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3

Applicable substantive law

1 Introduction

3.1 This chapter concerns the identification of the law that applies in an international arbitration. Various laws may apply to different aspects of the dispute.

3.2 After providing an overview of the types of choice of law issues that arise in international arbitration (Section 2), the remainder of this chapter focuses on the law applicable to the merits or substance of the parties' dispute. It first examines how an arbitral tribunal should determine the applicable law (Section 3). It then considers other issues such as mandatory laws, which apply regardless of the otherwise applicable substantive law (Section 4), how an arbitral tribunal should determine the content of the applicable law (Section 5), the compulsory application of the terms of the contract and trade usages (Section 6), the possibility of applying national rules of law or the *lex mercatoria* (Section 7), and finally the possibility for international arbitrators to decide cases based on principles of fairness and justice without reference to law (Section 8).

3.3 The treatment of applicable law issues in investment arbitrations under the ICSID Convention is completely different from international commercial arbitration. It is addressed in Chapter 10, Section 4.5.

2 Types of conflict of law issues in international arbitration

3.4 Determining the applicable law in an international litigation matter (i.e. before a state court) can be very complex, yet seductively interesting from an academic

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perspective. It involves an analysis of the interaction between different legal systems and their rules for determining the applicable law, usually referred to as 'conflict of laws rules' or 'private international law rules'. Indeed, it has been observed that:[1]

> The realm of the conflict of laws is a dismal swamp, filled with quaking quagmires and inhabited by learned but eccentric professors who theorise about mysterious matters in a strange and incomprehensible jargon. The ordinary court, or lawyer, is quite lost when entangled in it.

3.5 It might be thought that these conflict of laws complications would not exist in a system such as international commercial arbitration, one of the features and benefits of which is to do away with excess formality. This is not, however, entirely correct. While resolving conflict of laws issues in international arbitration is certainly more flexible than in international litigation, there is arguably an additional complication which does not exist in state courts: in international commercial arbitration there is no fallback legal forum or the *lex fori*. *Lex fori* means literally the law of the forum; it is the law of the jurisdiction where a domestic court proceeding is taking place. Among other matters, such a legal system provides the courts of that jurisdiction with fallback conflict of laws rules for determining the law that applies in a case involving foreign elements.

3.6 The *lex fori* should be distinguished from the *lex arbitri* which, as explained in Chapter 2, is the law regulating arbitration at the seat of the international arbitration (which is not necessarily its physical location but where it legally takes place). International arbitration proceedings have no *lex fori* because they are not connected to the seat of arbitration in the same way that domestic court proceedings are connected to the forum.[2] In particular, although the *lex arbitri* provides the legal backbone of the arbitration it does not provide a system of conflict of laws rules. So when an arbitral tribunal has to decide a question of applicable law, it does not have a fixed conflict of laws regime at its disposal.[3] Moreover, any and all elements which may precede or be a necessary part of resolving conflict of laws questions in domestic courts are undefined in international arbitration.

3.7 With that background, it is useful first to consider briefly the conflict of laws issues faced by a judge in domestic litigation proceedings. In international litigation, there are primarily two types of conflict of laws questions: First, which

1 WL Prosser, 'Interstate Publication', (1953) 51 *Michigan Law Review* 959 at p. 971, cited in E Gaillard, 'The Role of the Arbitrator in Determining the Applicable Law' in LW Newman and RD Hill (eds), *The Leading Arbitrators' Guide to International Arbitration*, Juris Publishing, 2004, p. 185.

2 Some authors consider that the seat of arbitration is the *lex fori*, but the prevailing view is that there is no *lex fori* in international arbitration. One of the early proponents of this view was Y Derains, 'L'application cumulative par l'arbitre des systèmes de conflit de lois intéressés au litige', (1972) *Revue de l'arbitrage* 99, at p. 102.

3 As explained in Section 3.2.1.4 below, both the Japanese (Article 36) and South Korean (Article 29(1)) arbitration laws are exceptions because they include a conflict of laws rule for arbitrators in determining the governing contractual law in the absence of party choice. These rules are, however, very flexible and do not cover all conflict of laws issues that might arise, as do domestic conflict of laws rules when there is a *lex fori*.

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law governs the procedure? Second, which law governs the parties' substantive rights?

3.8 The law governing the procedure in international litigation is necessarily that of the forum, i.e. the law of the jurisdiction where the court is situated or the *lex fori*; and the applicable rules of procedure are those of the court hearing the case. In other words, once a litigant brings court proceedings, the litigant usually has no choice as to the applicable procedural law or rules.

3.9 As to the law governing the parties' substantive rights, the judge will apply the substantive law of the *lex fori* unless there is a foreign element in the case and the conflict of laws rules of the *lex fori* otherwise direct the judge. Domestic conflict of laws rules are definitive in the manner that they determine the law applicable to any given situation. They may allow the litigating parties to choose the governing law, in which case the judge would apply the parties' chosen law. The conflict of laws rules might also include international, regional or bilateral conventions on applicable law. Several international conventions on applicable law have been prepared by the Hague Conference on Private International Law[4] but no Asia-Pacific states are parties to any such convention relevant in civil and commercial matters. There are also various regional conventions on applicable law, notably in Europe,[5] but again there are none in the Asia-Pacific. Whether their source is from an international or regional convention or purely domestic, conflict of laws rules are essentially part of the *lex fori* and will be applied accordingly. Any and all other conflict of laws questions that may arise in international litigation – to determine for example which law governs the parties' capacity to contract – are resolved definitively by those same conflict of laws rules.

3.10 In international arbitration, many more choice of law issues can arise than in international litigation. It is possible that a different law will govern each issue, thus creating a 'soup' of potentially relevant laws. The potential choice of law issues include:[6]

(i) Which law governs the arbitral procedure?
(ii) Which law governs the individual reference to or instance of arbitration?
(iii) Which law governs the arbitration agreement?
(iv) Which law governs supervisory, supportive, and enforcement measures?
(v) Which law governs a party's legal capacity?
(vi) Which law governs the parties' substantive rights?

Each of the above issues is addressed in turn.

4 An example relevant to civil and commercial matters is the Convention of 2 October 1973 on the Law Applicable to Product Liability, which has been adopted by most European Community states. A list of these Hague Conference conventions is available on its website: www.hcch.net.

5 For example, the 1980 Rome Convention on the Law Applicable to Contractual Obligations, which was recently superseded for European Community countries by EC Regulation No. 593/2008 on the Law Applicable to Contractual Obligations. There is also EC Regulation No. 864/2007 on the Law Applicable to Non-Contractual Obligations.

6 These are similarly listed in M Pryles, 'Choice of Law Issues in International Arbitration', February 1997 *The Arbitrator* 260. See also generally A Chantara-opakorn, 'Dealing with Conflict of Laws in International Commercial Arbitration under the ICC Arbitration Rules and the Arbitration Act of Thailand', (2007) January *Asian Dispute Resolution* 5.

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3.11 The question of the law governing the arbitral procedure has been dealt with in Chapter 2. As explained in that chapter, the international arbitration procedural law at the seat of arbitration normally applies. Alternatively, the parties may be free to choose a different procedural law.[7]

3.12 The law governing an individual reference or instance of arbitration means the procedural law governing a given submission to arbitration. Put another way, it is the procedural law that governs a particular dispute which has been referred to arbitration. A contract could lead to several separate disputes that might in turn give rise to several separate referrals to arbitration. It is possible – although unlikely – that a different arbitration procedural law will apply to each instance of arbitration.

3.13 The interesting question of which law governs an arbitration agreement is dealt with in Chapter 4.[8] For the purposes of this chapter it is sufficient to note two things. First, an arbitration agreement in the form of a clause in a broader commercial contract is considered to be an agreement separate and independent from the contract containing it. One consequence of this division is that the arbitration clause might be governed by a law other than the law governing the contract itself. The second point to note is that since an arbitration agreement is a contract, similar principles and methods can be used to determine which law governs an arbitration agreement as are used to determine which law governs any contract. This means that the choice of law methodology for contracts that is set out in the present chapter has some relevance to determining the law governing an arbitration agreement.

3.14 Supervisory, supportive and enforcement measures in an international arbitration are all proceedings that ordinarily take place before domestic courts. The law governing those measures depends on the law where they are sought, that is the *lex fori*, including the conflict of laws rules at that place. During arbitration proceedings, parties and arbitrators should keep in mind jurisdictions where enforcement may take place, so as to make efforts to ensure that the resulting award is valid and enforceable under the law of such fora.[9]

3.15 A party's capacity (for example to enter into a contract and/or an arbitration agreement) will generally be governed by its *lex personum* (personal law), that is the law of its nationality, even if a different law applies to the merits of the parties' dispute. For a company, that will be the law of the place of incorporation or place of business. For a state (i.e. a government), however, international arbitrators may in some circumstances find it inappropriate to apply that state's own law to the question of its capacity to contract internationally. A company is a legal person created under the laws of a state with powers that are limited by those laws. In contrast, a state possesses international legal personality, is capable of exercising rights and bears obligations under international law. When entering into a contract with a foreign party, it cannot be assumed that a state possesses

7 See Chapter 2, Section 4.1.
8 See Chapter 4, Section 3.2.
9 See further Chapter 7, Section 9 (relating to interim measures of protection) and generally Chapter 9.

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capacity that is limited by its own law.[10] Whether a party has validly entered into a contract or arbitration agreement may alternatively be determined by the law governing that contract or arbitration agreement.[11]

3.16 The question of which law governs the merits of the dispute is the focus of the rest of this chapter. As we will see, if the parties have not chosen the governing law, the answer is occasionally provided by the law of the seat of arbitration, but more generally has evolved by arbitration practice and academic studies. Even in those domestic jurisdictions where a fixed rule applies, international arbitral tribunals tend to follow international practice in applying such rules.

3 Determining the law applicable to the substance of the dispute

3.17 In some international arbitrations, the parties and arbitrators never actually refer to the substantive law at all. Even where there is a choice of law clause in the contract providing for the application of a specified law, the arbitral tribunal might not find it necessary to refer expressly to the law because the case can be decided directly by reading the contract clauses, perhaps supplemented by 'trade usages' of the particular industry.[12] Nonetheless, even if the law is not specifically referred to, every contract has to be governed by some law or rules of law.[13] The question is which law?

3.18 Article 28 of the Model Law is illustrative of provisions which address the question of applicable substantive law in international arbitration. It provides:

> *Article 28. Rules applicable to substance of dispute*
>
> (1) The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Any designation of the law or legal system of a given State shall be construed, unless otherwise expressed, as directly referring to the substantive law of that State and not to its conflict of laws rules.
>
> (2) Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

10 A state or state-controlled entity may not invoke its sovereignty or internal law to deny contractual consent. This is a consequence of the general principles of *pacta sunt servanda* and *bona fides* (see for example principle 38 of the 'List of Principles, Rules and Standards of the Lex Mercatoria', in KP Berger, *The creeping codification of the Lex Mercatoria*, Kluwer Law International, 1999, p. 296. The rule has been described as a general principle of international arbitration, see E Gaillard and J Savage (eds), *Fouchard Gaillard and Goldman on International Commercial Arbitration*, Kluwer Law International, 1999, n. 21, p. 322 et seq. See also relevant French cases: Cour d'Appel de Paris, *Gatoil v National Iranian Oil Company*, 17 December 1991, 1993 *Revue de l'arbitrage* p. 281 and Cour d'Appel de Paris, *Ministère tunisien de l'equipement v Bec Frères*, 24 February 1994, 1995 *Revue de l'arbitrage* 275. A similar principle is found in public international law, see International Law Commission, *Articles on Responsibility of States for Internationally Wrongful Acts*, 2001, UN Doc A/56/10, Articles 3 and 32, p. 170, para 4.85.

11 A party's capacity to enter into an arbitration agreement is considered in Chapter 4, Section 4.2.

12 Trade usages are dealt with below at Section 6.

13 Unless the parties agree that an arbitrator can decide as *amiable compositeur*, which is rare. See below Section 8.

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(3) The arbitral tribunal shall decide ex aequo et bono or as amiable compositeur only if the parties have expressly authorized it to do so.
(4) In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction.

3.19 The question of applicable substantive law in international arbitration can be divided into two distinct scenarios. The first is where the parties to the dispute have chosen an applicable law, as foreseen by Article 28(1) of the Model Law (see Section 3.1 below), and the second is where they have not chosen the law, as foreseen in Article 28(2) of the Model Law (see Section 3.2 below). A related question is the law applicable to non-contractual claims raised during arbitration proceedings (see Section 3.3 below).

3.20 The matters referred to in Article 28(3) and 28(4) of the Model Law are addressed elsewhere in this chapter.[14]

3.1 Freedom of parties to choose the law

3.21 The most important rule for determining the applicable substantive law in international arbitration is that the parties are free to choose it. This principle is reflected in the Model Law Article 28(1), which was set out above, and in virtually all arbitration rules and laws.[15]

3.22 The parties' choice of law is usually made in the contract itself, but can be made at any time, even after a dispute arises. Practice shows that arbitrating parties usually exercise their right to choose the applicable law. For instance, in 2009 parties chose the applicable law in 88% of arbitrations before the ICC International Court of Arbitration.[16]

3.23 In international arbitration, the parties are generally not restricted in their choice of applicable law. There is no requirement, for example, that the chosen law has some connection to the parties or to the dispute.[17]

3.24 Choice of law is, however, restricted for international arbitrations in China. Article 7 of the Chinese Arbitration Law does not mention freedom to choose the law, but provides simply that 'in arbitration, disputes shall be resolved on the basis of facts, in compliance with law and in an equitable and reasonable

14 See respectively Sections 8 and 6 below.
15 The arbitration laws of most Asia-Pacific jurisdictions include an identical or similar provision to Article 28(1) of the Model Law with the exception of China, which is discussed below. Section 30(2) of Malaysia's Arbitration Act has a slight but significant difference, substituting 'rules of law' for 'law' in the first sentence (see the discussion below in Section 7). Among the institutional rules, one exception is the SIAC Rules, which do not include a provision relating to the applicable substantive law. Most SIAC arbitrations are seated in Singapore so the fallback would be Article 28(1) of the Model Law which applies in Singapore without modification. The 2010 SIAC Rules now include a provision on applicable law at Article 27.
16 This figure hovered between 77% and 87% from 2000 to 2008. The percentage seems to be increasing gradually but steadily over the years. ICC statistics can be found in the ICC's Published Statistical Reports for each year. See, e.g. '2009 Statistical Report', (2010) 21 *ICC International Court of Arbitration Bulletin* 1.
17 See, e.g. Y Derains and E Schwarz, *A Guide to the ICC Rules of Arbitration*, 2nd edn, Kluwer, 2005, p. 238 (They cite ICC case number 4154 as stating that: 'The principle of autonomy – widely recognized – allows the parties to choose any law to rule their contract, even if not obviously related to it.')

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manner'. This provision is complemented by the treatment of applicable law in the Chinese law of contracts, which limits the types of contracts for which parties can choose the law, even if there is a foreign element in the case. The combined effect of these provisions is that parties may choose the applicable law only for certain types of contractual disputes that are submitted to arbitration seated in China.[18]

3.25 Domestic arbitration laws also sometimes contain restrictions. For example, Section 28(1)(a) of the Indian Conciliation and Arbitration Act 1996 provides that where the arbitration is 'other than an international commercial arbitration' Indian law will be the substantive law irrespective of party choice.[19]

3.26 The other limitation on the parties' choice of law is so-called 'mandatory laws', which apply regardless of the parties' chosen law. These are addressed below.[20] Apart from the exceptions just mentioned, it follows that if the parties have chosen the law, the arbitral tribunal must respect that choice, whatever it may be. It is only if they have not chosen the law, or if their choice is limited to certain aspects of the dispute, that a conflict of laws analysis becomes necessary.

