

Choice of Law in International Commercial Arbitration

Markus A. Petsche

Abstract The choice-of-law rules applied by arbitral tribunals differ in several respects from the approaches followed by domestic courts. Those differences arise in connection with three distinct choice-of-law problems: (i) the determination of the law applicable absent a choice of law by the parties, (ii) the interpretation and supplementation of the law chosen by the parties, and (iii) the application of mandatory norms. As far as item (i) is concerned, arbitration-specific choice-of-law rules typically grant arbitrators more freedom than ordinary conflict-of-laws norms. In relation to international sale of goods transactions, for example, Article 4(1)(b) of the Rome I Regulation on the law applicable to contractual obligations provides for the application of the law of the country where the seller has his habitual residence (unless the contract is more closely connected with another country), while Article 28(2) of the UNCITRAL Model Law on International Commercial Arbitration allows arbitrators to determine the applicable law on the basis of the conflict rule of their choosing. Under the arbitration laws of several countries, arbitrators are even entitled to apply non-national law such as general principles of law, the UNIDROIT Principles of International Commercial Contracts, or principles common to the parties' legal systems. With regard to item (ii), arbitral tribunals may similarly resort to non-national legal sources when interpreting, or filling the gaps of, the applicable domestic law. This was expressly contemplated by the drafters of the aforementioned UNIDROIT Principles according to whom the Principles "may be used to interpret or supplement domestic law" (see Preamble). As to item (iii), the conflict rules of codifications such as the Rome I Regulation lay down specific rules regarding the application of the mandatory norms of both the forum and other relevant jurisdictions. The former cannot be transposed to international arbitration due to the absence of a "forum" of international arbitral tribunals. The latter, while not directly applicable, may be taken into account by arbitral tribunals. However, it is more likely that arbitral tribunals will view the question of the application of specific mandatory norms from the angle of possible enforcement problems that may result from the non-application of those norms.

M.A. Petsche (✉)

Legal Studies Department, Central European University, Budapest, Hungary
e-mail: PetscheM@ceu.edu

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Introduction

International commercial arbitration proceedings give rise to a variety of choice-of-law issues. Those notably relate to the determination of (i) the law governing the arbitration agreement¹; (ii) the law governing the arbitration proceedings²; (iii) the law applicable to the merits (the applicable substantive law)³; and—to the extent that this question is properly framed as a choice-of-law issue—(iv) the law governing the arbitration award (or its enforceability).

This contribution examines the specific question of the determination of the applicable substantive law in the absence of a choice of law by the parties. The significance of this topic derives from the fact that the relevant rules and approaches differ quite dramatically from those applicable and/or followed in the context of international litigation. Indeed, as will be explained in this paper, arbitral tribunals typically enjoy considerably broader discretion than State courts in the determination of the applicable law.

Structure of the Chapter

This study discusses the two principal dimensions (or aspects) of such arbitral discretion. Section 2 explores choice-of-law discretion, i.e. the fact that arbitral tribunals enjoy considerable freedom in the determination of the applicable domestic law. Section 3 deals with the ability of arbitral tribunals to apply transnational rules, rather than a specific domestic law. While the former relates to the question of *how* arbitral tribunals may determine the applicable domestic law, the latter pertains to the question of *what* it is that they may apply.

¹For in-depth analysis of this issue, see, e.g., Julian D. M. Lew, ‘The Law Applicable to the Form and Substance of the Arbitration Clause’ in Albert Jan van den Berg (ed.) *Improving the Efficiency of Arbitration Agreements and Awards: 40 Years of Application of the New York Convention*, ICC Congress Series Volume 9 (1999)114; Klaus Peter Berger, ‘Re-examining the Arbitration Agreement: Applicable Law—Consensus or Confusion?’ In Albert Jan van den Berg (ed.), *Arbitration 2006: Back to Basics?*, ICCA Congress Series Volume 13 (2007) 301; Dongdoo Choi, ‘Choice of Law Rules Applicable for International Arbitration Agreements’ (2015) 11 Asian Int’l Arbtrn J 105.

²On this topic, see, e.g., Gabrielle Kaufmann-Kohler, Identifying and Applying the Law Governing the Arbitration Procedure—The Role of the Law of the Place of Arbitration in ICCA Congress Series Volume 9 (n 1) 336.

³On this issue, see, e.g., Wolfgang Kühn, ‘Express and Implied Choice of the Substantive Law in the Practice of International Arbitration’ in Albert Jan van den Berg (ed.), *Planning Efficient Arbitration Proceedings: The Law Applicable in International Arbitration*, ICC Congress Series Volume 7 (1996)380; Marc Blessing, ‘Choice of Substantive Law in International Arbitration’ (1997) 14(2) J of Int’l Arbtrn 39; Abdul F. Munir Maniruzzaman, Choice of Law in International Contracts—Some Fundamental Conflict of Laws Issues, *Journal of International Arbitration*, Volume 16 (1999), Issue 4, p. 141.

1 Discretion of Arbitral Tribunals in the Determination of the Applicable Domestic Law

1.1 Recognition of Arbitral Discretion in Arbitration Conventions, Laws, and Rules

Virtually all contemporary legal instruments in the area of international commercial arbitration provide for broad arbitral discretion in the determination of the applicable substantive law absent a choice of law by the parties. Three principal approaches can be distinguished: (i) requiring (or, perhaps more appropriately, allowing) arbitral tribunals to apply a closest-connection test; (ii) allowing arbitral tribunals to have recourse to the conflict-of-laws norms that they consider “appropriate”; and (iii) enabling arbitral tribunals *directly* to apply the law or rules of law that they consider appropriate without the need to refer to any particular choice-of-law rule (the *voie directe* method).

