal systems involved in the dispute, the terms of the contract, or, finally, substantive rules of non-national character.

Where possible, the arbitrator should resolve the dispute on the basis of the contract itself because such terms correspond to the interests of the parties. Since the principle of parties' autonomy in contractual mat-

157. P. O'KEEFE, *ARBITRATION IN INTERNATIONAL TRADE*, 191-92 (1975).

158. *Done* Apr. 21, 1961, 484 U.N.T.S. 349; see I.C.C., *ARBITRATION LAW IN EUROPE* 351 (1981).

159. 1961 European Convention, 484 U.N.T.S. at 374. The Working Group formed by the UNCITRAL and entrusted with the task of preparing a model law on international commercial arbitration decided to provide, as do the UNCITRAL Arbitration Rules, that the Tribunal should apply "the law determined by the conflict of laws rules which it considers applicable." Broches, *A Model Law on International Commercial Arbitration?* 18 GEO. WASH. J. INT'L L. & ECON. 79, 90 (1984). See *United Nations Commission for International Trade Law Arbitration Rules*, 31 U.N. GAOR Supp. (No. 17) at 35-50, U.N. Doc. A/CN. 9/SR. 178 (1976), reprinted in U.N. Commission on International Trade Law, *Decision on UNCITRAL Arbitration Rules and Text of the Rules*, 15 I.L.M. 201 (1976).

160. Luzzatto, *supra* note 77, at 63.

ters is universally recognized, the danger that an award based on the terms of the contract will not be enforced abroad is remote.¹⁶¹ Finally, by relying on the terms of the contract, the arbitrator need not choose between the legal systems involved in the dispute, and he thus can avoid problems arising from the application of the conflict of laws rules.

When the arbitrator cannot resolve a dispute on the basis of the contract itself, he must resort to the rules of substantive law. In some instances the arbitrator may resolve a dispute by relying on trade usages or general principles of law. Only on rare occasions, however, will usages and general principles provide a solution for all disputed issues, and the arbitrator should then turn to the transnational rules. In this way, an arbitrator applies rules which are familiar and accepted by the parties, without giving preference to any national legal system. Moreover, application of transnational rules allows the arbitrator, at least in some instances, to avoid potentially rigid conflict rules.¹⁶² In applying the rules of international trade, however, the arbitrator should ensure that mandatory rules of the seat of arbitration or place of enforcement of the award are not violated. Otherwise, the award may be unenforceable.¹⁶³

The application of transnational rules instead of national law was recently argued before a French court. In *Société Norsolor v. Société Pabalk Ticaret Sirketi*,¹⁶⁴ the *Tribunal de grande instance* was asked to rule on the validity of an I.C.C. arbitral award rendered in Vienna. The dispute arose out of a contract of representation concluded between French and Turkish companies. The I.C.C. arbitration clause contained in the contract was invoked by the Turkish claimant after unilateral abrogation of the contract by the French company. Emphasizing the international character of the contract, the arbitrator refused to base the award on a national law, deciding instead to apply "international *lex mercatoria*."¹⁶⁵ The arbitrator resolved the issue of the contract abrogation by reference to the principle of good faith and computed damages on the basis of equity ("en équité"). The French plaintiff alleged before the *Tribunal de grande instance* that an arbitrator not empowered to render an award based in equity may not render an award on a basis other than a national law. Consequently, according to the plaintiff, the arbitrator in

161. Ehrenhaft, *supra* note 7, at 1212.

162. J. LEW, *supra* note 20, at 438.

163. See Loquin, *Les pouvoirs des arbitres internationaux à la lumière de l'évolution récente du droit de l'arbitrage international*, 110 CLUNET 293, 342 (1983).

164. Judgment of Mar. 4, 1981, Trib. gr. inst., Paris, 108 CLUNET 836 (1981), with note by Kahn.

165. *Id.* at 838.

this case acted *ultra vires*. The court emphasized that under the I.C.C. Rules the arbitrator applies the law "designated as the proper law by the rule of conflict which [the arbitrator] deems appropriate."¹⁶⁶ Although the court found the term "equity," as used by the arbitrator, unclear and confusing, it nevertheless upheld the award because it did not violate French public policy.