3.2 Applicable law where there is no choice of law by the parties

3.27 Where the parties have not agreed on the governing law, the arbitral tribunal has to determine it by some form of conflict of laws analysis. As noted above, conflict of laws issues in international arbitration can be complex yet interesting. Despite this, conflict of laws in international arbitration has not been the subject of significant court decisions or academic studies in the Asia-Pacific region. The regional treatment in arbitration laws and rules is addressed below (3.2.1), before moving on to a discussion of the conflict of law methods used by international arbitrators generally (3.2.2). The latter section draws significantly on material from outside this region given the scant regional treatment.

3.2.1 Arbitration laws and institutional rules regarding applicable law in the absence of party choice

3.28 An arbitral tribunal's power to decide the law where the parties have not agreed on it is recognised in almost all arbitration rules and laws. There are several categories of approaches among the laws and rules in the Asia-Pacific region. These are addressed in turn.

18 See Jingzhou Tao, *Arbitration Law and Practice in China*, Kluwer, 2008, p. 101.
19 A similar provision exists for domestic arbitrations in Section 30(1) of the Malaysian Arbitration Act. India's arbitration law has a more restrictive definition of an 'international arbitration' than the Model Law, referring to the place of incorporation rather than principal place of business of any foreign party. Section 2(1)(f)(iii) of the Indian Conciliation and Arbitration Act may offer some prospect that the choice of law intentions of parties are followed because it refers to central management and control outside India. Parties should nonetheless be aware of Section 28(1)(a) when setting up locally incorporated project specific subsidiaries in India.
20 Mandatory laws are the subject of Section 4 below.

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3.2.1.1 *'Conflict of laws rules' and 'direct' approaches*

3.29 The first and most common approach among Asia-Pacific arbitration laws is that used in Article 28(2) of the Model Law, which empowers the arbitral tribunal to select the 'conflict of laws rules it considers appropriate'.[21] A second approach, which is very common in arbitral institutional rules in the region, allows the arbitral tribunal to choose an 'appropriate' law.[22] The latter is often referred to as the 'direct' approach because it does not require the arbitral tribunal to apply a set of conflict of laws rules. Examples of possible conflict of laws rules that could be referred to under the direct approach are provided below.[23]

3.30 Arbitral tribunals applying the direct approach will undoubtedly have conscious or unconscious recourse to their knowledge and experience of private international law.[24] One author believes that 'the arbitrators de facto use conflict of laws considerations even if they are not aware of doing so.'[25]

3.31 If the direct approach applies, it certainly does not relieve the arbitral tribunal from having to reason and justify its decision as to which law applies, as has occasionally been suggested.[26] The arbitral tribunal must still engage in some form of analysis, which should logically be based on conflict of laws principles. Indeed, for the choice of a law to be 'appropriate', the necessary implication is that conflict of laws rules should be applied in some way or another because they are the most pertinent rules to make such a choice. It would not be at all satisfactory if arbitrators could directly choose a law without due consideration and justification. One expert on international arbitration is highly critical of the suggestion that the direct approach could be understood as to relieve the arbitrators from applying any conflict of laws analysis. He says it 'leaves the parties' substantive rights to turn on subjective, unarticulated instincts of individual arbitrators and does little to further interests of predictability or fairness'.[27]

3.32 In practice, provided that an arbitral tribunal applying the direct approach justifies its decision, there is unlikely to be a practical difference between it and an approach that uses a set of conflict of laws rules. Experienced international

21 Article 28(2) of the Model Law was set out above. That provision applies unmodified, or similarly, in Hong Kong, Singapore, Korea, New Zealand, the Philippines and Australia. Discussed below in this section are the unusual provisions of India, Malaysia, China, Indonesia and Sri Lanka.

22 Most Asian institutional rules follow the direct approach. See, e.g. Article 34.1 of the ACICA Rules, Article 25.1 of the KCAB International Rules, Article 15 of the BANI Rules, and Rule 6 of the Indian Arbitration Centre Rules. The different approach of Article 31(1) of the HKIAC Rules is addressed below. In addition to being found in many institutional rules, this direct method is found in one regional arbitration law, that of India. Section 28(1)(b)(iii) of the Indian Conciliation and Arbitration Act provides: 'failing any designation of the law . . . by the parties, the arbitral tribunal shall apply the rules of law it considers to be appropriate given all the circumstances surrounding the dispute.'

23 See Section 3.2.2.8 below.

24 Gaillard and Savage, op. cit. fn 10, para 1550.

25 B Wortmann, 'Choice of Law by Arbitrators: The Applicable Conflict of Laws System', (1998) 14(2) *Arbitration International* 97, at p. 101.

26 See, e.g. JD Lew, LA Mistelis and SM Kröll, *Comparative International Commercial Arbitration*, Kluwer Law International, 2003, paras 14–59.

27 G Born, *International Commercial Arbitration: Commentary and Materials*, 2nd edn, Transnational Publishers, 2001, p. 531. This comment is repeated in G Born, *International Commercial Arbitration*, Kluwer, 2009, p. 2137.

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arbitrators tend to prefer the direct method because it is more straightforward, but the outcome should logically be the same either way.

3.2.1.2 *Requiring the application of the substantive law of seat of arbitration*

3.33 Indonesia and Sri Lanka appear to have adopted the approach of requiring arbitral tribunals to apply their respective local laws in the absence of a different choice by the parties.[28] The Indonesian Arbitration Law is unique in the Asia-Pacific in that it does not provide any indication as to how an arbitral tribunal should determine the law in the absence of party choice. Article 56(2) provides simply that 'the parties are entitled to designate the choice of law to be applied to the resolution of disputes which may arise, or which have arisen, between or among them'. It therefore appears that Indonesian law would apply as the fallback if another law has not been chosen. The Sri Lankan Arbitration Act contains an unusual provision at Section 24(3), the effect of which is that the parties would have to empower an arbitral tribunal specifically to decide the applicable law in the absence of party choice. The consequences of the parties not having so authorised the arbitral tribunal are not stated, but once again its language suggests that Sri Lankan law applies as the default.

3.2.1.3 *Requiring the application of the conflict of laws rules of the seat of arbitration*

3.34 Two Asian jurisdictions require the arbitral tribunal to apply the seat of arbitration's conflict of laws rules if the parties have not chosen the applicable law. One is China.[29] The second appears to be Malaysia, depending on how its relatively recent arbitration law will be interpreted. Malaysia's Arbitration Act 2005 is based principally on the Model Law, but has modified several provisions. Article 28(2) of the (unmodified) Model Law provides: 'Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable'. (Emphasis added) However, Section 30(4) of the Malaysian Arbitration Act is different: 'Failing any agreement [by the parties], the arbitral tribunal shall apply the law determined by the conflict of laws rules'. The Malaysian Arbitration Act thus omits 'which it considers applicable' while maintaining the definite article 'the' before 'conflict of laws rules'. The only linguistically loyal interpretation of Section 30(4) would be that 'the' is referring to Malaysian conflict of laws rules, thus suggesting that the arbitral tribunal must apply them.

3.35 While that interpretation is linguistically correct, it is possible that this drafting in the Malaysian law was an oversight and that Section 30(4) will be interpreted

28 This was also the position in the UK before it was rejected in *Compagnie d'Armement Maritime SA v Compagnie Tunisienne de Navigation SA* [1971] AC 572, at p. 596.

29 For China, if the nature of the contract is such that the parties may choose the law (see the discussion above at Section 3.1) and they have not chosen it, it must be determined by the arbitral tribunal applying Chinese conflict of laws rules. The usual conflict of laws rule that will be applicable points to the law with the closest connection to the contract (see Jingzhou Tao, op. cit. fn 18, at p. 103, who also sets out the Chinese guidelines for determining which law is most closely connected to a contract).

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liberally. There do not appear to be any court decisions or published arbitral awards on this point as yet.

3.2.1.4 *Requiring the application of the law with the closest connection to the dispute*

3.36 Two Asia-Pacific jurisdictions mandate a fixed conflict of laws rule for arbitrators to apply where the parties have not chosen the applicable law. Article 36(2) of the Japanese Arbitration Law provides: 'Failing agreement as provided in the preceding paragraph, the arbitral tribunal shall apply the substantive law of the State with which the civil dispute subject to the arbitral proceedings is most closely connected.' A rule with similar effect is found in Article 29(1) of the South Korean Arbitration Act.[30] Arguably, such laws do not leave international arbitrators the usual freedom to select the applicable law by any method they wish.[31] An analysis of this choice of law rule as applied by international arbitral tribunals is provided below.[32]

3.2.2 Conflict of laws methodology adopted by international arbitrators

3.37 As noted earlier, when there is an international element in a case before a domestic court, fixed conflict of laws rules in the *lex fori* direct the judge on how to determine the applicable law. As we have seen in the previous section, this is not true for international arbitrators because international arbitrations have no *lex fori* and the vast majority of arbitration legislation and rules leave arbitrators with great flexibility and little guidance. The question is how the arbitral tribunal will determine the applicable law within the scope of its broad discretion. A decision about which law applies may have a direct impact on the parties' substantive rights. Surprisingly, however, there is notable diversity in approaches adopted by arbitrators. Leading practitioners who have written separately on the subject claim to report on the 'common methods', yet different practitioners report different methods as being common.[33]

3.38 This section first explains that domestic courts tend not to interfere with conflict of laws decisions made by arbitral tribunals, before setting out the methodologies commonly used by international arbitrators to determine the applicable law.

30 See also Article 31 of the HKIAC Administered Rules and Rule 41(2) of the JCAA Rules. A similar rule applies in Switzerland, Germany, Italy and Mexico.

31 However, Blessing submits in relation to the equivalent Swiss provision that there is no such restriction: 'Clearly, it would not be incompatible with Article 187 (1) [of the Swiss Private International Law Act] to operate the voie directe advocated by a number of scholars and practitioners.' He appears to make this assertion on the basis that finding the closest connection is at the heart of every set of conflict rules anyway. See M Blessing, 'The New International Arbitration Law in Switzerland: A Significant Step Towards Liberalism', (1988) 5(2) *Journal of International Arbitration* 9, at p. 59.

32 See below Section 3.2.2.6.

33 The spread of methods is reported in S Greenberg 'The Law Applicable to the Merits in International Arbitration', (2004) 8 *Vindobona Journal* 315. The following discussion in this chapter draws on various aspects of that article.

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3.2.2.1 *Absence of court interference in arbitral tribunal's conflict of laws decisions*

3.39 There is nothing in either the grounds for setting aside awards or the grounds for resisting their enforcement that empowers a court to review an arbitral tribunal's decision as to the applicable law.[34] As a result, such decisions can be considered like those relating to the substance of the dispute, meaning that they are not subject to any review by the courts.

3.40 In practice, courts tend not to interfere in the power of arbitrators to decide the law even where the determination of law could affect the court's jurisdiction to decide claims under mandatory domestic laws. For example, in *Transfield Philippines Inc v Pacific Hydro Ltd*,[35] an ICC arbitral tribunal sitting in Singapore decided that Transfield's claims for misleading and deceptive conduct and negligent misrepresentation were governed by the laws of the Philippines, thus rejecting Transfield's contention that those claims were governed by Australian trade practices legislation. Transfield later sought to bring those claims in the Supreme Court of Victoria, Australia, contending that the claims were no longer capable of settlement by arbitration because the arbitral tribunal had declined to hear them. Justice Hollingworth held:[36]

> 71. The . . . arbitral tribunal held that [Transfield's] claims for misleading and deceptive conduct and misrepresentation were governed by the law of the Philippines and the [Australian trade practices legislation was] not applicable to the arbitral proceeding. The arbitral tribunal gave thorough consideration to the approach it should adopt to the selection of the applicable law, and found that 'the preponderance of claims put forward are clearly rooted in a contract governed by the law of the Philippines.'
>
> . . .
>
> 73. . . . it would not be appropriate for an Australian court to adjudicate claims for misrepresentation under Australian statutes dealing with misleading and deceptive conduct, once the arbitral tribunal had determined, applying appropriate choice of law rules, that such claims are governed by the law of the Philippines. To do so would lead to a multiplicity of proceedings, usurp the jurisdiction of the tribunal and deny the intention of the parties as expressed by them in the arbitration agreement.

3.41 Practice and doctrine have developed various solutions for resolving conflict of laws issues in international arbitration. These vary in flexibility, rigour and appropriateness for an international environment. Some of the major themes are assessed in the following sections.

3.2.2.2 *Substantive law of the seat of arbitration*

3.42 A now very outdated approach was for arbitrators to apply the substantive law of the seat of arbitration. It was thought that if parties had not chosen the substantive

34 See Article 34 of the Model Law (or its equivalent) and Article V of the New York Convention. The setting aside and enforcement of awards are addressed in Chapter 9.
35 See, e.g. *Transfield Philippines Inc v Pacific Hydro Ltd* [2006] VSC 175, Supreme Court of Victoria, Australia, per Justice Hollingworth.
36 Ibid., at para 73.

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law but had chosen the seat of arbitration, the choice of seat implied a choice of the same substantive law.

This solution is simple and predictable. However, parties choose the seat of arbitration for a variety of reasons, such as its international arbitration (procedural) laws, its neutrality, the quality of its courts, geographic convenience, and relevant infrastructure.[37] The seat of arbitration often has no further connection whatsoever with the underlying transaction. It would therefore be artificial to presume either (i) that the parties implicitly wanted the seat's law to be the substantive law or (ii) that it would be an appropriate law to apply by virtue only of the fact that it is the law of the seat of arbitration. Finally, this method is even less relevant when an arbitral institution, or the arbitral tribunal, has decided the seat of arbitration rather than it having been agreed by the parties. In such circumstances, there is no compelling basis for assuming any implicit choice by the parties in favour of that law. 3.43

3.2.2.3 *Conflict of laws rules of the seat of arbitration*

A related, but much better, method is for the arbitral tribunal to apply the domestic conflict of laws rules of the seat of arbitration. This has historically been one of the most commonly used methods for resolving conflict of laws questions in international arbitration. It was the solution recommended by the Institute of International Law as early as 1957[38] and was used in England prior to the enactment of its Arbitration Act 1996. 3.44

From a practical perspective, using the seat of arbitration's conflict of laws rules is convenient. It not only provides a solution to establishing the law applicable to the contract, but also provides a comprehensive set of rules to resolve any other conflict of laws question that may arise. For example, the same conflict of laws rules could be used to determine the law applicable to non-contractual claims that are raised in the arbitration.[39] 3.45

Theoretical support for this method is found in the juridical conception of international arbitration. According to this theory, international arbitrators act under the legal auspices of the domestic jurisdiction where the seat of arbitration is located. But the international trend towards delocalisation – even in its softer form – rejects the notion of relying on the seat of arbitration as a fallback legal system. Delocalisation supports detachment of arbitration proceedings from the national legal jurisdiction where they take place.[40] Applying delocalisation 3.46

37 See further Chapter 2, Section 6, on selecting the seat of arbitration.
38 *Annuaire de l'Institut du Droit International 1957*, at p. 469. This recommendation did not gain state support and was not adopted.
39 See the discussion of the law applicable to non-contractual claims at Section 3.3 below.
40 Chapter 2, Section 5 which examines the juridical and delocalised conceptions of international arbitration. Examples of discussions of delocalisation are J Paulsson, 'Delocalisation of International Commercial Arbitration: When and Why it Matters', (1983) 32 *International and Comparative Law Quarterly* 53; P Mayer, 'The Trend Towards Delocalisation in the last 100 years', presented in The Internationalisation of International Arbitration, the LCIA Centenary Conference, London, 1995, pp. 37–46. And against delocalisation: R Goode, 'The Role of the Lex Loci Arbitrii in International Commercial Arbitration', (2001) 17(1) *Arbitration International* 19.