Examples illustrating the first approach notably include Swiss and German arbitration laws. Under Swiss Law, failing a choice of law by the parties, arbitral tribunals “*shall decide the case according to the rules of law... with which the case has the closest connection.*”⁴ Under German law, absent a determination by the parties, arbitral tribunals “*shall apply the law of the State with which the subject-matter of the proceedings is most closely connected.*”⁵

The second approach has notably been followed in the European Arbitration Convention of 1961, the UNCITRAL Model Law, and the English Arbitration Act. Under the European Convention, absent a choice of law by the parties, the arbitrators “*shall apply the proper law under the rule of conflict that [they] deem applicable.*”⁶ The Model Law and English Act similarly refer to the application of “*the law determined by the conflict of laws rules which [the tribunal] considers applicable.*”⁷

The third and last approach can be illustrated by French law, as well as various institutional arbitration rules. Under the French Code of Civil Procedure, failing a relevant determination by the parties, arbitral tribunals “*shall decide the dispute in accordance with the rules of law [they] consider[...] appropriate.*”⁸ Similarly worded provisions can be found in the ICC, LCIA, and VIAC Rules.⁹

All of these approaches entail a degree of discretion in the determination of the applicable substantive law that is (far) superior to any discretion that domestic courts may enjoy. In the specific context of the EU, for example, courts are bound

⁴Swiss Private International Law Act Art. 187(1).

⁵German Arbitration Act Sect. 1051(2).

⁶European Convention on International Commercial Arbitration Art. VII(1).

⁷Model Law Art. 28(2); English Arbitration Act S. 46(3).

⁸French Code of Civil Procedure Art. 1511.

⁹ICC Rules Art. 21(1); LCIA Rules Art. 22(3); VIAC Rules Art. 27(2).

by the provisions of the Rome I Regulation¹⁰ which lays down a number of specific choice-of-law norms pertaining to different categories of contracts including, inter alia, contracts for the sale of goods, contracts for the provision of services, and franchise and distribution agreements.¹¹ Only in exceptional circumstances may courts depart from these specific rules.¹²

1.2 Specific Methodological Approaches Followed by Arbitral Tribunals

This Section discusses some of the principal methods applied by arbitral tribunals when determining the applicable substantive law in the absence of an agreement between the parties including (i) the application of the conflict norms of the arbitral seat; (ii) the cumulative application of domestic conflict norms; and (iii) the application of general principles of choice of law.

1.2.1 Application of the Domestic Conflict Norms of the Place of Arbitration

Contrary to the other two methods examined below, this particular approach does not involve the exercise of any arbitral discretion. It is discussed in this Section because it played and continues to play a rather significant role in arbitral practice. Under this approach, arbitral tribunals apply the conflict norms of the seat, i.e. those conflict norms that the courts of the seat are bound to apply. These conflict norms can be qualified as the “general” conflict norms of the country of the seat and can be contrasted with the “specific” conflict norms contained in that country’s arbitration law, if any.

The following cases will serve as illustrations for this particular method. In CAC case No. 44/70,¹³ an arbitral tribunal seated in the Czech Republic heard a dispute between a Claimant of unidentified nationality and a group of Austrian Respondents. It decided to apply Czech law to the merits of the dispute on the grounds that the Czechoslovak Statute on International Private and Procedural Law No. 97/1963 (i.e. the conflict norms of the seat) mandated the application of this law.¹⁴

¹⁰Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

¹¹Regulation Art. 4(1).

¹²See Regulation Arts. 4(3), 4(4).

¹³CAC case No. 44/70, 9 January 1975 in Pieter Sanders (ed.), *Yearbook Commercial Arbitration* (hereinafter, the *Yearbook*) 1977, Vol. II, 142.

¹⁴*Ibid.*

In joint ICC cases No. 2977, 2978, and 3033 (the well-known *Götaverken* case),¹⁵ an arbitral tribunal having its seat in Paris heard a dispute between a Swedish shipyard and a Libyan State entity. The arbitral tribunal held that the substantive applicable law had to be determined “*either by an international convention or by the conflicts (sic!) of laws rules of France, as the country of the place of arbitration.*”¹⁶ It ultimately based its decision to apply Swedish law primarily on French conflict rules and the weight allocated by these rules to the place of construction, the place of delivery, and the place of payment.¹⁷

In ICC case No. 5460,¹⁸ a sole arbitrator sitting in London heard a dispute between an Austrian franchisor and a South African franchisee. With regard to the determination of the law governing the merits he observed that: “*The place of this arbitration is London, and on any question of choice of law I must therefore apply the relevant rules of the private international law of England.*”¹⁹ He held that under those conflict norms, South African law was the “proper law” of the contract.²⁰

Similar approaches have also been adopted in more recent arbitral awards. In ICC case No. 12112,²¹ for example, a sole arbitrator sitting in Switzerland heard an investment dispute between two EU Claimants and a non-EU State. The parties’ contract provided for the application of the laws of the State party and, when giving effect to this provision, the sole arbitrator did so on the grounds that the Swiss conflict norms (i.e. the conflict norms of the seat) recognized the validity of such a choice, noting that “*the lex fori [was]... decisive to the determination of the applicable law.*”²²

Finally, in ICC case No. 13756,²³ a sole arbitrator sitting in Sweden heard a dispute between an US agent and a Russian principal. As regards the law applicable to the contract, he noted that the parties had agreed on the application of the Hague Convention on the Law Applicable to Agency Agreements, which led to the application of the law of the State of Michigan.²⁴ As regards the contract’s formal

¹⁵*AB Götaverken v. General National Maritime Transport Company (GMTC)*, as legal successor of Libyan General Maritime Transport Organization (GMTO), Award, ICC Case Nos. 2977, 2978 and 3033, 1978 in Yearbook 1981, Vol. VI, 133.