The *Norsolor* decision recognized the power of the arbitrator to depart from the national substantive law in favor of rules of international trade. Moreover, the decision approved the direct application of the substantive rules, at least in an arbitration conducted under the I.C.C. Rules. The *Norsolor* decision constitutes a significant step in the development of a truly international or denationalized arbitration.

An arbitrator who cannot find transnational rules governing the issue in dispute, or is unwilling to apply these rules, must apply national law. The arbitrator's preliminary inquiry should determine whether a true conflict exists. If there is no true conflict, the determination of applicable law is of little importance.

When a true conflict exists, commentators suggest that the closest-connection approach offers a desirable solution.¹⁶⁷ The closest-connection analysis assumes that the legal system of the jurisdiction most closely connected to the dispute should govern the disputed issues. The problems associated with this analysis in international arbitration concern the manner in which the most closely related jurisdiction is determined. Because the arbitrator determines the relative weight of the connecting factors, he therefore has great discretion. An abuse of this discretion will frustrate the parties' expectations with respect to the applicable law. Nevertheless, the closest-connection analysis is a preferable manner of solving a true conflict situation in international arbitration because it focuses on the relationship between the dispute and the applicable national law. The soundness of this solution was noted by the arbitrators in the *ARAMCO* arbitration: "[T]he governing law should coincide with the economic milieu where operation is to be carried out."¹⁶⁸

OBSERVATIONS

Most legal systems recognize the principle of the autonomy of the parties and their freedom to choose the law governing the contractual

166. *Supra* note 26, rule 13(3).

167. Croff, *supra* note 81, at 633.

168. *ARAMCO* arbitration, 27 I.L.R. at 167.

relationship. The arbitrator's power to determine the governing *lex arbitri* and *lex causae* should be considered an extension of the principle of party autonomy because an arbitrator acts as an agent of the parties in determining the laws governing the dispute. Consequently, the arbitrator should try to determine the intent of parties with regard to the applicable law. Moreover, the arbitrator should have as much power as the parties to choose the applicable law.

The recent decades have witnessed the emergence of a clear trend toward recognizing the business community's needs for international arbitration detached from the *lex arbitri*. Where the local forum has no interest in the proceedings, national courts permit arbitrators to conduct the proceedings under foreign or non-national rules of procedure. On the other hand, when the arbitrated dispute has substantial connections with the forum, national courts are more reluctant, with the exception of France, to permit application of foreign procedural law. Consequently, an arbitrator who must choose the *lex arbitri* should inquire into the law governing the arbitration in the forum. If the *lex fori* considers invalid awards based on foreign or non-national rules of procedure, the arbitrator should follow the *lex arbitri* of the forum. If the local law requires application of its own rules of procedure only if the arbitrated dispute has substantial connections with the forum, the arbitrator must determine the relationship between the dispute and the forum. When the dispute has no significant contacts with the forum or the forum permits application of foreign law even when significant contacts exist, the arbitrator may choose a *lex arbitri* other than the local rules.

Given the contractual nature of arbitration, the arbitrator's decision on the applicable law should reflect the interests of the parties. Thus, when the intention of parties as to the *lex arbitri* can be established, that law should apply. When the parties' intent cannot be established, the arbitrator should determine which set of rules is best suited to the proceedings. This could be either the *lex arbitri* of the place most closely related to the dispute or the rules of procedure prepared by an international organization. Application of non-national rules of procedure offers the most desirable alternative because these rules stem directly from the international business community and reflect its needs and expectations.

In selecting the applicable substantive law, the parties usually are influenced by considerations such as the neutrality and sophistication of a legal system. The parties are not concerned with the state's interest in applying its law to the dispute. By analogy, the arbitrator choosing the substantive law should not begin an analysis by considering the state's

interest and, therefore, should not turn to the conflict rules. The conflict rules codify state policies with regard to choice of law questions. Since the arbitrator is accountable to the parties rather than the sovereign, the arbitrator need not implement state policies. Consequently, the arbitrator's determination of the applicable law should be based on an analysis of the substantive rules rather than on application of conflict of laws rules. This same conclusion could be reached by an examination of the purpose of the national conflict rules, which indicates that a sovereign has no interest in binding an arbitrator by the sovereign's own conflict rules.

In choosing the substantive rules, the arbitrator should consider the national legal systems involved in the dispute, as well as non-national rules. The arbitrator's choice should be made on the basis of the completeness and sophistication of a set of rules, rather than their source.