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theory, the conflict of laws rules of the seat of arbitration would be considered inappropriate. Another more practical problem is that domestic conflict of laws rules are developed with national and sometimes political interests in mind. They may not be well suited for use in a truly international dispute.[41]

3.47 On balance, despite some notable support for using the seat of arbitration's conflict of laws rules,[42] we agree with the majority of commentators who oppose such an approach.[43] The approach is out of touch with the truly transnational character of international arbitration, ignores the fact that domestic conflict of laws rules may not be well suited or adapted to international arbitrations, limits the flexibility that is such a commendable feature of international arbitration, and fails to address the situation where the parties have failed to agree on the seat of arbitration (meaning that the seat would have to be determined by the *lex arbitri*, arbitral rules or arbitral institution).

3.2.2.4 *Cumulative application of the conflict of laws rules connected to the dispute*

3.48 The cumulative method involves applying all of the domestic conflict of laws rules connected to a particular dispute to see whether they converge and result in the application of one substantive law.[44] For example, consider a dispute between a party from India and a party from Thailand in relation to a project that took place in the Philippines. Applying the cumulative method, the arbitral tribunal would need to examine the conflict of laws rules of India, Thailand and the Philippines to see whether, in the circumstances of the case, they would all lead to the application of the same substantive law.

3.49 When performing the cumulative method, the domestic conflict of laws rules of each jurisdiction should be applied exactly as a judge of that state would apply them. For example, if the various conflict of laws rules all designated the law with the 'closest connection to the dispute', that phrase should be applied in the same way it is applied by judges in the jurisdictions where those laws have been enacted.[45] Any less rigorous interpretation would be inaccurate.

41 Lew, Mistelis and Kröll, op. cit. fn 26, paras 17–41.
42 See for example P Nygh and M Davies, *Conflict of Laws in Australia*, 7th edn, LexisNexis, 2002, p. 233 describing it as a 'strong presumption'; O Lando, 'The Law Applicable to the Merits of the Dispute' in JDM Lew (ed), *Contemporary Problems in International Arbitration*, Kluwer Law International, 1986, p. 101; Born, 2009, op. cit. fn 27, pp. 2138–2143.
43 Most contemporary commentators consider this method is outdated. See, e.g. the considerable authority cited by P Fouchard, E Gaillard and B Goldman, *International Commercial Arbitration*, Kluwer Law International, 1999, para 1541. The historical, traditional arguments are in B Goldman, 'Les conflits de lois dans l'arbitrage international de droit privé' (1963) 109 *Recueil des Cours* 351.
44 A seminal article on this method is Derains, 1972, op. cit. fn 2, p. 99. See also *Korean Seller v Jordanian Buyer* ICC Case No. 6149, (1995) XX *Yearbook of Commercial Arbitration*, 41–57.
45 M Blessing, 'Regulations in Arbitration Rules on Choice of Law' (1994) 7 *ICCA Congress Series* 391, at p. 411. Furthermore, in order to apply domestic conflict of laws rules correctly, the arbitrator would have to take into account that jurisdiction's attitude towards the doctrine of 'renvoi'. Renvoi is a technical conflict of laws concept that is beyond the scope of this book. In brief, the doctrine deals with whether or not a foreign jurisdiction's conflict of laws rules are taken into account when applying that jurisdiction's laws. Properly applying renvoi could help achieve a convergence when using the cumulative method, but may also complicate the process.

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3.50 Surprisingly enough, it is not uncommon for the cumulative method to result in convergence.[46] This is because domestic conflict of laws rules rely on a finite number of connecting factors.[47] For example, it is common to find a conflict of laws rule which says that, absent party choice of law, a contract is to be governed by the law with which it has the closest connection. Common threads are also found in subsets of that rule. For example, in many legal systems there is a presumption that the law with the closest connection to a sale of goods contract is the law of the seller's place of business.[48] Thus, even if the conflict of laws rules are themselves not the same, the different rules may nonetheless lead to the application of the same substantive law.

3.51 If convergence is not initially achieved, a slightly more complicated variation of this method is to sidestep the conflict of laws convergence and look directly for convergence of substantive legal solutions from the different potentially applicable laws. In this situation, the arbitral tribunal would need to examine whether the legal outcome is the same regardless of which potentially applicable law is applied. Whenever there is a dispute about which law applies, it is not uncommon for arbitrators to analyse the parties' substantive rights under several potentially applicable laws in any event, by way of prudence, and to give further support to their reasoning.

3.52 If convergence of solutions is ultimately found, the cumulative method is very sound theoretically. Successful application of it means that the interests of the states connected to the case are respected. This may in turn increase the enforceability of the resulting award.[49] It also removes any perceived subjectivity or arbitrariness arising from the flexibility left to international arbitrators to decide which law applies.

3.2.2.5 *General principles of private international law*

3.53 This method involves the arbitral tribunal applying 'general principles' of private international law or conflict of laws.[50] Despite historical calls for a 'supranational' system,[51] there is no universally accepted set of conflict of laws rules. This means that the exact nature of these general principles is often debated.

3.54 An arbitral tribunal using this method has several alternatives. It might compare the conflict of laws rules of the domestic legal systems connected to the dispute to establish common themes. In doing so, it would be looking for general principles of private international law as between the jurisdictions connected to the case, rather than general principles of private international law throughout

46 As noted by Born, 2009, op. cit. fn 27, p. 2129.
47 Although in a slightly different context, the major trends in connecting factors and the weights attached to them are summarised by Blessing, 1994, op. cit. fn 45, p. 414.
48 See, e.g. Article 3 of the Convention of 15 June 1955 on the Law Applicable to International Sales of Goods and Article 4(1)(a) of EC Regulation No. 593/2008 on the Law Applicable to Contractual Obligations.
49 See Chapter 9 regarding enforcement of awards generally. If a state's conflict of laws rules have been respected there are less likely to be issues of public policy that may derail the enforcement process.
50 As noted above, 'private international law' is another name for conflict of laws rules.
51 Goldman advocated the need for such an approach as early as 1963, see Goldman, op. cit. fn 43, p. 415.

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the world. Another possibility is to extract general principles from international or regional conventions on private international law, such as the 1980 Rome Convention on the Law Applicable to Contractual Obligations ('Rome Convention')[52] and the various Hague Conventions.[53] Finally, some arbitral tribunals simply announce what they consider to be a general principle of private international law based on their own experience.

3.55 There are no international or regional conventions on conflict of laws that apply in the Asia-Pacific, but those applicable in Europe, such as the Rome Convention, could be considered for general guidance. In that respect, Giardini suggests that much more importance should be given to regional conventions on private international law as evidence of general principles. He says that arbitrators should use conventions like the Rome Convention to back up other methods and reduce arbitrariness.[54]

3.56 Other commentators note the growing acceptance of general principles of private international law,[55] while others criticise them as too unpredictable because of inconsistency in determination.[56] One author suspects that 'purporting to use the conflict laws of international law is, in reality, nothing more than a veiled attempt to allow the arbitrators to choose any substantive law they wish'.[57]

3.57 Indeed, while individual arbitrators may have their own views about what does or does not constitute a general principle of private international law, it is not clear the extent to which general principles exist from a truly international perspective. Apart from some very general rules, like the 'closest connection' rule for contracts, there are few universally accepted conflict of laws rules, even for determining the law applicable to contractual obligations. Any individual arbitrator's view about what constitutes a general principle is likely to be clouded by his own background and experience, thus leading to unpredictability.

3.2.2.6 *Law with the closest connection to the dispute*

3.58 The freedom granted to international arbitrators by arbitration rules and laws means that they can decide to adopt a very simple method, like determining which law has the closest connection to the dispute. As noted above, this rule is often found in domestic legal systems for determining the law applicable to contracts and is one of the few general principles of private international law. It has also been adopted by international conventions such as the Rome Convention.

52 This was recently superseded for European Community countries by EC Regulation No. 593/2008 on the Law Applicable to Contractual Obligations. See also EC Regulation No. 864/2007 on the Law Applicable to Non-Contractual Obligations.
53 An example relevant to civil and commercial matters is the Convention of 2 October 1973 on the Law Applicable to Product Liability, which has been adopted by most EC states. A list of the conventions prepared by the Hague Conference on Private International Law is available on its website: www.hcch.net.
54 A Giardina, 'International Conventions in Conflict of Laws and Substantive Law', (1994) 7 *ICCA Congress Series* 459, at p. 459.
55 J Lew, 'Relevance of Conflict of Laws Rules in the Practice of Arbitration', (1994) 7 *ICCA Congress Series* 447, at p. 451.
56 See, e.g. Born, 2001, op. cit. fn 27, p. 531. However, Born's more recent treatise points out simply that 'there is as yet no such body of international conflict of laws rules'; see Born, 2009, op. cit. fn 27, p. 2132.
57 SJ Toope, *Mixed International Arbitration*, Grotius Publications, 1990, p. 51.

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3.59 Although this method may seem straightforward, it is not always easy to determine which law has the closest connection to a dispute. In fact, it is precisely this question which conflict of laws rules generally seek to answer. They purport to direct judges to the law with the closest connection. Take, for example, a dispute arising from a simple sale of goods transaction involving companies from different countries. Company A sells and promises to deliver goods to Company B. B pays the price but A does not deliver anything. B sues A. There is no logical reason why either A's or B's law is more closely connected to the dispute. As noted above, many conflict of laws rules create a presumption in favour of the application of the law of the seller's place of business. An arbitral tribunal that decides to apply (or is required to apply) the law with the closest connection to the dispute might well have to refer to general principles of private international law in any event, in order to apply the closest connection rule. If so, this effectively means going back to square one – i.e. the relevant conflict of laws rule.

3.2.2.7 *Implied intent*

3.60 Some consider that international arbitrators should attempt to discern the parties' implicit choice of law. One experienced practitioner considers that, from his experience, implied intent is sometimes so obvious that it cannot be ignored,[58] while another finds the idea of searching for an implied intent artificial.[59] It is indeed difficult to see any difference between applying an objective criterion, such as connecting factors, and searching for a virtually hypothetical implied intent. It would seem that the same factors are applied either way.

3.61 Various theories of presumed intent have nonetheless developed. One example is the 'implied negative choice' theory[60] according to which if parties from different states have not agreed on the applicable law in their contract, it is presumed that each party specifically rejected the national law of the opposing party. The argument is that during negotiations each party would have proposed its own law. The absence of a choice of law clause in the final contract means the other party must have rejected this proposal.

3.62 This implied negative choice theory is dubious because the absence of a contractual choice of law does not necessarily mean the parties could not agree. If a party wanted to reject a law specifically, it could have tried to negotiate a clause that said so in the contract. Parties may simply prefer to leave the choice of law up to the arbitral tribunal to make once the substance of a particular dispute is known. What is more, applying this theory would often rule out the law that should naturally apply. In a sale of goods case, for example, it would be artificial to rule out the law of both parties' places of business simply because neither was specified as the applicable law in the contract.

58 Blessing, 1994, op. cit. fn 45, p. 407.
59 AFM Maniruzzaman, 'Conflict of Laws Issues in International Arbitration: Practice and Trends', (1993) 9(4) *Arbitration International* 371, at p. 371.
60 Blessing, 1994, op. cit. fn 45, p. 407.

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3.63 From a theoretical perspective, if genuine evidence of contractual intent can be found, it should be applied. Otherwise, however, the theories of implied intent seem to be superficial if the same connecting factors would be used for a more objective method anyway.

3.2.2.8 *Selecting a set of conflict of laws rules*

3.64 As indicated above,[61] Article 28(2) of the Model Law and almost all Asia-Pacific arbitration laws require the arbitral tribunal to choose and apply 'conflict of laws rules', while most regional institutional rules allow arbitral tribunals directly to choose the law that they 'consider appropriate' without passing via conflict of laws rules.

3.65 If an arbitral tribunal must choose a set of domestic conflict of laws rules, there are several which could logically be considered. One is the conflict of laws rules of the seat of arbitration, addressed above.[62] Another possibility is the conflict of laws rules of the place where the award is likely to be enforced. However the place of enforcement is rarely a certainty.

3.66 Another option is to apply the conflict of laws rules of the jurisdiction that would have been competent but for the arbitration clause.[63] However, this is extraordinarily complex and has been strongly rejected by commentators.[64] Usually, several jurisdictions would find themselves competent (except, perhaps, where there is an effective applicable international convention on judicial competence, such as in European Community countries). Moreover, the answer might turn on where the action was first commenced, something about which the arbitral tribunal could only speculate. Finally, one reason parties choose arbitration is to find a more neutral dispute resolution forum than the one that would ordinarily be competent.[65]

3.67 Better conflict of laws rules include those of the place of contractual performance, those of a jurisdiction with some element common to the parties, such as common residence, domicile or nationality, or those of the jurisdiction with the closest connection to the dispute. One might wonder, however, how an arbitrator would decide between these possibilities.

3.2.2.9 *Conclusions on methods adopted by international arbitrators; a preferred approach*

3.68 The cumulative method, if it works, is the most rigorous and acceptable approach. It should satisfy the parties, it is theoretically justified because it is international, and it increases the enforceability of the resulting arbitral award by respecting

61 See above Section 3.2.1.1.
62 See above Section 3.2.2.3.
63 According to Wortmann, op. cit. fn 25, p. 105, this method was first proposed and examined by the Italian jurist Dionisio Anzilotti in 1906.
64 Blessing, 1994, op. cit. fn 45, p. 412.
65 P Lalive, 'Les règles de conflit de lois appliquées au fond du litige par l'arbitre international siégeant en Suisse', (1976) *Revue de l'arbitrage* 157, at p. 161.

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the interests of the states connected to the dispute. The disadvantage of this method is that it can be complex and does not always result in convergence.

3.69 If the cumulative method fails, the next best option is debatable. There is comfort in the security and certainty of the choice of law rules of the seat of arbitration. As noted above, however, we consider the seat of arbitration's conflict of laws rules inappropriate, mainly because there is often no connection whatsoever between the seat of arbitration and the underlying substantive dispute.

3.70 In our view, the preferred approach failing successful application of the cumulative method is to apply the general principles of private international law, established by eliciting common themes from the conflict of laws rules of the jurisdictions connected to the substance of the dispute. If an appropriate general principle of private international law cannot be established, a fallback rule should be to apply the law with the closest connection to the underlying substantive dispute, taking into account the particular claims that the parties have raised.

3.71 Given the uncertainty of the determination of applicable substantive law in international commercial arbitration, some guidance would be welcome to assist arbitrators in this process. This would be especially useful for arbitrators who do not have expertise in the specialised discipline of the conflict of laws. Rather than attempting an international convention, however, a set of soft guidelines would be preferable. These could provide guidance without being proscriptive to the detriment of flexibility.

3.3 The law applicable to non-contractual claims

3.72 Normally, arbitration clauses are drafted broadly enough to include non-contractual claims within the jurisdiction of the arbitral tribunal. Contractual choice of law clauses are often narrower, referring expressly to the contract. For example, a typical choice of law clause might be drafted in the following terms: 'this contract shall be governed by and construed in accordance with the laws of X', while a typical arbitration clause is broader, such as: 'all disputes arising out of or relating to this contract shall be decided by arbitration . . . '. Thus, read literally, a choice of law clause generally does not cover all claims that potentially fall within the scope of an arbitration agreement.[66] Furthermore, there is no guidance on this in arbitration rules or laws. This raises the

66 Numerous courts have found arbitration clauses that are even narrower than the example given above as sufficiently broad to cover tort claims. For example, the Korean Supreme Court has held that an arbitration agreement submitting 'legal disputes regarding this contract' to arbitration was broad enough to cover tort claims (91 Da 17146, 14 April 1992, cited in Seung Wha Chang, 'Article V of the New York Convention and Korea', (2008) 25 *Journal of International Arbitration* 865, at p. 868). Such clauses are, however, occasionally read down so as not to cover torts. See, e.g. *Jan De Nul NV v Inai Kiara Sdn Bhd* [2006] 3 CLJ 46, where the Malaysian Court of Appeal found that tort claims were not covered by an arbitration clause which referred to 'any dispute or difference arising out of and/or in connection with this agreement'. The Malaysian Court of Appeal referred with approval to the Full Federal Court of Australia decision of *Hi-Fert Pty Ltd v Kiukiang Maritime Carriers* [1998] 159 ALR 142. Aspects of the *Hi-Fert* decision related to this issue were specifically overruled by the Full Federal Court in *Comandate Marine Corp v Pan Australia Shipping Pty Ltd* [2006] FCAFC 192. See also the discussion of this point in Chapter 4, Section 8.1.