¹⁶*Ibid.*, 136.

¹⁷*Id.*, 137.

¹⁸*Austrian franchisor v South African franchisee*, Final Award, ICC Case No. 5460, 1987, Yearbook 1988, Vol. XIII, 104.

¹⁹*Ibid.*, 106.

²⁰*Id.*

²¹*First Investor, in liquidation (EU country), Second Investor (EU country) v Ministry of Agriculture (Non-EU country)*, Final Award, ICC Case No. 12112 in Yearbook 2009, Vol. XXXIV, 77.

²²*Ibid.*, 81.

²³*Agent (US) v Principal (Russian Federation)*, Final Award, ICC Case No. 13756, 2008 in Yearbook 2014, Vol. XXXIX, 118.

²⁴*Ibid.*, 120.

validity, however, the arbitrator resorted to the conflict norms of the 1980 Rome Convention on the Law Applicable to Contractual Obligations on the grounds that this Convention was in force in the place of the arbitral seat (Sweden).²⁵

1.2.2 Cumulative Application of Domestic Conflict Norms

One method whereby arbitral tribunals make use of their discretion in the determination of the applicable substantive law consists of the *cumulative* application of the conflict norms involved. What conflict norms are “involved” will be a matter for the arbitral tribunal to decide but those norms are typically considered to include those of the parties’ respective legal systems and, frequently, those of the seat. The applicability of this method requires, of course, that the conflict norms concerned be identical or, at least, that they point towards the same domestic law. This approach can therefore only be applied where there is convergence between the relevant conflict norms.

The following examples will usefully illustrate this method. In ICC case No. 6281²⁶ a sole arbitrator sitting in France heard a dispute between an Egyptian buyer and a Yugoslav seller. As regards the determination of the applicable substantive law, the arbitrator examined Egyptian, Yugoslav, and French conflict norms.²⁷ Those norms provided for different connecting factors (place of signing of the contract; place of principal office of the seller; habitual residence of the seller) but they all led to the application of Yugoslav law.²⁸

In ICC case No. 7319²⁹ a sole arbitrator sitting in an unidentified location heard a dispute arising out of an agreement for the distribution of goods in Ireland (the distributor was presumably Irish and the manufacturer French). In his determination of the law governing the merits, the sole arbitrator decided to apply “*both the Irish and the French rules of conflict, given that these are the only ones having a direct connection with the parties and the dispute.*”³⁰ The arbitrator held that French and Irish conflict norms were similar in their recognition of the closest-connection test and concluded that Irish law was applicable to the merits.³¹

Lastly, in a Stockholm Chamber of Commerce case,³² an arbitral tribunal seated in Stockholm heard a dispute between a Chinese seller and a US buyer. In its

²⁵Id.

²⁶*Egyptian Company (buyer) v Yugoslav Company (seller)*, Final Award, ICC Case No. 6281, 26 August 1989 in Yearbook 1990, Vol. XV, 96.

²⁷Ibid., 97.

²⁸Id., 98.

²⁹*Manufacturer v Distributor*, Partial Award, ICC Case No. 7319, 1992, in Yearbook 1999, Vol. XXIV, 141.

³⁰Ibid., 145.

³¹Id.

³²*Licensor and buyer v Manufacturer*, Interim Award and Final Award, 17 July 1992 and 13 July 1993, in Yearbook 1997, Vol. XXII, 197.

decision on the applicable substantive law, the arbitral tribunal reviewed possible choice-of-law approaches and observed that, in the case at hand, it was “*immaterial which doctrinal method is employed because the center of gravity rule is common to all conflict-of-laws systems which may be resorted to (including the Chinese, United States and Swedish conflict-of-laws systems).*”³³ The tribunal ruled that Chinese law was applicable.³⁴

1.2.3 Application of General Principles of Choice of Law

Another method consists of the application of *general principles* of choice of law. In theory, the application of such an approach should raise difficult threshold questions as to what norms enjoy sufficiently broad acceptance in order to constitute general principles. In practice, arbitral tribunals applying this method have been largely undisturbed by this question. They have based their findings either on limited comparative analysis or on the fact that the norms at stake were enshrined in international instruments (without paying particular attention to the ratification or acceptance statuses of those instruments).

In ICC case No. 1512³⁵ for example, a sole arbitrator sitting in Switzerland heard a dispute between a Pakistani guarantor and an Indian beneficiary. The parties’ agreement provided for the application of Indian law. The arbitrator decided to give effect to such a choice on the grounds that “*few principles [were] more universally admitted in private international law than that... according to which the law governing the contract is that which has been chosen by the parties*”.³⁶

ICC case No. 6149³⁷ involved a dispute between a Jordanian and a Korean party submitted to an arbitral tribunal having its seat in Switzerland. The arbitral tribunal based its decision to apply Korean law to the merits of the dispute primarily on the cumulative application of the conflict norms concerned.³⁸ However, it then went on to clarify that this decision was “*further supported by some other general principles prevalent in modern conflict of laws*”,³⁹ specifically those contained in the 1955 Hague Convention on the Law Applicable to International Sale of Goods and those contained in the 1980 Rome Convention on the Law Applicable to Contractual Obligations.

³³*Ibid.*, 203.

³⁴*Id.*

³⁵*Indian Company v Pakistani Bank*, Award, ICC Case No. 1512, 1971 in Yearbook 1976, Vol. I, 128.

³⁶*Ibid.*, 130.

³⁷*Seller v Buyer*, Interim Award, ICC Case No. 6149, 1990 in Yearbook 1995, Vol. XX, 41.

³⁸*Ibid.*, 53.

³⁹*Id.*, 54.

Finally, in ICC case No. 6527⁴⁰ an arbitral tribunal sitting in France heard a dispute between a Turkish seller and a buyer of unidentified nationality. In its determination of the applicable substantive law, the tribunal rejected the approach whereby arbitral tribunals are bound by the conflict norms of the seat and considered it “*more appropriate to apply the general principles of international private law as stated in international conventions, particular (sic!) those in the field of the sale of movable goods.*”⁴¹

1.3 Explanation of Arbitral Discretion

1.3.1 Absence of an Arbitral Forum (and of an Arbitral Lex Fori)

The easy answer to the question of why arbitral tribunals enjoy conflict-of-laws discretion is that such discretion is provided for in the applicable arbitration laws and rules. But why do these laws and rules afford arbitral tribunals discretion? One explanation for this legislative and institutional approach is that arbitral tribunals, unlike domestic courts, do not have a forum. The very same idea also underlies the criticism that is sometimes addressed to the use of the concept of arbitral “seat”⁴² which some consider unduly to equate the relationship that an arbitral tribunal entertains with the place of arbitration with the link that exists between a domestic court and its home jurisdiction.

Domestic courts necessarily have a forum. This is due to the fact that such courts constitute judicial organs of a particular state (the forum state) and that they derive the entirety of their powers from the law of that state. As is frequently noted in this connection, courts therefore have a duty to apply the law of the forum (the *lex fori*), including the forum’s conflict-of-laws norms.

Traditionally, there has been a tendency to assimilate arbitral tribunals to state courts and to consider that the place of arbitration (or arbitral seat) is the equivalent of a judicial forum. Proponents of this “localized” approach to international commercial arbitration have advocated, to varying extents, the applicability of the law of the forum, including its choice-of-law rules.⁴³

⁴⁰*Buyer v Seller*, Final Award, ICC Case No. 6527, 1991 in Yearbook 1993, Vol. XVIII, 44.

⁴¹*Ibid.*, 46.

⁴²Although this author has some sympathy for this criticism, the term arbitral “seat” is used as a synonym for “place of arbitration” throughout this contribution.

⁴³For a classic article taking such a position, see F.A. Mann, ‘Lex Facit Arbitrum’ in P.Sanders (ed.) *Arbitration: Liber Amicorum for Martin Domke* (The Hague, Martinus Nijhoff, 1967) 157.

In the contemporary context, such views are generally considered as obsolete. Critics of the traditional approach point out that arbitral tribunals are not judicial organs of any state and that they do not therefore have a *lex fori* which they would be bound to apply.⁴⁴ As has been shown, the vast majority of arbitration statutes implicitly adopt this view insofar as they do not require arbitral tribunals to apply the general conflict norms of the place of arbitration.⁴⁵

1.3.2 Predictability and Legitimacy of Choice-of-Law Determinations

The second explanation for arbitral discretion pertains to the interests that the conferral (or recognition) of such discretion is intended to serve. Unlike the first explanation, it does not rely on any presumably “inherent” characteristics of the arbitral process. Rather, it relates to the objectives underlying the adoption of norms providing for arbitral discretion or, viewed from the perspective of the parties, to the advantages that such discretion offers. This author submits that those advantages consist of enhanced predictability and legitimacy of arbitral choice-of-law determinations.

Parties to a transaction have a basic interest in the predictability of the rules applying to their legal relationship. Those rules include the conflict of laws norms that a court or tribunal will apply in order to determine the applicable substantive law. The fact that the parties failed to determine the applicable law in their contract does not call into question the relevance of predictability since such a failure is typically attributable to the parties’ inability to reach an agreement, rather than to perceived irrelevance of the issue of the applicable law.

Even though it may seem contradictory, limited arbitral discretion may adversely affect the predictability of arbitral choice-of-law determinations. Limited arbitral discretion could result from the adoption of narrowly-tailored⁴⁶ conflict norms specific to international arbitration (virtually nonexistent in practice). It may also stem from approaches that seek to extend the applicability of the forum’s general conflict norms (i.e. the conflict norms applicable to courts) to the field of international arbitration. As has been shown above, a number of arbitral tribunals have followed this approach, even in recent years.⁴⁷

⁴⁴See, e.g., N. Blackaby, C. Partasides et al., *Redfern and Hunter on International Arbitration* (Oxford 2015), § 3.212.

⁴⁵See *supra* 1.1.

⁴⁶“Narrowly-tailored” conflict norms for the purposes of the present contribution are conflict norms that use specific connecting factors (such as residence, domicile, place of performance, place of signing, etc.) to determine the applicable law.

⁴⁷See *supra* 2.2.1.

But why does limited discretion undermine predictability? The answer is that limited discretion *may* diminish predictability whenever the conflict norm that the arbitral tribunal applies, if any, is unpredictable for the parties. This may be the case where that conflict norm is peculiar to one or a few jurisdictions only and/or where that conflict norm differs from the conflict norms applied in the parties' respective home jurisdictions.