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question as to which law applies to non-contractual claims that are raised in an arbitration.

3.73 Complex contractual disputes might give rise to any number of non-contractual claims. Examples of these are restitution, unjust enrichment, *culpa in contrahendo*, and torts, including statutory torts like antitrust or trade practices claims. Claims based on any of these doctrines could well be governed by a law different from the law governing the contract. It certainly should not be assumed that the contractual law will govern non-contractual claims simply because those claims are somehow connected to the contractual relationship.

3.74 Surprisingly little attention has been given to the law applicable to non-contractual claims in arbitration.[67] It is possible that when a non-contractual issue arises, lawyers and arbitrators fail to recognise that a different law might apply to it. They might not properly identify the differences. As will be seen below, in many cases the law applicable to non-contractual claims will be the same law that governs the contract. But in other cases it can be different, and it may well be to the distinct advantage of one party to argue that a different law applies.

3.3.1 Characterisation of claims as contractual or not

3.75 The first step in determining whether a different law might apply to a given claim is to characterise the claim as contractual or otherwise. If it is a contractual claim, the applicable contractual law should apply. If not, the issue of applicable law needs to be considered separately.

3.76 It is not always evident whether a particular claim is based in contract, tort or otherwise. Sometimes claims can be dressed up as one or the other, depending among other things on whether the party making the claim sees some advantage in having a different law apply to it. Domestic legal systems generally provide established rules enabling the judge to characterise claims. Those rules are part of the *lex fori* (i.e. the legal system where the court is situated). But an international arbitrator has no *lex fori* because, as noted above,[68] the laws of the seat of arbitration do not constitute a *lex fori*. An international arbitrator must therefore decide which characterisation rules to use, if any, in order to characterise the claims.

3.77 To ensure consistency and eliminate overlap, the chosen characterisation system must be consistent with the law governing the contract.[69] It has been suggested that claims should be characterised by a cumulative application of all the characterisation rules of the jurisdictions connected, or possibly connected,

67 One eminent private international law professor has commented, following a speech on this topic, that: 'You have explored a subject that is new; it seems that there has never been a study on those problems of [the law applicable to] tort and extra-contractual responsibility in arbitration.' (Authors' translation from original French). See P Lagarde, 'Débats' in C Reymond, 'Conflits de lois en matière de responsabilité délictuelle devant l'arbitre international', (1991) [1988–1989] *Travaux du Comité Français de Droit International Privé* 97, at p. 107. We are not aware of more recent studies on this subject although, as addressed below, the law applicable to non-contractual claims generally is the subject of a new European Community Regulation.
68 See above Section 2.
69 Reymond, op. cit. fn 67, p. 99.

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to the dispute and, if that does not work, by using general principles of private international law.[70]

3.78 In our view, the best characterisation rules to ensure harmony with the contractual law are those of the law governing the contract. The contractual law necessarily has a close connection to the dispute. Using its characterisation rules will eliminate inconsistencies and overlaps. This approach also avoids the complexities of the cumulative approach and the uncertainty associated with general principles of private international law.

3.3.2 Parties' choice of law applicable to non-contractual claims

3.79 As noted above,[71] the parties' ability to choose the law governing their contract is of paramount importance in international arbitration. It is also a widely recognised general principle of private international law and applied by domestic courts all over the world. But it is not clear whether the same principle applies to empower the parties to choose the law to govern non-contractual claims.

3.80 Experts' views are mixed. At least one commentator is confident that, as a matter of policy, parties can choose the law applicable to torts after the tort has occurred. He is less decisive as to whether parties can choose the law before a tort occurs, but concludes that they probably can.[72] On the other hand, a leading treatise states that 'according to traditional private international law thinking, the principle of party autonomy does not apply [to non-contractual claims]'.[73]

3.81 There are logical reasons why party autonomy may be restricted in relation to the law governing non-contractual claims. Contracts regulate the relationship between private, consenting parties. Tort law is mandatory and formulated by legislators in order to attribute responsibility and provide compensation specifically outside contractual relationships. A tort may even affect third parties' rights, such that a choice of law for a tort claim between two parties may impact the rights of others. Furthermore, certain statutory torts are designed to protect the common good (e.g. relating to anti-trust, environmental protection, safety of employees, etc.). It would not be acceptable if contracting parties could circumvent mandatory laws designed to improve or protect a nation's society as a whole by choosing a foreign law as applicable.[74]

3.82 These policy considerations do not seem to be reflected in international arbitration legislation. Arbitration laws tend not to prohibit – at least expressly – parties from choosing the law to govern tort claims. For example, Article 28(1) of the Model Law states: 'The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the

70 Reymond, op. cit. fn 67, p. 112.
71 See Section 3.1 above.
72 W Kuhn, 'Express and Implied Choice of the Substantive Law in the Practice of International Arbitration', (1994) 7 *ICCA Congress Series* 380, at p. 387.
73 Gaillard and Savage, op. cit. fn 10, para 1530.
74 See further the discussion of mandatory laws at Section 4 below.

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substance of the dispute.'[75] (Emphasis added) 'Dispute' is broad enough to cover tort claims, but it is possible that some courts will interpret it narrowly.

3.83 Support for the view that parties can choose the law governing non-contractual claims, even in advance of the facts giving rise to the claim, can be found in the recent European Community Regulation on the Law Applicable to Non-contractual Obligations ('Rome II Regulation'), which entered into force on 12 January 2009. The Rome II Regulation obviously has no direct applicability in any Asia-Pacific jurisdiction, but arbitrators may take it into account because it is the first significant regional convention of its kind and was prepared by some of the world's foremost experts in private international law. Article 14(1) of the Rome II Regulation expressly permits parties to choose the law governing non-contractual claims both '(a) after the event giving rise to the damage occurred; or (b) where all the parties are pursuing a commercial activity, also by an agreement freely negotiated before the event giving rise to the damage occurred'. Thus in the European Community commercial parties can choose the law to govern existing or future non-contractual claims. Nonetheless, Articles 14(2) and 14(3) of the Rome II Regulation ensure that, despite such freedom of choices, mandatory domestic laws and European Community laws cannot be avoided. We expect that international arbitrators and even courts in the Asia-Pacific will find the rules of the Rome II Regulation of some guidance for international matters, unless they conflict with general principles of private international law in the jurisdiction concerned.

3.84 Despite the right to choose the law governing non-contractual claims, it is very rare that parties to arbitration proceedings do so expressly, whether before or after the relevant events occur. If the contract contains a clause designating the contractual law, that clause may be broad enough to cover non-contractual claims. This is a matter of interpretation. But, as noted above, choice of law clauses tend to be narrow, referring specifically to the contract.

3.85 Nonetheless, it could be considered that contractual choice of law clauses should be read broadly, with a presumption that the parties intended to choose the same law for all claims relating in any way to the contract. The parties might have intended that the contractual choice of law would apply to any dispute relating to the contract. An arbitral tribunal could therefore perhaps find that the parties implicitly chose the same law for their non-contractual claims. Furthermore, the contractual law will be practical, convenient and closely connected to the dispute.

3.3.3 Law applicable to torts claims in the absence of choice

3.86 Without a choice of law for non-contractual claims, a convenient approach is to invoke the conflict of laws rules applicable under the contract's governing law to determine the law governing the non-contractual claims.[76] From a practical

75 This is equivalent in most arbitration laws and rules in Asia and elsewhere.
76 As preferred by Lalive, op. cit. fn 65, p. 164.

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point of view, using the contractual law's conflict of laws rules ensures perfect harmony of legal solutions. The substantive laws of the chosen jurisdiction are applied to the contract and the same jurisdiction's conflict of laws rules are used to determine other applicable laws.

3.87 This method is attractive but has one problem in cases where the contractual law has been chosen by the parties. Contractual choice of law clauses generally exclude the conflict of laws rules of the jurisdiction designated. They often say, for example: 'This Agreement shall be governed by and construed in accordance with the laws of X without regard, however, to its conflict of laws rules . . . .' Article 28(1) of the Model Law gives the same effect to any contractual choice of law clause to which the Model Law applies: 'Any designation [by the parties] of the law or legal system of a given State shall be construed, unless otherwise expressed, as directly referring to the substantive law of that State and not to its conflict of laws rules'. The exclusion of local conflict of laws rules is designed to prevent the frustration of the parties' agreement on the applicable law because those rules may, in contrast to the agreement, designate another law.

3.88 It might, however, be assumed that the exclusion of local conflict of laws rules is intended only to avoid an unexpected law applying to the contract. Arguably, these exclusions are not intended to prevent an arbitral tribunal using those conflict of laws rules for other issues, such as determining the law applicable to non-contractual claims.

3.89 Apart from applying the conflict of laws rules of the law governing the contract, there are other possible methods for determining the law governing non-contractual claims. The arbitral tribunal could establish the applicable law using a method analogous to any of those described above for establishing the law governing contracts where the parties have not chosen it.[77] In complex commercial torts, there will rarely be convergence among the conflict of laws rules connected to the dispute, thus making the cumulative approach difficult to achieve. As regards the general principles of private international law applicable to non-contractual claims, there is very little global uniformity in approaches. Claude Reymond suggests applying the law of the centre of gravity of a tort.[78] As Peter Nygh explains, such an approach:[79]

> makes the choice of law dependent on the number of contacts the parties, the events and the issue have with the several jurisdictions involved in an interstate or international incident, and gives the controlling voice to the jurisdiction with the most important 'contacts.' In that jurisdiction the 'centre of gravity' of the tort is said to lie.

3.90 Once again, guidance might alternatively be sought from the Rome II Regulation which sets out the European Community's view on the law governing non-contractual claims. Its basic rule is (Article 4(1)):

77 See Reymond, op. cit. fn 67, p. 104 and Gaillard and Savage, op. cit. fn 10, para 1531.
78 Reymond, op. cit. fn 67, p. 104.
79 P Nygh, 'Some Thoughts on the Proper Law of a Tort', (1977) 26(4) *International and Comparative Law Quarterly* 932, at p. 933.

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> the law applicable to a non-contractual obligation arising out of a tort/delict shall be the law of the country in which the damage occurs irrespective of the country in which the event giving rise to the damage occurred and irrespective of the country or countries in which the indirect consequences of that event occur.

3.91 There are various special circumstances and exceptions to this rule stipulated in the Rome II Regulation. Of particular relevance to international commercial arbitration is Article 4(3):

> Where it is clear from all the circumstances of the case that the tort/delict is manifestly more closely connected with a country other than that indicated in [Articles 4(1) and 4(2)], the law of that other country shall apply. A manifestly closer connection with another country might be based in particular on a pre-existing relationship between the parties, such as a contract, that is closely connected with the tort/delict in question.

3.92 Arbitrators and lawyers in the Asia-Pacific, especially if they come from or were trained in civil law countries, might well be guided by the Rome II Regulation's approach. Common lawyers may be less interested because Rome II was drafted from a predominantly civil law perspective.

3.93 An example of an arbitral tribunal determining the law applicable to non-contractual claims in this region occurred in *Transfield Philippines Inc v Luzon Hydro Corporation Ltd*.[80] The dispute related to the construction of a hydro-electric power station in Northern Luzon, the Philippines. The subcontractor, Transfield Philippines Inc. ('TPI'), commenced arbitration against the contractor, Luzon Hydro Corporation ('LHC'), and sought various relief under the contract. In accordance with the arbitration clause, the seat of the ICC arbitration was Singapore and a contractual choice of law clause stipulated that the contract was governed by the laws of the Philippines.

3.94 In addition to its contractual claims, TPI raised claims for pre-contractual misleading and deceptive conduct and negligent misrepresentation by LHC's directors about what TPI might expect in relation to the project. It contended primarily that those claims were governed by Australian trade practices legislation rather than Philippines law, on the basis that the relevant misrepresentations and misconduct had occurred in Australia. The arbitral tribunal ruled on the issue of applicable law in its first partial award as follows:[81]

> . . . the claims for misleading and deceptive conduct are governed by the law of the Philippines under either of two alternative approaches. The first is to apply the law of the Philippines directly without recourse to choice of law rules ('voie directe'). Alternatively if the governing law is to be selected indirectly through the application of a choice of law rule, the arbitral tribunal determines that the appropriate choice of law rule (application of the law most closely connected with the claim) also leads to the selection of the law of the Philippines.

80 See, e.g. *Transfield Philippines Inc v Pacific Hydro Ltd* [2006] VSC 175 (Supreme Court of Victoria, Australia).
81 Page 24 of the arbitral tribunal's first partial award dated 18 February 2002, cited in *Transfield Philippines Inc v Pacific Hydro Ltd* [2006] VSC 175, at para 68 (Supreme Court of Victoria, Australia).

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> [TPI] has indicated that it will institute court proceedings in Australia if this arbitral tribunal does not determine claims under the [Australian trade practices legislation]. [TPI] has submitted that resort to two tribunals is undesirable. The arbitral tribunal agrees. However, this consideration is not of itself sufficient to warrant the application of a law which the tribunal considers in all the circumstances, not to be appropriate to the dispute between the parties. Further, this tribunal notes that [TPI] has also sought damages for misrepresentation under the law of the Philippines. The claim for misrepresentation will still proceed in this arbitration but will be determined in accordance with the law of the Philippines.

3.95 The arbitral tribunal did not appear to ground its decision on the fact that TPI's non-contractual claims were covered by the contractual choice of law clause. Rather, it held that Philippines law governed the claims because it was the appropriate law or, alternatively, by virtue of a general principle of private international law because it was the law most closely connected to the claims.

3.96 Given the uncertainty of using the cumulative approach or trying to establish general principles of private international law applicable to non-contractual claims, in our view, as a general rule it is best to use the contractual law's conflict of laws rules (discussed above in this section). That legal system will not only provide characterisation rules, but also a system of conflict of laws rules that can be applied to any and all conflict of laws issues that may arise. Alternatively, an arbitral tribunal might use the Rome II Regulation for guidance as to the general principles of private international law for torts.

4 Limitations on choice of law: Mandatory laws and public policy

3.97 Mandatory laws are imperative provisions of law that are imposed on arbitrating parties regardless of their choice of law. They constitute a limitation on the general principle that parties are free to choose the applicable law. It is rare in practice that a mandatory law will apply. One may apply only if the legal system to which the mandatory law belongs cannot be ignored by virtue of some close connection that legal system has to the facts of the underlying dispute and the mandatory law itself was intended to be applied in the circumstances of the case, including, where relevant, extraterritorially.

3.98 In a seminal article on the topic, Pierre Mayer explains that:[82]

> a mandatory rule (loi de police in French) is an imperative provision of law which must be applied to an international relationship irrespective of the law that governs that relationship. To put it another way: mandatory rules of law are a matter of public policy (ordre public), and moreover reflect a public policy so commanding that they must be applied even if the general body of law to which they belong is not competent

82 P Mayer, 'Mandatory Rules of Law in International Arbitration', (1986) 2(4) *Arbitration International* 274, at p. 274. See further generally (2009) 18(1–2) *American Review of International Arbitration* which is a special edition of this journal focusing on mandatory laws in international arbitration and litigation, including several articles by leading scholars and practitioners.

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by application of the relevant rule of conflict of laws. It is the imperative nature per se of such rules that make them applicable.

3.99 Mandatory laws only exist when there is a fundamental and unavoidable public policy objective at stake. A classic example that could interfere with a commercial relationship is anti-trust or competition laws.[83] States enact anti-trust laws to encourage competition for the protection of consumers. If commercial parties were able to avoid complying with anti-trust laws by simply choosing a different law to govern their contract, this would completely frustrate the broad, policy objectives behind anti-trust laws.