An example will be useful to illustrate this point. A seller from country A enters into a contract with a buyer from country B. Under the conflict rules of both country A and country B, sale of goods transactions are governed by the law chosen by the parties and, absent such a choice, by the law of the seller. The arbitral tribunal seated in country C applies C's general conflict norm which provides for the application of the law of the buyer. Such a choice-of-law determination is not predictable for the parties (unless they are familiar with the private international law of C).

The same example can also be used to show how increased arbitral discretion may enhance predictability. Assume that, rather than being (or considering itself to be) bound by the general conflict norms of C, the arbitral tribunal has (or considers itself to have) broad discretion and chooses to apply the law of the seller. Such a result is arguably more predictable for the parties than the application of the law of the buyer (unless the parties are familiar with the private international law of C and expected its application by the arbitral tribunal).

In practice, as has been explained above, such an outcome (i.e. the application of the more predictable law of A in our scenario) can be achieved either by *cumulatively* applying the conflict norms of the parties or by applying *general principles* of choice-of-law (under the—perhaps questionable—assumption that the rule providing for the application of the law of the seller constitutes such a principle). As far as the former method is concerned, it is worth noting that, under the cumulative method, the conflict norms of the seat need not necessarily be included in those norms that the tribunal applies cumulatively (although this was done in at least two of the three cases examined above).

Increased arbitral discretion may enhance not only the predictability, but ultimately also the legitimacy of arbitral choice-of-law determinations. For present purposes, a legitimate choice-of-law ruling is understood as a decision that the parties accept as fair and correct. Both the cumulative method and the application of general principles are likely to encounter a high level of acceptance from the parties. This is due to the fact that both approaches normally entail the application of the conflict norms applied in the parties' home jurisdictions.

2 Right of Arbitral Tribunals to Apply Transnational, Rather Than Domestic, Law

2.1 *Legislative Recognition⁴⁸ of the Right of Arbitral Tribunals to Apply Transnational Law*

The recognition of the right of arbitral tribunals to apply transnational law absent a choice of law by the parties requires acceptance of two ideas. The first such idea is that arbitral tribunals should not be under an obligation to apply a conflict-of-laws rule (or reasoning). In fact, as long as arbitral tribunals have to resort to a particular conflict norm (and despite the fact that they have broad discretion to decide what conflict norm they wish to apply), they will inevitably have to apply a particular domestic law.

The second idea, which does not necessarily follow from the acceptance of the first one, is precisely the recognition of the right to apply transnational rules, rather than a specific domestic law. In those instruments that do recognize such a right, arbitral tribunals are not required to apply a particular “law”, but are authorized to apply the “rules of law” which they consider appropriate. While the former expression confines the scope of arbitral discretion to domestic laws, the latter is generally regarded as permitting the application of transnational law.

It is fair to say, however, that the majority of texts in the field of international commercial arbitration do not grant arbitral tribunals such a right. Amongst those more “conservative” instruments are the European Arbitration Convention, the English and German acts, and the Model Law.⁴⁹ Those instruments invariably require arbitral tribunals to apply a conflict norm (typically the conflict norm they consider appropriate), the application of which necessarily leads to the application of a particular domestic law.

Amongst the more “permissive” legal instruments are French and, possibly, Swiss law, as well as various sets of institutional rules. Under French law, absent a choice of law by the parties, arbitral tribunals can directly apply the “rules of law” which they consider appropriate.⁵⁰ The rules of the ICC, the LCIA, and the VIAC

⁴⁸The right of arbitral tribunals to apply transnational law absent a choice of law by the parties has also been recognized by the domestic courts of various countries. Those courts have enforced arbitration awards based on transnational law and rejected allegations that the application of such rules would be in violation of international public policy or otherwise incompatible with the rules governing the enforcement or setting aside of arbitral awards. For reasons of space, this judicial recognition of the right of arbitral tribunals to apply transnational law cannot be examined in this contribution. For scholarly discussion, see, e.g., David Rivkin, ‘Enforceability of Arbitral Awards Based on *Lex Mercatoria*’ (1993) 9 *Arbtrn Int’l* 67; Markus Petsche, ‘The Application of Transnational Law (*Lex Mercatoria*) by Domestic Courts’ (2014) 10(3) *J of Priv. Int’l* L 489, 503–505.

⁴⁹European Convention on International Commercial Arbitration Art. VII(1); English Arbitration Act Sect. 46(3); German Arbitration Act Sect. 1051(2); Model Law Art. 28(2).

⁵⁰French Code of Civil Procedure Art. 1511.

confer similar discretion upon arbitral tribunals.⁵¹ Whether this can also be said about Swiss law is questionable since the PILA, although it allows the application of “rules of law”, simultaneously provides for a closest-connection test. While it is arguable that such a test necessarily leads to the application of a particular domestic law, authoritative Swiss writers take the opposite view.⁵²

2.2 *Application of Transnational Law in Practice*

This Section provides a few examples illustrating how and when arbitral tribunals have applied transnational law in the absence of a choice of law by the parties. Since it cannot possibly examine the application of all forms or branches of transnational law, it focuses on three categories of decisions: (i) those where arbitral tribunals have decided to apply the rules that are common to the parties’ legal systems (the so-called *tronc commun*); (ii) those where they have decided to apply the CISG as a manifestation of transnational law (and not because it would be applicable under its own rules); and (iii) those where arbitral tribunals have applied the UNIDROIT Principles.