3.100 That said, a mandatory competition law (or any other mandatory law) will not apply simply because the dispute is somehow related to the legal system which enacts that law. There must be a real connection to the underlying transaction that would trigger the law's application. Thus, for example, if an arbitration between parties from China and Singapore in relation to the acquisition of a company in the Philippines happens to have its seat of arbitration in Australia, there is no ground whatsoever to apply mandatory Australian competition or trade practices laws. On the facts given, there would be no connection between those laws and the underlying transaction.

3.101 Other classic examples of mandatory laws relate to criminal law, corruption, money-laundering, racial or gender discrimination, environmental protection, and employment law.

3.102 The concept of mandatory laws is not generally seen in statutes relating to arbitration or in arbitration rules. There are no references to them in the Asia-Pacific arbitration laws or institutional rules. References to mandatory laws can sometimes be seen in regional or international conventions on applicable law. The recent European Community Regulation on the Law Applicable to Contractual Obligations ('Rome I Regulation'), which entered into force for European Community countries at the end of 2009, provides various rules for determining the law applicable to contracts, based on its predecessor the Rome Convention. It also reserves the possibility for courts to apply mandatory laws regardless of the applicable contractual law. While this obviously has no direct application in the Asia-Pacific, Article 9 provides a useful definition of mandatory laws that may guide arbitrators in this region:

> 1. Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any

83 In the famous *Mitsubishi v Soler* case (1985) 105 S Ct 3346, the US Supreme Court confirmed that issues arising from US anti-trust legislation were capable of settlement by arbitration, laying down a principle that has been followed in numerous other jurisdictions and which has enhanced the efficacy of dispute resolution by arbitration. By confirming the arbitrability of such issues, a related question arose about whether and to what extent mandatory competition laws that are not part of the law governing the contract must be applied. See also See DF Donovan and AKA Greenawalt, 'Mitsubishi after Twenty Years: Mandatory Rules before Courts and International Arbitrators', in LA Mistelis and JDM Lew (eds), *Pervasive Problems in International Arbitration*, Kluwer, 2006, p. 42 et seq.

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situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.
2. Nothing in this Regulation shall restrict the application of the overriding mandatory provisions of the law of the forum.
3. Effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful. In considering whether to give effect to those provisions, regard shall be had to their nature and purpose and to the consequences of their application or non-application.

3.103 A regional example of a court applying a mandatory law in the context of arbitration proceedings can be found in a series of Federal Court of Australia decisions in *Clough Engineering Ltd v Oil & Natural Gas Corporation Ltd*.[84] Clough had won a tender from Oil & Natural Gas to develop oil and gas fields off the coast of India. The contract was governed by Indian law and included an arbitration clause with the seat of arbitration in India. Before arbitration was commenced, Clough sought an injunction from the Australian Federal Court to prevent certain Australian banks from paying out on an unconditional performance bond with a value of 10% of the contract price which Clough had procured in favour of Oil & Natural Gas in order to secure the contract. Clough argued that the Federal Court had jurisdiction to issue the injunction for several reasons, including the fact that it had claims against Oil & Natural Gas under mandatory provisions of the Australian Trade Practices Act. The connection between these claims and Australia was that the relevant written communications that amounted to Oil & Natural Gas's allegedly unconscionable conduct had been received in Australia and the damage, alleged to be the unconscionable calling of the performance bonds, would occur in Australia.

3.104 Justice Gilmour, referring to various authorities, noted:[85]

> The [Trade Practices Act] is 'a public policy statute'. Its operation cannot be ousted by private agreement. 'Parliament passed the [TPA] to stamp out unfair or improper conduct in trade or in commerce; it would be contrary to public policy for special conditions such as those with which this contract was concerned to deny or prohibit a statutory remedy for offending conduct under the [TPA]': . . . . Any attempt to contract out of the remedies conferred by the Act may be void . . . .

3.105 Justice Gilmour granted an ex parte interim injunction in favour of Clough. He must have been satisfied that there was at least a prima facie case for applying mandatory trade practices laws despite acknowledging that this was contrary to the parties' choice of Indian substantive law and arbitration seated in India. The

84 [2007] FCA 881 (7 June 2007); [No. 2] [2007] FCA 927 (19 June 2007); [No. 4] [2007] FCA 2110 (21 December 2007); [2008] FCA 191 (29 February 2008); [2008] FCAFC 136 (22 July 2008).
85 *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd* [2007] FCA 881 (7 June 2007), at para 41.

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injunction was ultimately set aside, as confirmed on appeal to the Full Court of the Australian Federal Court.[86]

3.106 While it is not uncommon that mandatory laws are asserted in the context of international arbitrations, they are rarely applied. Examples of how arbitral tribunals have dealt with these issues can be found in ICC jurisprudence:

(i) *ICC Case No. 4132 (1983)* – A supply and purchase agreement was governed by Korean law but European antitrust law was considered. The arbitral tribunal recognised that antitrust and fair trade laws possessed a public policy character. It ultimately held, however, that since the agreement did not affect trade between EU Member states, only Korean law was relevant.[87]

(ii) *ICC Case No. 6320 (1992)* – The arbitrators accepted that US mandatory laws prohibiting corruption could apply extraterritorially to a contract governed by Brazilian law. However, a condition (which was not met in this case due to lack of factual, geographic proximity to the US) would be that the particular rule relating to corruption reflected 'an important and legitimate interest' of the US.[88]

(iii) *ICC Case No. 6379 (1990)* – The arbitral tribunal would not allow Italian law, which had been chosen by the parties to govern their contract, to be disregarded in favour of Belgian distributorship law, which provides that it must be applied to exclusive distributorship agreements producing effects in all or part of Belgium.[89]

(iv) *ICC Case No. 7047 (1994)* – The parties entered into a contract governed by Swiss law for sales assistance in support of various products. In an attempt to avoid liability for non-performance of its obligations, the defendant relied on regulations in the country where the contract was to be performed, which prohibited the use of intermediaries in that field of activity. The arbitral tribunal rejected the defendant's argument on the grounds that 'the parties are entitled to submit their legal relations to whatever law they choose, and to exclude national laws which would apply in the absence of a choice. Consequently the provision of the law thus excluded can only prevail over the chosen law in so far as they are matters of public policy'.[90] The asserted laws were not, according to the arbitral tribunal, matters of public policy.

3.107 The above examples demonstrate the high burden of a connection to the underlying dispute that a party seeking to assert the application of a mandatory law must establish. Mandatory laws are not, and should not be, applied readily, but

86 *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd* [2008] FCAFC 136 (22 July 2008).
87 Award in *ICC Case No. 4132*, in S Jarvin, Y Derains and JJ Arnaldez, *Collection of ICC Arbitral Awards 1974–1985*, ICC Publishing, 1990, p. 164 at p. 167.
88 Award in *ICC Case No. 6320*, in S Jarvin, Y Derains and JJ Arnaldez, *Collection of ICC Arbitral Awards 1991–1995*, ICC Publishing, 1997, p. 577 at p. 584.
89 Award in *ICC Case No. 6379*, in ibid., p. 134 at p. 142.
90 Award in *ICC Case No. 7074*, in S Jarvin, Y Derains and JJ Arnaldez, *Collection of ICC Arbitral Awards 1996–2000*, ICC Publishing, 2003, p. 32 at p. 51.

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only where there is a real connection to the dispute and real public policy issues at stake.

3.108 It is sometimes said that there are two kinds of mandatory laws, those of a domestic nature and those of an international nature. We do not find the distinction especially useful because the real question should be whether a particular mandatory law is in fact mandatory in the given circumstances, particularly taking into account the location of the conduct (i.e. the relevant aspect of performance of the contract) which potentially offends the law. If the distinction is made, however, it will be important[91] because only international mandatory laws should affect international arbitrations. As Voser notes, 'a domestic mandatory rule can only have the quality of an international mandatory rule if the enacting state itself wants it to be applied in international situations'.[92]

3.109 A question arises as to whether an arbitral tribunal should apply a mandatory law only when a party has requested its application or whether it may do so of its own initiative, i.e. ex officio. It is one thing for an arbitral tribunal to go beyond the parties' choice of law agreement and apply, on one party's request, a mandatory law, the application of which is disputed by the opposing party. An even more delicate question is whether arbitrators should consider applying a mandatory law on the arbitral tribunal's own initiative when neither party has requested the application of that law.

3.110 This conundrum leads authors Barraclough and Waincymer wisely to point out that 'arbitrators confronted with mandatory rules questions find few easy answers'.[93] The authors argue that the issue will remain unclear until the nature of arbitration (judicial or contractual) is resolved one way or the other. Not surprisingly, Professor Pierre Mayer's seminal 1986 article identifies the same central, intellectual debate as being at the core of whether to apply mandatory laws. Mayer notes that arbitrators 'would . . . be confronted, unlike the national judge, with a conflict between the will of the State having promulgated the mandatory rule of law, on the one hand, and on the other hand, the will of the parties from which indeed his authority is derived'.[94]

3.111 Professor Mayer focuses on when and to what extent arbitrators (i) may apply mandatory laws, (ii) are obliged to do so and (iii) if so, which mandatory laws. He says that if a party invokes the mandatory law, the arbitral tribunal would at least be required to consider applying it. If, however, neither party has referred to the mandatory law, but its existence nonetheless comes to the arbitral tribunal's

91 See generally N Voser, 'Current Development: Mandatory Rules of Law as a Limitation on the Law Applicable in International Commercial Arbitration', (1996) 7 *American Review of International Arbitration* 319.
92 Ibid., p. 347.
93 A Barraclough and J Waincymer, 'Mandatory Rules of Law in International Commercial Arbitration', (2005) 6 *Melbourne Journal of International Law* 205, at p. 243. See also more recently J Waincymer, 'International Commercial Arbitration and the Application of Mandatory Rules of Law', (2009) 5(1) *Asian International Arbitration Journal* 1.
94 Mayer, op. cit. fn 82, p. 275. See also P Mayer, 'Effect of International Public Policy in International Arbitration' in Mistelis and Lew, op. cit. fn 83, p. 141 et seq. See also the discussion of delocalisation in Chapter 2, Section 5.2.

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attention, or is simply obvious, the tension between the judicial and contractual nature of arbitration intensifies. If arbitration is characterised as purely contractual, then the arbitral tribunal should do nothing that the parties have not requested of it. If proceeding in this way offends an arbitrator's professional integrity he should resign. But if the nature of arbitration is considered to be quasi-judicial, then arbitrators owe duties to the state. In that latter scenario, one may ask to which state(s) an arbitral tribunal owes a duty; the state of the seat of arbitration, the applicable substantive law, the parties' nationalities, or another?

3.112 Apart from the Australian example given above, there are few examples of courts in the Asia-Pacific dealing with the application of mandatory laws in international arbitration.[95] These issues have, however, come to the attention of domestic European courts as well as the European Court of Justice ('ECJ') in the context of EC competition laws. In the famous *Eco Swiss v Benetton*[96] case, the contract contained a choice of law clause selecting Dutch law to govern the contract and an arbitration clause providing for arbitration of all disputes or differences under the rules of the Netherlands Arbitration Institute. Eco Swiss obtained an award in its favour of just over US$26 million. Benetton sought to set aside the award in the Netherlands on the basis that the underlying agreement was contrary to EC competition law. The competition law in question had not been raised by either party during the arbitration. The Dutch court submitted several questions to the ECJ, one being whether an arbitral tribunal had a duty ex officio to apply EC competition laws. The ECJ avoided answering that question directly, but held that a Dutch court could, during setting aside proceedings, examine whether EC competition law had been respected. This means that if mandatory competition laws are not dealt with by the arbitral tribunal, an award can still be set aside if it contravenes such laws. Following this decision, a prudent arbitral tribunal, in the interests of increasing the enforceability of its award, ought to consider raising and addressing such mandatory competition laws during the arbitration.

3.113 Also interesting is the Paris Court of Appeal decision of *Thales v Euromissile*[97] which, among other issues, proceeded on the assumption that an arbitral tribunal could raise a competition law issue ex officio. A subsequent decision of the Swiss Federal Tribunal cast confusion on the matter. The Federal Tribunal doubted that competition law was per se of a sufficiently public policy character to be raised as a basis to set aside an arbitral award. On the one hand, this means that arbitrators may be reluctant to raise competition laws ex officio. On the other hand, however, it means that if an arbitrator considers the competition law to be mandatory he or she may wish to apply it in the place of a domestic judge so that the parties cannot escape the application of these laws.[98]

95 See, however, the hypothetical example given in the conclusion of Waincymer, op. cit. fn 93, p. 39.
96 (1999) ECR 3055.
97 18 November 2004, Paris Court of Appeal, *Case No. 2002/60932*.
98 See C Partasides and L Burger, 'The Swiss Federal Tribunal's Decision of 8 March 2006: A Deepening of the Arbitrator's Public Policy Dilemma', (2006) 3 *Concurrences*, p. 26, which discusses all three of these cases.

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3.114 Another factor influencing whether an arbitral tribunal should apply a mandatory law is its source, i.e. which jurisdiction it comes from. Domestic judges dealing with an international litigation case may apply mandatory laws of their own jurisdiction (the *lex fori*) that are applicable in international matters even if the dispute is governed by a foreign substantive law. Whether or not domestic judges will apply foreign international mandatory laws that are not part of the *lex fori* depends on the *lex fori*'s conflict of laws rules and its rules regarding the application of foreign mandatory laws. For countries within the EC, the above-cited Article 9 of the Rome II Regulation provides for the application of mandatory laws that are neither part of the *lex fori* nor the *lex contractus* (law governing the contract).

3.115 Once again, a difficulty in relation to conflict of laws issues in international arbitration is that there is no *lex fori* and the rules of the *lex arbitri* are of limited relevance.[99] Nonetheless, lawyers and international arbitrators should be alert to any jurisdictions where mandatory laws may be relevant. It is obvious that if a party asserts an international mandatory law that is part of the *lex contractus*, the arbitral tribunal must apply it. But if the mandatory law arises from some other legal system connected to the dispute, the matter is more complex. Potential mandatory laws arise from any jurisdiction which has a close factual connection to the transaction at the heart of the dispute.

3.116 Authors Barraclough and Waincymer contend that there are four categories of mandatory laws which are not (or should not be) controversial. These are: (i) laws which legitimately create a force majeure for one of the parties, (ii) laws implementing transnational public policy, (iii) mandatory rules of the *lex contractus*, and (iv) mandatory procedural rules of the *lex arbitri* that are applicable to international arbitrations.[100]

3.117 Perhaps most contentious is mandatory substantive laws of the *lex arbitri*. These are potentially applicable, but in reality they may have no connection to the underlying transaction. As in the example of competition laws given above, mandatory laws of the *lex arbitri* should be applied very sparingly.

3.118 Voser convincingly objects to the application of any mandatory laws (procedural or substantive) at the seat of arbitration. Her analysis of the European and US conflict of laws approaches to applying mandatory laws leads her to recommend that arbitral tribunals apply an approach 'based on the Continental European theory of Special connection of mandatory rules ('Sonderanknupfungstheorie')'.[101] In Voser's view, this approach ensures the application of genuine mandatory rules of all concerned states. She asserts that the seat of arbitration is acknowledged as having a close relationship for any mandatory procedural laws, but not mandatory laws that apply to the merits of the case, unless the seat has some other connection to the dispute. Her rationale is the absence of a *lex fori* – arbitral tribunals are not an organ of the state and are therefore under no obligation to

99 See above Section 2; see also Chapter 2, Section 5.2, on the delocalisation debate.
100 Barraclough and Waincymer, op. cit. fn 93, p. 218.
101 Voser, op. cit. fn 91, p. 345.