2.2.1 *Application of the Tronc Commun*

Under the doctrine of the *tronc commun*⁵³ arbitral tribunals apply the rules that are common to the parties’ respective legal systems. Sometimes the application of the *tronc commun* is agreed by the parties.⁵⁴ Other times it is the result of an independent decision of arbitral tribunals. As is easily understood, this method has practical limitations since it can only effectively be applied where the relevant rules are indeed identical or at least similar. In practice, the necessity to engage in legal comparison between the rules of two or more legal systems may give rise to various complications.

⁵¹ICC Rules Art. 21(1); LCIA Rules Art. 22(3); VIAC Rules Art. 27(2).

⁵²See Anya George, Georg von Segesser, ‘Swiss Private International Law Act (Chapter 12), Article 187 [Decision on the merits: applicable law]’ in Loukas A. Mistelis (ed.) *Concise International Arbitration* (2nd edn, Kluwer 2015) 1225, 1228.

⁵³See, e.g., Mauro Rubino-Sammartano, ‘Le “tronc commun” des lois nationales en présence (Réflexions sur le droit applicable par l’arbitre international)’ (1987) *Revue de l’Arbitrage* 133; Bertrand Ancel, ‘The Tronc Commun Doctrine: Logics and Experience in International Arbitration’ (1990) 7(3) *J of Int’l Arbtrn* 65.

⁵⁴In ICC case No. 2272, for example, the parties had agreed that “the arbitrators shall decide, seeking to bring into agreement the rules of Belgian law and of Italian law which govern this matter.” See *Italian claimant A v Belgian respondent B*, Award, ICC Case No. 2272, 1975 in *Yearbook* 1977, Volume II, 151.

A number of arbitral tribunals have applied the *tronc commun* absent a choice of law by the parties. In ICC case No. 2886, for example, an arbitral tribunal hearing a dispute involving a commercial agency agreement decided to apply the rules common to the agent and the principal (the rules common to German and Yugoslav law).⁵⁵ In ICC case No. 5103, the arbitral tribunal decided to apply the rules common to French and Tunisian law in a dispute involving several European buyers and Tunisian sellers.⁵⁶

2.2.2 Application of the CISG as Part of Transnational Law

In a large number of (sale of goods) cases where the parties failed to select the applicable law, arbitral tribunals have applied the CISG on the basis of the CISG's provisions governing its own applicability. In other cases—those that we are concerned with here—arbitral tribunals have chosen to apply the CISG because they considered it to form part of the general principles of international commercial law (which are included in the broader concept of transnational law), resort to which they deemed appropriate in the cases submitted to them. In those cases, the arbitral tribunals concerned did not, therefore, examine whether the CISG's applicability requirements were met. On the contrary, they sometimes expressly or implicitly stated that this was not the case.

In ICC case No. 7331, for example, an arbitral tribunal having its seat in Paris heard a dispute between a Yugoslav and an Italian party.⁵⁷ In its determination of the applicable substantive law, the tribunal first observed that it was “*not bound to apply any particular national law.*”⁵⁸ It then went on to state that “*general principles of international commercial practice... should govern the dispute*” and that such principles were “*most aptly contained in the United Nations Convention on Contracts for the International Sale of Goods.*”⁵⁹ En passant, it noted that this solution was particularly appropriate in light of the fact that both Yugoslavia and Italy were signatories to the Convention.⁶⁰

In ICC case No. 8502 another arbitral tribunal sitting in Paris heard a dispute between a Vietnamese seller and a Dutch buyer.⁶¹ The tribunal considered that the reference in the contract to the Incoterms and the UCP 500 reflected the parties’ “*willingness to have their Contract governed by international trade usages and customs.*”⁶² It decided that depending on the circumstances, it would refer either to

⁵⁵Collection of ICC Arbitral Awards 1974–85, 332.

⁵⁶Collection of ICC Arbitral Awards 1986–90, p. 361.

⁵⁷An excerpt of the award is available at: <http://www.unilex.info/case.cfm?id=140>.

⁵⁸*Ibid.*

⁵⁹*Id.*

⁶⁰*Id.*

⁶¹An excerpt of the award is available at: <http://www.unilex.info/case.cfm?id=395>.

⁶²*Ibid.*

the CISG or to the UNIDROIT Principles on International Commercial Contracts as instruments codifying such usages and customs.⁶³

In ICC case No. 8817 an arbitral tribunal seated in Paris heard a dispute between a Danish and a Spanish party.⁶⁴ When determining the law governing the merits, it noted that the appropriateness of the applicable rules depended on their “*presence in the legal systems of both parties*.”⁶⁵ It found that such considerations supported the application of the CISG since both Denmark and Spain were Contracting Parties at the time of its ruling (although that had not been the case at the time of the conclusion of the contract).

Finally, in ICC case No. 9474 an arbitral tribunal with an undisclosed seat heard a dispute between parties of similarly undisclosed nationalities.⁶⁶ In the absence of a choice of law by the parties, the tribunal suggested applying “*the general standards and rules of international contracts*”,⁶⁷ which the parties accepted. It held that such standards and rules could be found in a variety of instruments including the Principles of European Contract Law, the UNIDROIT Principles, and the CISG.⁶⁸ It decided to refer to the rules contained in these instruments depending on their relevance for deciding particular issues submitted to it.⁶⁹

2.2.3 Application of the UNIDROIT Principles

According to their drafters, the UNIDROIT Principles may serve three distinct purposes:

- (i) they may constitute the applicable substantive law;
- (ii) they may be used to interpret or supplement the applicable law; and
- (iii) they may serve as a legislative model.⁷⁰

As regards the first of these three functions, the drafters expressly envisioned that the Principles may not only be chosen by the parties, but also be applied where the parties failed to specify the applicable law.⁷¹

⁶³Id.