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apply the public policies of that state. A fundamental premise of Voser's argument is that the mandatory laws of all sufficiently interested states are to be treated equally. Since an arbitral tribunal does not itself belong to any state, all mandatory laws, including those of the seat of arbitration, are 'foreign' and relevant (or irrelevant) to the same extent.[102]

3.119 As should be clear from this section so far, we tend to agree with Voser. The point is whether or not the mandatory law has a genuine factual connection to the issue it seeks to regulate. The *lex arbitri*'s mandatory laws should always be kept in mind because there is a risk that a judge in subsequent setting aside proceedings will see his own mandatory laws as prevailing and apply them as international public policy. Nonetheless, the mere fact that an arbitral award could possibly be set aside is insufficient for an arbitral tribunal to decide to apply a law that it otherwise determines to be irrelevant, if doing so would affect a party's substantive rights. An arbitral tribunal should do what it finds to be correct as a matter of law in the circumstances. It should not be excessively constrained by hypothetical predictions as to future decisions of state courts. Barraclough and Waincymer's advice is a sound conclusion:

> For arbitrators who want a present workable solution for their daily practice, there do appear to be two feasible alternatives. There is a restrictive approach that applies mandatory rules only in the accepted categories . . . or alternatively an approach that gives arbitrators a broad discretion . . . [A]t present, giving arbitrators a broader discretion, on balance, seems to be the most attractive of determining mandatory rules' applicability.

5 Content of the applicable law

3.120 So far this chapter has focused on determining which law applies to a dispute. Once the law is established, an arbitral tribunal has to determine its content. Given the diverse range of countries across which an international arbitration may span, it very often happens that some or all of the arbitrators are not specialists in the applicable law. It is also not uncommon that none of the parties' lawyers are specialists in the applicable law either. A question therefore arises as to how an international arbitrator should establish the content of the law.

3.121 Once again, this issue differs in international arbitration in contrast with domestic litigation. A domestic court will have a well established body of rules relating to the manner in which foreign law is established and dealt with. There are no such rules in international arbitration, once again because there is no fallback *lex fori*. No Asia-Pacific arbitration laws or rules contain guidance as to how foreign law is to be established.[103] Arbitrators therefore have considerable

102 Ibid., p. 338.
103 Apart from simple confirmations of an arbitrator's power to decide how to ascertain the law. See, e.g. Section 2GB(6) of the Hong Kong Arbitration Ordinance, which provides that 'In conducting arbitration proceedings, an arbitral tribunal may decide whether and to what extent it should itself take the initiative in ascertaining the facts and the law relevant to those proceedings'. Some laws do provide guidance or a

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freedom to establish it in the manner they deem fit,[104] provided always that the parties' fundamental due process rights are respected.

3.122 After considering numerous questions and issues relating to how an international arbitral tribunal should determine the content of the applicable law, a special task force on this topic, appointed by the International Law Association's International Commercial Arbitration Committee, summarised them in the following four 'overarching and thematic questions':[105]

i. How should arbitrators acquire information about the contents of the applicable law?
ii. How should arbitrators interact with the parties about the contents of the applicable law?
iii. How should arbitrators make use of the information they receive about the contents of the applicable law?
iv. How should arbitrators address situations that may call for special treatment regarding the contents of the applicable law?

3.123 The task force, after analysing various domestic court approaches to determining the content of foreign laws, concluded that domestic approaches are unsuitable for international arbitration. It proceeded to assess the issues relevant to arbitral tribunals before concluding among other things that:[106]

> a balanced approach is the most acceptable general approach to the determination of the contents of the applicable law in international commercial arbitration. Arbitrators should primarily rely on the parties to articulate legal issues and to present the law, and disputed legal issues. They should give parties appropriate directions in relation thereto and should give appropriate weight to information so obtained.

3.124 The point made here about the arbitrators relying principally on the parties to articulate legal issues is important. While arbitral tribunals may be permitted some limited scope to apply provisions of the governing law that have not been specifically plead by a party (the '*jura novit curia*' principle, well known in civil law countries), they cannot stray too far from the pleadings and apply statutes, cases or principles of law that the parties would not reasonably have expected them to apply.[107]

mechanism for arbitrators to determine the content of law. See, e.g. Article 1044 of the Dutch Code of Civil Procedure and Section 27(2) of the Danish Arbitration Act.

104 There is English authority suggesting that where the seat of arbitration is in England or Wales, an arbitral tribunal should apply the England and Wales approach to determining the content of foreign law, see *Hussman (Europe) Ltd v Al Ameen Dev & Trade Co* [2000] EWHC 210 (Comm). There are multiple reasons why this view should not be preferred, which reasons are analogous to our arguments as to why the theories of applying the seat of arbitration's substantive law or choice of law rules is inappropriate, see Sections 3.2.2.2 and 3.2.2.3 above.

105 *Ascertaining the Contents of the Applicable Law in International Commercial Arbitration*, International Commercial Arbitration Committee of the International Law Association, October 2008, available at www.ila-hq.org/en/committees/index.cfm/cid/19, at p. 7.

106 Ibid., p. 22.

107 These limits have recently been analysed in Swiss case law. On 9 February 2009 (Case reference 4A-400/2008), the Swiss Federal Tribunal set aside an award of the Court of Arbitration for Sport (CAS) because one of the bases of the CAS's decision was a law that had not been pled by the parties and was inapplicable in any event. See also an earlier Federal Tribunal decision which, after confirming that arbitrators sitting in Switzerland can apply a law not specifically pled by the parties (*jura novit curia*), distinguished contractual

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3.125 The task force also produced a (non-binding but guiding) list of recommendations for arbitrators faced with the task of determining the content of the applicable law. They are summarised below:[108]

(i) Arbitrators should identify the potentially applicable laws and rules and ascertain their contents insofar as it is necessary.

(ii) In ascertaining the contents of the applicable law and rules, arbitrators should respect due process and public policy and avoid bias or appearance of bias.

(iii) When it appears to the arbitrators that the contents of the applicable law might be significant, they should promptly raise that topic with the parties and establish appropriate procedures as to how the contents of the law will be ascertained.

(iv) Rules governing the ascertainment of the contents of law by national courts are not necessarily suitable for arbitration given the fundamental differences between international arbitration and litigation before national courts.

(v) Arbitrators should primarily receive information about the contents of the applicable law from the parties.

(vi) Arbitrators should not introduce legal issues – propositions of law that may bear on the outcome of the dispute – that the parties have not raised.

(vii) Arbitrators are not confined to the parties' submissions about the contents of the applicable law but may question the parties about legal issues and about their submissions and evidence on the contents of the applicable law. They may also review sources not invoked by the parties relating to those legal issues and may, in a transparent manner, rely on their own knowledge as to the applicable law.

(viii) Before rendering a decision or an award, arbitrators should give parties a reasonable opportunity to be heard on all legal issues. They should not give decisions that might reasonably be expected to surprise the parties, or that are based on legal issues not raised by or with the parties.

(ix) In ascertaining the contents of a potentially applicable law or rule, arbitrators may consider and give appropriate weight to any reliable source, including statutes, case law, submissions of the parties' advocates, opinions and cross-examination of experts, scholarly writings and the like.

(x) If arbitrators intend to rely on sources not invoked by the parties, they should bring those sources to the attention of the parties and invite their comments.

(xi) If in the course of deliberations arbitrators consider that further information about the contents of the applicable law is necessary to the disposition

provisions which had not been pled. It held that an arbitral tribunal cannot decide a case based on a contractual clause that the parties had not discussed (30 September 2003, 4P 100/2003, (2004) 22 *ASA Bulletin* 574).

108 These are partially quoted and partially summarised and/or paraphrased. For the full citation of this list see 'Ascertaining the Contents of the Applicable Law in International Commercial Arbitration', International Commercial Arbitration Committee of the International Law Association, October 2008, available at www.ila-hq.org/en/committees/index.cfm/cid/19, p. 22 et seq.

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of the case, they should consider reopening the proceedings to enable the parties to make further submissions.

(xii) In disputes implicating rules of public policy or other mandatory rules, arbitrators may be justified in taking measures appropriate to determine the applicability and contents of such rules, including by independent research.

3.126 In practice, disputes about the manner in which the content of the applicable law should be determined are rare. The usual approach is for the parties' lawyers to plead the content of that law, with or without the assistance of a legal expert. In many cases, the parties' dispute can be resolved by establishing the facts and then directly applying the parties' contract. Express referral to the law is not always necessary.

6 Trade usages

3.127 The term 'trade usages' refers to the way that business is conducted in a particular trade or industry. Regardless of what the applicable law is and whether or not it has been determined, an arbitral tribunal may need to consider relevant trade usages to give appropriate context to the facts, contract and applicable law.

3.128 Most arbitration rules and laws require arbitral tribunals to take into account trade usages in reaching their decisions. For example, Article 28(4) of the Model Law provides that 'In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction'.[109] Applying trade usages is also a general principle of international commercial law.[110]

3.129 The importance of trade usages is emphasised and well explained in the context of ICC arbitration by Craig, Park and Paulsson:[111]

> Reference to trade usages may frequently fill gaps in the applicable law, since usages in the world of international commerce may frequently develop more rapidly than the law.
>
> . . .
>
> The application of trade usages is consistent with the primacy of contractual terms. Usages may be deemed incorporated into the contract as a matter of specific intent (for

109 This applies unmodified, or equivalently, in Hong Kong, Singapore, Korea, New Zealand, Malaysia, India, Japan, the Philippines and Australia. Sri Lanka is different. According to Section 24(4) of its Arbitration Act, 'the arbitral tribunal shall decide according to . . . trade usages only if the parties have expressly authorised it to do so'. (Emphasis added) Neither the Chinese nor Indonesian arbitration laws refer to trade usages. Most arbitration institutional rules provide something similar to Article 28(4) of the Model Law.

110 See, e.g. Article 1.9(2) of the UNIDROIT Principles of International Commercial Contracts (2004 edn). See also CR Drahozal, 'Commercial Norms, Commercial Codes, and International Commercial Arbitration', (2000) 33 *Vanderbilt Journal of Transnational Law* 79, at p. 109, observing 'that the requirement [to consider trade usages] is not one that results simply from national substantive contract laws'.

111 W Craig, WW Park and J Paulsson, *International Chamber of Commerce Arbitration*, 3rd edn, Oceana Publishing, 2000, pp. 330–332. See also S Bainbridge, 'Trade Usages in International Sales of Goods: An Analysis of the 1964 and 1980 Sales Conventions', (1984) 24 *Virginia Journal of International Law* 619.

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> instance, if reference is made in the contract to Incoterms, or contracting regulations), or by implication (a custom is not referred to but is deemed by the arbitrators to have been within the contemplation of the parties). In this sense trade usages can be said to be internal to the contract and an expression of what the parties intended or can be deemed to have intended.

3.130 In *Ganda Edible Oils Sdn Bhd v Transgrain Bv*, the Malaysian Supreme Court of Civil Appeal was asked to consider whether the arbitrator had based the award on trade usages, which the court found had not occurred. In the course of judgment, the court observed:[112]

> One has to understand what is meant by 'custom of trade' before dealing with the subject. A custom is a particular rule which has existed either actually or presumptively from time immemorial and obtained the force of law in a particular locality. It is distinguishable from particular trade or local usages which have been imported as express or implied term [sic] into commercial or other contracts . . . . . The arbitrator may apply his own knowledge of the usage, but before that can be done, there must be sufficient material for its inclusion. It follows that where persons execute a contract under circumstances governed by usage, the usage, when proved, must be considered as part of the agreement. In general, every usage must be notorious, certain and reasonable and must not offend against the intention of any statute. By notorious, it means that it has acquired such notoriety in a particular branch of trade or business or amongst the class of persons who are affected by it, that any person who enters into a contract affected by the usage must be taken to have done so with the intention that the usage should form part of the contract. By certainty, usage is required to be as certain as the written contract itself. It must be uniform and reasonable before it can be imported into a contract.

3.131 An abundance of ICC and other arbitral case law confirms that industry specific trade usages must be used to complement the content of the applicable law and the contract. In some instances, arbitral awards have gone further by holding that, in addition to industry specific trade usages, there are general trade usages in international commerce which are analogous to general principles of international commercial law. Such usages may be considered relevant in addition to the applicable law. A few examples may be cited from ICC jurisprudence:

(i) In *ICC Case No. 5721* (1990), the arbitral tribunal found that: 'Article 13(5) of the [1975] ICC Arbitration Rules invites the Tribunal to take account of trade usages and the contractual stipulations. From that perspective, the Tribunal is allowed to make reference to the lex mercatoria . . . the Tribunal therefore bases its decision on the general notion of good faith in business and the usages of international trade.'[113]

(ii) In *ICC Cases Nos. 6515 and 6516* (1994), the contract provided for the application of Greek law. The arbitral tribunal held that 'it results from

112 [1988] 1 MLJ 428, at p. 430.
113 Award in *ICC Case No. 5721*; in S Jarvin, Y Derains and JJ Arnaldez, *Collection of ICC Arbitral Awards 1986–1990*, ICC Publishing, 1994, p. 401 at p. 404 (informal translation from the original in French).

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the combination between the provisions of the second paragraph of the arbitral clauses, of Art. 2 [rectius 1] in the Greek Civil Code and of Art. 13(5) in the [1975] ICC Rules of Arbitration that the arbitral tribunal must primarily resort to Greek law and subsidiarily to the relevant usages of international trade, if and when needed'.[114]

(iii) In *ICC Case No. 9479* (1999), the contract was governed by New York law. The arbitral tribunal held: 'the Arbitral Tribunal finds any question concerning the validity of the Agreement must be decided under the Law of the State of New York. Any other question will have to be decided according to the provisions of the Agreement in the light of, and, in case of need, supplemented by the usages of international trade. Whenever necessary, the Arbitral Tribunal will have regard to international public policy.'[115]

(iv) Finally, in *ICC Case No. 1472*, the arbitral tribunal noted: 'considering that, in the case under consideration, the contracts were signed in Paris, French national law should apply, supplemented, if necessary, by international custom and practice governing international contracts.'[116]

3.132 While these awards suggest a fairly broad interpretation of the term 'trade usage', as noted above it is normally limited to customs specific to a particular trade or industry, or specific to a course of dealing between the disputing parties. As to the content of trade usages, it is up to any party who wants to rely on a trade usage to prove its existence and meaning. This can be done in many ways, such as through trade publications and guidelines and/or by expert witness testimony. Provided that the *lex arbitri* permits the arbitral tribunal to use trade usages,[117] such usages are often considered more important than the applicable law itself.[118] The arbitral tribunal must take them into account.

7 Non-national rules of law and the *lex mercatoria*

3.133 Given the inherently transnational nature of the international commercial disputes that are decided by international arbitration, one may wonder whether domestic laws are suitable substantive laws to apply. A series of academic studies and the application by international arbitrators of non-national general

114 Award in *ICC Case No. 6515 and 6516*, in Jarvin, Derains and Arnaldez, op. cit. fn 90, p. 241 at p. 243 (informal translation from the original in French).
115 Final Award in Case 9479, (2001) 12(2) *ICC International Court of Arbitration Bulletin* 67, at p. 68.
116 Cited in Y Derains, 'Le statut des usages du commerce international devant les juridictions arbitrales', (1973) *Revue de l'arbitrage* 122.
117 As noted by P Bernardini 'International Arbitration and A-National Rules of Law', (2004) 15(2) *ICC International Court of Arbitration Bulletin* 58, at p. 65, the application of trade usages must be permitted by the law of the seat of arbitration.
118 G Aksen, 'The Law Applicable in International Arbitration – Relevance of References to Trade Usages' in (1994) 7 *ICCA Congress Series* 470; Derains, 1972, op. cit. fn 2, p. 99.

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principles of international commercial law (or the so-called '*lex mercatoria*')[119] has led to considerable debate on the topic.[120]

7.1 Choice of the *lex mercatoria* by the parties

3.134 Parties to international arbitration proceedings are generally permitted to select a non-national system of law to govern their dispute. This possibility is implicitly recognised in the Model Law. The language of Article 28(1) should be recalled:

> The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Any designation of the law or legal system of a given State shall be construed, unless otherwise expressed, as directly referring to the substantive law of that State and not to its conflict of laws rules. (Emphasis added)

3.135 The reference to 'rules of law' in the first sentence should be distinguished from 'the law or legal system of a given State' in the second sentence. The former logically includes any rules of law, state-based or otherwise,[121] while the latter concerns the situation where the parties have chosen a domestic legal system.[122]

3.136 Section 30(2) of the Malaysian Arbitration Act deviates from Article 28(1) of the Model Law by substituting 'rules of law' for 'the law', which would exclude non-national rules of law. Since most institutional arbitration rules allow parties to select 'rules of law',[123] one may wonder how this Malaysian provision will be interpreted when the parties have chosen such a set of institutional rules. Ordinarily, chosen rules prevail over non-mandatory provisions of the *lex arbitri*. But since the Malaysian legislators appear to have deliberately modified Article 28(1) to restrict the parties' choice of law, choosing a set of institutional rules may be insufficient to reinstate that free choice.

3.137 A party agreement on a non-national system of law to govern a contract can be made in a countless number of ways, including references to the *lex mercatoria*, general principles of international trade law, etc. A typical example is the following clause which was contained in a contract relating to the supply

119 The concept of the *lex mercatoria*, or law of merchants, dates back to the Middle Ages, but was revived in modern times by scholars like B Goldman, 'Frontiers du droit et "lex mercatoria"', (1964) 9 *Archives de Philosophie du Droit* 177.
120 For a clear overview of these debates and issues see generally M Pryles, 'Application of the Lex Mercatoria in International Commercial Arbitration', (2003) 18(2) *Mealey's International Arbitration Report* 1.
121 Note that some commentators question whether Article 28(1) was intended to allow parties to choose the *lex mercatoria*. See, e.g. HM Holtzmann and JE Neuhaus, *A Guide to the UNCITRAL Model Law on International Commercial Arbitration: Legislative History and Commentary*, Kluwer, 1989, pp. 766–769 and D Caron, L Caplan and M Pellonpää, *The UNCITRAL Arbitration Rules – A Commentary*, Oxford University Press, 2006, p. 128 suggesting that 'rules of law' is limited to established texts or conventions, but excludes unwritten laws like the *lex mercatoria*.
122 Article 28(1) of the Model Law applies unmodified, or similarly, in Australia, Hong Kong, Singapore, New Zealand, India, Japan, the Philippines and South Korea. Malaysia is discussed below.
123 A provision equivalent to Article 28(1) of the Model Law in the sense of allowing parties to choose 'rules of law' exists in most Asia-Pacific institutional rules. Exceptions are Article 34.1 of the ACICA Rules ('the law') and Article 15(1) of the BANI Rules ('the law').

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of energy between an Asian state-owned energy provider and a foreign private company, which stipulated that:

> Any questions relating to this contract which are not expressly or implicitly settled by the provisions contained in this contract shall be governed by the principles of law generally recognized in international trade as applicable to international distribution contracts, with the exclusion of national laws.

3.138 In another interesting example, the parties appear to have sought the application of the principles of law common to both of their legal systems, and failing such common principles by a form of *lex mercatoria* applicable in 'civilised nations':

> The signatories base their relations with respect to this Agreement on the principles of goodwill and good faith. Taking into account their different nationalities, this Agreement shall for the purpose of arbitration be given effect and shall be interpreted and applied in conformity with principles of law common to [Country A] and [Country B] and, in the absence of such principles, then in conformity with the principles of law normally recognized by civilized nations in general, including those which have been applied by international tribunals.

3.139 A non-national system of law should not be agreed to without careful consideration. While it may appear attractive in the context of a transnational negotiation to select as the governing law something like 'the principles of law normally recognised by civilised nations in general', such attractiveness comes at the price of certainty and predictability. What is a civilised nation? Does the notion of a civilised nation change in time or is it stagnant? Where do we find the principles of law recognised by civilised nations? What is the impact of 'normally' – does it mean that the arbitrators can find a principle of law but then choose not to apply it?

3.140 For all these reasons, it is not surprising that while parties are generally permitted to choose a non-national system of law, they rarely do. In the five-year period from 2004 and 2008, parties in ICC International Court of Arbitration administered arbitrations agreed that their dispute would be governed by general principles of international commercial law, the *lex mercatoria*, the UNIDROIT Principles of International Commercial Contracts, or some equivalent in a total of only 19 choice of law clauses.[124] This figure is insignificant given that the ICC Court's total case load over that same period was 2937 arbitrations. The low figure shows that the excitement about the *lex mercatoria* in certain academic circles far outweighs its practical utility and significance. On the other hand, it shows that the *lex mercatoria* is not an esoteric concept that is never used. This is also confirmed by the fact that, despite the relatively infrequent choice of the

124 We refer to 'choice of law clauses' rather than 'arbitrations' intentionally here as there are slightly more choice of law clauses than arbitrations. Furthermore, the figure of 19 does not include agreements indicating that the 1980 UN Convention on the International Sale of Goods should apply (25 such choice of law clauses in that period), or other international conventions (such as 'The Hague Convention on Law' and the 'Geneva Convention', each chosen once), or attempts by parties to choose regional laws (such as 'OHADA law' (OHADA being the Organisation pour l'Harmonisation en Afrique du Droit des Affaires) and 'European Economic Community law', each chosen twice), nor does it include the choice of *ex aequo et bono/amiable compositeur*, which is dealt with in Section 8 below.

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lex mercatoria as governing law, it is more frequently referred to by arbitrators to fill gaps in a domestic law or to support general findings in their decisions that are based on some domestic law.

7.2 Choice of the *lex mercatoria* by the arbitral tribunal

3.141 Aside from the ability of parties to choose a non-national system of law, it is theoretically possible for an arbitral tribunal to decide to apply non-national law where the parties have failed to choose the governing law. This is not considered to be permitted in Model Law jurisdictions. In contrast to Article 28(1) of the Model Law, which allows the parties to choose 'rules of law', Article 28(2) restricts the arbitral tribunal's selection in the absence of party choice to 'the law . . . '. When reading Articles 28(1) and 28(2) together, it seems that the intention was to restrict arbitrators to selecting a domestic law. This interpretation is supported by commentators.[125]

3.142 Some jurisdictions in this region have gone further than Article 28(2) of the Model Law to ensure that the arbitral tribunal cannot select non-national laws in the absence of party choice. Article 36(2) of the Japanese Arbitration Law limits arbitrator choice to 'the substantive law of the State . . . '.[126]

3.143 India has gone the opposite direction, modifying the Model Law in such a way as to empower arbitrators to select non-national laws. Section 28(b)(iii) of the Conciliation and Arbitration Act provides that, in the absence of party choice, the arbitral tribunal 'shall apply the rules of law it considers to be appropriate given all the circumstances'. (Emphasis added)

3.144 Most Asia-Pacific institutional rules follow the Model Law approach in this regard, with the exception of HKIAC, KCAB and ACICA. The HKIAC and KCAB Rules allow arbitral tribunals to select 'rules of law'. This is interesting since the arbitration laws of neither Hong Kong nor Korea permit this under their equivalent of Article 28(2) of the Model Law. Article 34(1) of the ACICA Rules is very curious. It provides that 'The Arbitral Tribunal shall apply the law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the Arbitral Tribunal shall apply the rules of law which it considers applicable'. (Emphasis added) Thus it appears that the ACICA Rules restrict party choice to 'the law', whereas arbitrators may choose 'rules of law'. This may well be a drafting oversight.[127]

3.145 While arbitral tribunals are sometimes permitted to select non-national rules of law, they should think carefully before doing so.[128] The rarity (noted above)

125 See, e.g. Holtzmann and Neuhaus, op. cit. fn 121, pp. 764–772.
126 Article 29(2) of the Korean Arbitration Act similarly refers to 'the law of the State . . . '. For comments on the *lex mercatoria* from the Japanese perspective see L Nottage 'Practical and Theoretical Implications of the Lex Mercatoria for Japan: CENTRAL's Empirical Study on the Use of Transnational Law', (2000) 4 *Vindobona Journal* 132.
127 This point is taken up and discussed further, and with a suggested solution, in Chapter 4 of L Nottage and R Garnett (eds), *International Arbitration in Australia*, Federation Press, forthcoming 2010.
128 For some examples of arbitral awards where arbitral tribunals have decided to apply, or reject the application of, the *lex mercatoria*, see Pryles, op. cit. fn 120, p. 16 et seq.

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of parties choosing non-national rules in their contracts, as mentioned earlier, suggests that international businesses are not especially fond of them, probably because of the absence of certainty and depth in their content.

3.146 It is more acceptable for arbitral tribunals to apply – but still with considerable caution – non-national rules of law or general principles of international commercial law to substitute, fill gaps in or even occasionally to interpret domestic laws.[129] As noted in the previous section, international arbitrators occasionally also apply the *lex mercatoria* as a trade usage, although doing so is rare.

7.3 Discussion of the *lex mercatoria*

3.147 There is a rich and romantic academic debate about the content and even existence of so-called bodies of law such as the *lex mercatoria*. It is certain that – if it exists – the *lex mercatoria* is a law. An arbitrator applying it is not somehow authorised to apply his own view on the general principles of law. Nor can he apply general notions of fairness and justice without reference to law.[130] He must rather search out and determine the content of the *lex* on a particular point and then apply it, just as he would apply a domestic law. This is well explained by Lord Mustill:[131]

> The *lex mercatoria* is a *lex*, albeit not yet perfected. It creates norms which an arbitrator must seek out and obey in every case to which the *lex* applies. Whether the reason for its application is understood to be an express or implied agreement between the parties, or the concept that it forms the essential juridicial context of the bargain, there is no room here for the arbitrator to impose his own ideas, unless of course they happen to coincide with the rules of the *lex mercatoria*: for if he does so, he falsifies the transaction. Naturally, everyone hopes that the *lex mercatoria* will in every case yield a solution which will seem fair to all. But even if this expectation is disappointed, the *lex mercatoria* must still prevail; otherwise it would not be a law. Thus, since the prime maxim of the *lex mercatoria* is *pacta sunt servanda*; an arbitrator who smoothes the corners of a contract which seem to him too sharp is not complying with his mandate.

3.148 There have been various attempts effectively to codify the *lex mercatoria*. One is the UNDROIT Principles of International Commercial Contracts, first published in 1996 and then revised in 2004, with a further revised version currently being prepared. They set out basic principles of contractual formation, interpretation and obligations in a somewhat civil law influenced manner, but in a user-friendly, flexible, logical structure. Like most soft law in international arbitration, the UNIDROIT Principles have no independent force of law unless parties expressly select them, in which case they apply quasi-contractually. They are also occasionally applied by arbitrators as a restatement of the *lex mercatoria*.

129 See in this regard KP Berger, *International Economic Arbitration*, Kluwer, 1993, p. 563; J-F Poudret and S Besson, *Comparative Law of International Arbitration*, 2nd edn, Thomson, 2007, para 696; Lew, Mistelis and Kröll, op. cit. fn 26, para 18–42; Craig, Park and Paulsson, op. cit. fn 111, p. 623.
130 See Section 8 below on *ex aequo et bono* and *amiable composition*.
131 M Mustill, 'The New Lex Mercatoria: The First Twenty-five Years', (1988) 4(2) *Arbitration International* 86, at p. 103.

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Another well-known attempt at codification is German Klaus Peter Berger's book *The Creeping Codification of the Lex Mercatoria* (Kluwer, 1999), which formed the basis for his more recent and commendable CENTRAL Transnational Law Database, which describes itself as 'the world's first' in providing 'international practitioners and academics with an easy-to-use online knowledge & codification platform for transnational commercial law, the New Lex Mercatoria'.[132]

3.149 While these attempts at codification are truly impressive, one may wonder about their global utility. It is quite possible that the content of the *lex mercatoria* varies according to the peculiarities of the parties and the particular dispute in question. For example, the content of the *lex mercatoria* might be different when a question of law arises between parties from Thailand and Indonesia, as compared to the same question of law arising between parties from Singapore and Hong Kong, or parties from Germany and France. The point is well summarised by a former Chief Justice of New South Wales, Australia:[133]

> It seems to me that [the *lex mercatoria*] equates universality with only the European world. This alleged universal law merchant held no sway in India, or China and even less in the less developed or undiscovered parts of the world. Thus, the cry of universality must surely ring hollow. In much the same way, the new *lex mercatoria* can hardly be said to bear the imprint of universality. Is it seriously suggested that the trade usages of the highly sophisticated international conglomerates in the Western world are to be found or accepted in less developed commercial societies? It seems to me that there is a new *lex mercatoria* in the same very confined way that there was once in the Middle Ages.

3.150 It should also be noted in this regard that the whole concept (or at least the alleged substantive content) of the *lex mercatoria* is sometimes criticised as being overly Westernised, designed to enable Western multinationals to escape local laws that that are unhelpful to them.[134] Such criticisms may well derive from some rather one-sided historical applications of a so-called *lex mercatoria*. A good example is Lord Asquith's infamous decision in the *Abu Dhabi* oil arbitration.[135] His decision on the proper law of the contract was critical to the outcome of the case. Applying conflict of laws principles, Lord Asquith acknowledged that Abu Dhabi law would be appropriate because the contract was made in Abu Dhabi and was to be performed there. He concluded, however, that:[136]

132 See www.tldb.net. See also UNILEX, at www.unilex.info, which provides cases and materials on the UNIDROIT Principles and also KP Berger (ed), *The Practice of Transnational Law*, Kluwer Law International, 2001.
133 A Rogers, 'Contemporary Problems in International Commercial Arbitration', (1989) *International Business Lawyer* 154, at p. 158.
134 See, e.g. Toope, op. cit. fn 57, p. 96 who describes the *lex mercatoria* as an effort to 'legitimize as law the economic interests of Western corporations' and M Sornarajah, 'The UNCITRAL Model Law: A Third World Viewpoint', (1989) 6(4) *Journal of International Arbitration* 7 ('Third World countries are likely to be more wary of encroachments on their sovereignty in the name of transnational mercatorialism than other states') and at p. 16 ('The so-called lex mercatoria is a creation of a coterie of Western scholars and arbitrators who have loaded it with norms entirely favourable to international business', 'it could become the vehicle for the introduction of norms that are inimical to the interests of developing countries').
135 *Petroleum Dev (Trucial Coast) Ltd v Sheikh of Abu Dhabi*, (1952) 1 *International and Comparative Law Quarterly* 247. Some background to this case was provided in Chapter 1, para 1.22.
136 Ibid., at pp. 250–251.

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> [the Sheik, an] 'absolute, feudal monarch' . . . administers a purely discretionary justice with the assistance of the Koran; and it would be fanciful to suggest that in this very primitive region there is any settled body of legal principles applicable to the construction of modern commercial instruments.

3.151 Lord Asquith decided to apply 'principles rooted in the good sense and common practice of the generality of civilised nations – a sort of "modern law of nature"'. He declined to apply English law directly, but presumptuously determined that 'some of its rules are . . . so firmly grounded in reason, as to form part of this broad body of jurisprudence' and are 'principle[s] of ecumenical validity' and 'mere common sense'.[137] Using this 'modern law of nature', Lord Asquith applied the English rule which 'attributes paramount importance to the actual language of the written instrument in which the negotiations result' and determined the case predominantly in favour of the English oil concession holder.

3.152 Lord Asquith's characterisation of Middle Eastern law as primitive was controversial. El-Kosheri criticises it as a 'lack of sensitivity towards the national laws of developing countries', blaming it on 'ignorance, carelessness or . . . unjustified psychological superiority complexes'.[138]

3.153 As hinted at above, doubt is sometimes cast on the very existence of the *lex mercatoria*. Indeed it can be argued that its existence has not been necessary because domestic laws have always regulated private commercial dealings. This can be contrasted with the public international law sphere where the inapplicability of private law has led to the evolution of 'customary international law' to regulate the conduct between nation states. On the other hand, while the traditional subjects of public international law (states) are different from those in private international law (individuals, companies and states acting as commercial entities), there is no reason why customary laws should not also have evolved for transnational commercial law. We therefore consider it difficult to deny the existence of a *lex mercatoria* in some form.