⁶⁴An excerpt of the award is available at: <http://www.unilex.info/case.cfm?id=398>.

⁶⁵Ibid.

⁶⁶An excerpt of the award is available at: <http://www.unilex.info/case.cfm?id=716>.

⁶⁷Ibid.

⁶⁸Id.

⁶⁹Id.

⁷⁰UNIDROIT Principles of International Commercial Contracts (2010), Preamble.

⁷¹Id. The Preamble states that the Principles “may be applied when the parties have not chosen any law to govern their contract.” For a recent overview of the application of the UNIDROIT Principles in practice, see Michael Joachim Bonell, ‘Symposium Paper: The *UNIDROIT Principles of International Commercial Contracts*: Achievements in Practice and Prospects for the Future’ (2010) 17 Austl Int’l LJ 177.

The following cases will illustrate this particular function of the UNIDROIT Principles. In ICC case No. 10422, an arbitral tribunal with an undisclosed seat heard a dispute between a European manufacturer and a Latin-American distributor.⁷² The parties had not selected the applicable law but had agreed that such law should be “neutral” vis-à-vis the parties. The arbitral tribunal read this requirement of neutrality as supporting its decision that “*general principles and rules of international contracts*” should apply.⁷³ It ultimately decided to apply the UNIDROIT Principles, considering that those Principles represented, with some exceptions, “*a restatement of the rules which business persons engaged in international trade consider to be (sic!) meet their needs and expectations.*”⁷⁴

In ICC case No. 11265, an arbitral tribunal having its seat in the Netherlands heard a dispute between parties of unidentified nationalities.⁷⁵ As far as the determination of the applicable substantive law was concerned, it considered, first of all, that the application of a particular national law was inappropriate in light of the fact that the case presented significant links with several countries (including Bermuda, Rwanda, and Tanzania).⁷⁶ It further observed that neither of the parties was opposed to the application of a national or transnational law and that one of the parties had expressly requested the application of the UNIDROIT Principles.⁷⁷ On the basis of these considerations, it held that the Principles should apply.⁷⁸

In a case decided under the rules of the Russian Chamber of Commerce and Industry,⁷⁹ an arbitral tribunal hearing a dispute between a Russian and a Hungarian party decided to apply the UNIDROIT Principles on the grounds that those Principles reflected the “*most common approaches of the majority of national legal systems in regulating problems of international commercial transactions.*”⁸⁰ It also noted that the Principles were “*broadly applied in international commercial practice and widely used by [the] international business community.*”⁸¹

Lastly, in ICC case No. 13012, an arbitral tribunal with an unidentified seat heard a dispute between a US and a French party.⁸² When addressing the question of the applicable substantive law, the tribunal approvingly cited earlier decisions rendered by ICC arbitral tribunals declining to apply a particular domestic law,

⁷²An abstract of the award is available at: <http://www.unilex.info/case.cfm?id=957>.

⁷³*Ibid.*

⁷⁴*Id.*

⁷⁵A French-language excerpt is available at: <http://www.unilex.info/case.cfm?id=1416>.

⁷⁶*Ibid.*

⁷⁷*Id.*

⁷⁸*Id.*

⁷⁹Award in case No. 100 of 30 October 2009. An abstract of the award is available at: <http://www.unilex.info/case.cfm?id=1550>.

⁸⁰*Ibid.*

⁸¹*Id.*

⁸²An excerpt of the award is available at: <http://www.unilex.info/case.cfm?id=1409>.

notably on the basis of considerations of neutrality.⁸³ It also referred to decisions of tribunals that, for similar reasons, opted for the application of the UNIDROIT Principles. It therefore decided to apply the Principles, along with what it referred to as “*the fundamental rules of the Lex Mercatoria*” and commercial usages.⁸⁴

2.3 *Rationale Underlying the Application of Transnational Law*

Arbitral tribunals apply transnational law because they perceive it to offer certain advantages or benefits when compared to domestic laws. This Section will explore the two most significant such advantages, namely (i) the *neutrality* of transnational law and (ii) its particular *suitability* as a set of norms governing international business transactions.

2.3.1 *Neutrality*

Neutrality of the applicable substantive law refers to the fact that the application of a particular law does not put any party at a disadvantage. Neutrality in this sense is not related to the actual *substance* of the applicable law, i.e. the way in which that law balances the parties’ respective rights and obligations (substantive neutrality). Not only would an assessment of such substantive neutrality be virtually impossible, but it is also rather unlikely that the balance struck in a particular domestic law should significantly differ from the one prevailing under transnational law.

Neutrality for present purposes can therefore be characterized as *practical*, rather than *substantive*. It requires that the parties be placed on an equal footing in relation to factors such as (i) familiarity with the applicable law; (ii) access to relevant legal authorities; (iii) ability to understand applicable legislation and case law in their original language; and, more generally, (iv) costs incurred in the performance of legal research, to name just the principal ones. Neutrality also has a *psychological* aspect, i.e. it requires that the parties subjectively feel that they are not disadvantaged as a result of the application of a particular substantive law.

Where a court or arbitral tribunal is bound to apply a particular domestic law, neutrality may be compromised. Assume, for example, that a Spanish supplier enters into a contract with an Indian distributor and that the parties fail to agree on the law governing their contract. A dispute arises and the arbitral tribunal hearing the dispute needs to decide the issue of the applicable substantive law. In most cases, it will decide to apply either Indian or Spanish law, i.e. the law of one of the

⁸³Ibid.

⁸⁴Id.

parties.⁸⁵ This evidently undermines the achievement of neutrality since the party whose law is found to be applicable will frequently be in a better position in relation to the practical issues listed above.

An alternative option for the arbitral tribunal would be to apply the law of a third country, say English law or French law. While such a choice is indeed likely to ensure neutrality, it would lead to a situation where the application of a particular law is inconvenient, rather than convenient, for both parties. In other words, the choice of the governing law preserves equality but at the cost of putting both parties in an equally undesirable situation.

The application of transnational law offers a superior solution to the problem of neutrality. Like the application of the law of a third country, it ensures that none of the parties is, a priori, better off in terms of the above-mentioned practical considerations pertaining to the applicable law.⁸⁶ Unlike the application of the law of a third country, the application of transnational law does not, in principle, generate particular inconveniences for any party, especially where the arbitral tribunal decides to resort to a particular transnational law codification such as the UNIDROIT Principles.

Arbitral case law confirms that considerations of neutrality are crucial for the parties and play a significant role in the choice-of-law decisions of arbitral tribunals. In ICC case No. 10422 referred to above, the parties had been unable to agree on the applicable law, but had stipulated that such law should be “neutral”.⁸⁷ The arbitral tribunal decided that the UNIDROIT Principles should apply.⁸⁸ In ICC case No. 13012 discussed above, the arbitral tribunal similarly emphasized the importance of neutrality. Quoting from the award rendered in ICC case No. 7110, it observed that the parties’ choice to submit disputes to arbitration could be regarded as an implicit agreement to subject such disputes to a neutral substantive law.⁸⁹

2.3.2 Suitability as a Set of Rules Governing International Business Transactions

A number of scholars have highlighted that domestic laws do not provide an adequate normative framework for international business transactions. Berger, for example, considers that the application of domestic law amounts to a “nationalization of international commercial cases” and that such a phenomenon is

⁸⁵A court established in one of the Member States of the EU, for example, would in principle apply Indian law since Art. 4(1)(f) provides for the application of “the law of the country where the distributor has his habitual residence”.

⁸⁶Ole Lando, ‘The *Lex Mercatoria* in International Commercial Arbitration’ (1985) 34(4) ICLQ 747, 748 (stating that the parties “plead and argue on an equal footing” and that “nobody has the advantage of having the case pleaded and decided by his own law”).

⁸⁷(n 72).

⁸⁸*Ibid.*

⁸⁹(n 82).

“irreconcilable with the interests of the international commercial community.”⁹⁰ This “dilemma of international commercial law”⁹¹ is due to the fact that domestic law (whether statutory or judge-made) is generally adopted with the sole or principal aim of regulating domestic legal relationships without taking into account the specificities of international transactions.

There are two principal reasons why domestic laws may be inappropriate in an international context. Firstly, they may unduly interfere with party autonomy, i.e. the parties’ freedom of contract. The case law of the German Federal Court on the validity of clauses contained in standard forms is illustrative in this respect. Under this case law, a large number of such clauses (e.g., exclusions or limitations of liability; penalty clauses) are void not only in consumer contracts but also in contracts concluded between merchants, including international ones.⁹²

Secondly, domestic laws may contain unpredictable rules and may therefore lead to unpredictable outcomes. This may occur when the relevant rule of domestic law is one that is applied only in one or a few jurisdictions. Illustrative examples notably include the rule of the Scandinavian Sale of Goods Act which requires the buyer immediately to notify the seller upon arrival of the goods in order to preserve his right to bring a claim based on late delivery⁹³ and domestic provisions providing for unusually short limitation periods.⁹⁴

Recourse to transnational law allows arbitral tribunals (and the parties to the dispute) to avoid the application of such undesirable domestic rules. As is well known, transnational law consists of norms and usages that are widely applied or followed at the international level. It is therefore extremely unlikely that isolated or restrictive domestic norms such as those at issue in the German and Scandinavian examples referred to above could ever be regarded as rules of transnational law.

3 Conclusion

In the absence of a choice of law by the parties, international arbitral tribunals enjoy broad discretion when determining the applicable substantive law. Such discretion pertains not only to the particular *method* by which arbitral tribunals may determine the applicable domestic law, but also to the *nature* of the rules that they may choose to apply (as has been seen, arbitral tribunals are frequently authorized to apply transnational rules). This arbitral discretion is enshrined in the vast majority of arbitration laws and rules and is regularly relied upon in arbitral practice.

⁹⁰Klaus Peter Berger, *The Creeping Codification of the New Lex Mercatoria* (2nd rev. edn, Kluwer 2010) 19–20.

⁹¹*Ibid.*, 19.

⁹²*Id.*, 28–29.

⁹³Lando (n 86) 753.

⁹⁴*Ibid.*, 748.

Evidently, arbitral discretion in the determination of the applicable substantive law is not a *per se* objective. Rather, it constitutes a tool to achieve other, more vital, aims. On the one hand, as has been explained, broad discretion allows arbitral tribunals to ensure the predictability and legitimacy of their choice-of-law decisions. On the other hand, as has also been highlighted, it assists arbitral tribunals in enhancing the neutrality and suitability of the applicable rules.

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