3.154 The main drawback of the *lex mercatoria* is uncertainty in the determination of its content. If it exists, then its content could not possibly be temporally, geographically or circumstantially stagnant, but should rather be considered as dynamic, depending, among other factors, on the parties' backgrounds and the peculiarities of their commercial relationship. Given the almost infinitely diverse combination of these variants, once the appropriate principles of law are established, it would be surprising if their depth to resolve complex commercial questions is really adequate. In other words, while it might set forth general principles, trying to establish the content of detailed, technical provisions of the *lex mercatoria* seems futile.

3.155 Starting from the unquestionable principle that it would be inappropriate for Western companies (or anyone else for that matter) to impose on non-Westerners their own view of what commercial law should be, the main perceived benefit

137 Ibid., at p. 251.
138 AS El-Kosheri, 'Is There a Growing International Arbitration Culture in the Arab-Islamic Juridical Culture?', (1996) 8 *ICCA Congress Series* 47, at p. 48.

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of using the *lex mercatoria* must be to guarantee *pacta sunt servada* and to ensure that international dealings are resolved in a way that recognises their international character, rather than by applying potentially rigid and occasionally ill-suited domestic laws. If that is the goal, then the *lex mercatoria* is not necessary for achieving it. That goal is achieved in any event because wise international arbitration lawyers and arbitrators focus on the contract and the parties' relationship and will apply domestic laws in an internationally sensible way. Moreover, provisions such as Article 28(4) of the Model Law, discussed in the previous section, help to preserve *pacta sunt servada* and a common sense approach to resolving international commercial disputes. It might therefore be the case that parties should draft their contracts carefully and choose their lawyers and arbitrators wisely rather than selecting a somewhat elusive *lex mercatoria*. For all these reasons, the minimal use of the *lex mercatoria* these days is unsurprising.

8 Deciding cases without law: *Ex aequo et bono* and *amiable compositeur*

3.156 Both the Model Law and most institutional arbitration rules permit an arbitral tribunal to decide a case as '*ex aequo et bono or as amiable compositeur*'.[139] In brief, this means deciding a case based on principles of fairness and justice without necessarily following the law. The terms '*ex aequo et bono*' and '*amiable compositeur*' have much the same meaning. The concept they represent can alternatively be referred to as '*general principles of justice and fairness*'.[140] For the purposes of this discussion we mainly use the term *ex aequo et bono*.

3.157 Deciding disputes *ex aequo et bono* is very rarely permitted in domestic courts.[141] Courts must apply the law. The possibility for parties to empower an arbitral tribunal to decide *ex aequo et bono* is therefore an advantage of arbitration over litigation. *Ex aequo et bono* may be preferable where the parties consider that the law is not well suited or is insufficiently evolved to meet their particular needs and/or where a key priority is to preserve their long-term business relationship. Agreements on *ex aequo et bono* are therefore more common in long-term contracts than short-term contracts.

139 Article 28(3) provides in full: 'The arbitral tribunal shall decide ex aequo et bono or as amiable compositeur only if the parties have expressly authorized it to do so.' This applies unmodified, or in a very similar form, in Australia, Hong Kong, Singapore, New Zealand, India, Japan, the Philippines and South Korea. Other domestic laws are dealt with below. An equivalent provision exists in the following institutional rules: KLRCA, SIAC, HKIAC Administered, BANI, JCAA, KCAB. Article 34.2 of the ACICA Arbitration Rules adds a requirement that deciding in this way be consistent with the applicable procedural law: 'The Arbitral Tribunal shall decide as amiable compositeur or ex aequo et bono only if the parties have, in writing, expressly authorized the Arbitral Tribunal to do so and if the law applicable to the arbitral procedure permits such arbitration.'(Emphasis added)

140 This is the language used in Section 24(4) of the Sri Lankan Arbitration Act.

141 An exception for certain UK courts is noted in the Final Report of the ICC Commission on Arbitration's Task Force on Amiable Composition and *ex aequo et bono*, September 2008, pp. 9–10.

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3.158 Several arbitration laws in this region go against the norm and do not permit arbitral tribunals to decide based on *ex aequo et bono*. The Model Law has been modified in Malaysia and Bangladesh such that there is no provision about deciding *ex aequo et bono* or similar in the arbitration legislation of these two states. One commentator has suggested, in respect of Bangladesh, that deciding *ex aequo et bono* would be possible provided that the chosen arbitration rules allow it.[142] The rationale for this view is that the law is simply silent on the issue rather than prohibitive. We are not entirely convinced by this suggestion. When a jurisdiction bases its law on the Model Law but deliberately omits a provision such as this, as is the case for Malaysia and Bangladesh, it might well be considered that the legislators intended to exclude the possibility for parties to refer disputes to an *ex aequo et bono* decision.

3.159 Another law which does not allow *ex aequo et bono* is that of Vietnam. The Vietnamese Ordinance on Commercial Arbitration requires that disputes submitted to arbitration be resolved according to law,[143] saying nothing about *ex aequo et bono*, *amiable compositeur*, or similar. This has led one commentator to conclude that deciding as *amiable compositeur* may not be permitted in Vietnam.[144]

3.160 Where the law or arbitration rules allow decisions based on *ex aequo et bono*, the parties must expressly request and authorise the arbitral tribunal to proceed in this manner. Thus Article 28(3) Model Law provides that 'the arbitral tribunal shall decide ex aequo et bono or as amiable compositeur only if the parties have expressly authorized it to do so'. A similar requirement for an express agreement can be found in most Asia-Pacific arbitration laws[145] with two exceptions.

3.161 The first exception is Article 56 of the Indonesian Arbitration Law which provides simply that 'The arbitrator or arbitration tribunal shall render its decision based upon the relevant provisions of law, or based upon justice and fairness'. There is no express requirement for an agreement of the parties. The second exception is China. According to Jingzhou Tao, while the Chinese arbitration law does not refer to *ex aequo et bono* in the same way that the Model Law does, Chinese arbitration commissions are empowered to render decisions based on such equitable principles, and it is in fact impossible for the parties to request the arbitral tribunal to ignore such principles and decide the case strictly according to law. He concludes, however, that an arbitral tribunal cannot ignore the law altogether as it might be able to do under the Model Law.[146]

3.162 Despite the exceptions just mentioned, party agreement is normally required to authorise the arbitral tribunal to decide *ex aequo et bono*. While there is no

142 AFM Maniruzzaman, 'The New Law of International Commercial Arbitration in Bangladesh: A Comparative Perspective', (2003) 14 *American Review of International Arbitration* 139, at p. 163.
143 See Articles 3(2) and 7(2) of the 2003 Vietnamese Ordinance on Commercial Arbitration.
144 Hop X Dang, 'Towards A Stronger Arbitration Regime For Vietnam', (2007) 1 *Asian International Arbitration Journal* 80, at p. 95.
145 See above footnote 139.
146 See Jingzhou Tao, op. cit. fn 18, pp. 105–106, also referring to Hu Li, 'Arbitration *ex aequo et bono* in China', (2000) 66(3) *Arbitration* 188. See also Article 43(1) of the CIETAC Rules which provides that 'The arbitral tribunal shall independently and impartially make its arbitral award on the basis of the facts, in accordance with the law and the terms of the contracts, with references to international practices and in compliance with the principle of fairness and reasonableness'.

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form requirement for such an agreement,[147] it is prudent for arbitral tribunals to ensure that the agreement is clear, specific and either made in writing or evidenced in writing. In *Hewitt v McKensey*,[148] Hewitt sought to set aside an arbitral award before the Supreme Court of New South Wales, Australia, on various grounds including that the arbitrator had acted as *amiable compositeur* without authorisation from the parties. The sole arbitrator's award stated that the parties had authorised him to act as *amiable compositeur* during a preliminary conference at which the procedure for the arbitration was discussed. However, Hewitt testified during the setting aside proceedings that neither he nor his solicitor, who had been present at the preliminary conference, could recall that agreement having been reached. The judge concluded that, in the circumstances, there was insufficient evidence that the parties had authorised the arbitrator to act as *amiable compositeur*, noting:[149]

> The passage that I have just quoted [about the preliminary conference] was followed by a statement that [the arbitrator] 'would prepare minutes containing his directions, which he would circulate to the parties'. One would have thought that something as important as an agreement [to act as amiable compositeur] even if not in writing . . . would have been recorded in those minutes had it been struck at the preliminary conference.

3.163 The judge consequently found that the sole arbitrator had misconducted himself. The request to set aside the award was ultimately rejected though because the judge was not convinced that the sole arbitrator would have reached a different conclusion on the merits had he applied the law rather than acting as *amiable compositeur*.

3.164 One may wonder what *ex aequo et bono* actually means for the arbitrator's decision-making process. For the avoidance of doubt, it is useful at this point to distinguish *ex aequo et bono* from the *lex mercatoria*, which was discussed in the previous section. The *lex mercatoria* is a body of law, only no universally accepted written version of it exists. If the *lex mercatoria* is the applicable law, the arbitral tribunal must first work out its relevant content and then apply it, just as it would apply some domestic law once its content is determined. On the other hand, deciding a case *ex aequo et bono* is certainly not the same as applying a law or even 'gap filling' mechanisms for contracts. It is also not the same as applying principles of 'equity' in the sense of the common law doctrine and remedy. Making a determination *ex aequo et bono* is a distinct approach to dispute resolution which must be separated from the law and any mechanisms that might be contained in it. Thus Lord Mustill has noted that 'the essence of

147 One exception is that under Section 22 of the uniform Australian state Commercial Arbitration Acts, which occasionally apply to international arbitrations in Australia, the parties must agree in writing in order for the arbitrator to decide the case 'by reference to considerations of general justice and fairness'.
148 *Hewitt v McKensey* [2003] NSWSC 1186 (16 December 2003).
149 Ibid., at para 54. It should be noted that this arbitration was governed by the New South Wales Commercial Arbitration Act which does require, at Section 22, that an agreement for the arbitrator to act as *amiable compositeur* must be in writing. The judge considered it unnecessary for him to decide the effect of there not having been a written agreement since there was insufficient evidence of an oral agreement in any event.

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amiable composition is to dispense the arbitrator from the duty of enforcing any system of law'.[150]

When deciding *ex aequo et bono*, an arbitrator is thus relieved from applying the law. Rather than turning to the law, the arbitral tribunal should apply common commercial sense, making its decisions based on what it deems to be fair and reasonable, taking into account the peculiarities of the parties' relationship. While the arbitral tribunal is still required to provide reasons for its decisions, the reasoning need not be legal reasoning but should rather be based on principles of fairness and justice. It has been said that if an arbitrator acting as *ex aequo et bono* wishes to rely on and apply the law, he must explain and justify why he is doing so.[151] 3.165

In a detailed analysis of *ex aequo et bono*, Trakman explains that:[152] 3.166

> If the adjudicative decision is to be 'fair', it must be fair against the background of the practical reasonableness of the respective claims of the parties. If it is to be 'just', it must produce consequences that are just in light of customs and usages that are related to the interests of those parties. If it is to be practically reasonable, it must be reasonable in light of the interdisciplinary context surrounding the dispute, not because of the wholly personal conceptions of fairness of whosoever happens to be the adjudicator.
> ...
> In particular, the process of deciding *ex aequo et bono* is grounded in notions of common sense, practical expediency and fairness that are not necessarily attributed to law. Ultimately, internal limits upon discretion *ex aequo et bono* depend on a functional not a formal process of reasoning. They hold that, no matter how informal and expeditious, adjudicative proceedings should be transparent and applied evenhandedly to the parties.
> ...
> the foundations of ex aequo et bono are situated in realistic decision-making that is directed at resolving practical but often complex problems. The decision-maker is bound neither to apply nor to disregard the law as a matter of principle, but to exercise discriminating judgment on the practical reasons by which to decide each case. Those practical reasons are informed by specific patterns of fact, by identifiable party practices and by applicable customs and usages. The practical reasons that guide decisions ex aequo et bono may also justify adopting alternative processes of dispute resolution, including but not limited to those that are provided for by law.

While arbitrators deciding *ex aequo et bono* need not apply the law, there is some debate as to whether they should apply the terms of the parties' contract literally, or whether they may digress from those terms. One expert contends that 3.167

150 Mustill, op. cit. fn 131, p. 103.
151 Detailed guidelines on how an arbitrator acting *ex aequo et bono* should conduct himself and the arbitration are provided in 'Amiable Composition: Report of ICC France Working Group', *International Business Law Journal/Revue de Droit des Affaires Internationales*, Article No. 6 of Dec 2005, pp. 753–768.
152 L Trakman, 'Ex Aequo et Bono: De-mystifying an Ancient Concept', (2007) *University of New South Wales Faculty of Law Research Series* 39, at Sections V, VI and VII respectively (footnotes omitted). L Trakman is the former Dean of Law at the University of New South Wales, Australia. See also M Rubino-Sammartano, 'Amiable Compositeur (Joint Mandate to Settle) and Ex Bono et Aequo (Discretional Authority to Mitigate Strict Law): Apparent Synonyms Revisited', (1992) 9(1) *Journal of International Arbitration* 5.

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'the better view, adopted by a majority of commentators and other authorities, is that arbitrators may depart from the terms of the parties' contract in fashioning a fair and equitable result, provided that they do not rewrite the structure of the agreement'.[153] However, this does not seem to sit comfortably with the Model Law. Article 28(4) of the Model Law provides that 'in all cases' the arbitral tribunal must decide in accordance with the contract and trade usages. The positioning of Article 28(4) numerically *after* Article 28(3) suggests that Article 28(4) applies to and limits Article 28(3).

3.168 This issue was examined in a case before the Court of Appeal of Quebec, Canada, interpreting the equivalent article of the Quebec Code of Civil Procedure, which is based on the Model Law.[154] The main issue was whether the arbitrator, under Article 944.10(3) of the Code of Civil Procedure, had exceeded his mandate of *amiable compositeur* when he decided to ignore two provisions of the parties' contractual accounting formula. The court affirmed that the arbitrator had indeed exceeded his powers. As such, it found that Article 944.10(3) applies both to an 'ordinary' arbitrator as well as one acting as *amiable compositeur*. Although an arbitrator is entitled to a certain degree of discretion[155] when acting as *amiable compositeur*, he cannot remove or rewrite provisions in the parties' contract, unless the parties have explicitly authorised him to do so.[156] In the course of her judgment, Judge Bich noted:[157]

> **Par. 66** The difference between an 'ordinary' arbitrator and an arbitrator acting as amiable compositeur therefore rests mainly on the fact that the former is bound to apply the rules of law, mainly the 'rules of positive law', . . . regardless whether the law in question is mandatory, whereas the latter, who is still bound by rules of public policy, including the rules of natural justice, can, on the basis of equity, interpret the applicability of non-mandatory laws or can even decide to depart from them in a manner conforming to the general principles of law . . . .
>
> . . .
>
> **Par. 99** The power of amiable composition cannot, and should not, call into question the fact that an arbitrator's primary role is to adjudicate disputes and not to substitute his own views for those of the parties in renegotiating disputed contractual clauses.
>
> **Par. 100** Although there is a fine line between contractual interpretation and contractual revision with a view to adapting the contract to changed circumstances, it should be highlighted that granting the power of amiable composition does not ipso facto grant a power of adaptation. The parties must be explicit if they intend to grant that power to the arbitrator.

3.169 The Court of Appeal's approach seems sensible. First, it conforms with the plain language of Article 28(4) of the Model Law. Second, it is legally logical.

153 Born, 2009, op. cit. fn 27, p. 2242. See also the discussion in the Final Report of the ICC Commission on Arbitration's Task Force on Amiable Composition and *ex aequo et bono*, September 2008, p. 12 et seq.
154 *Coderre v Coderre* (2008 QCCA 888), Court of Appeal of Quebec, 13 May 2008. Article 944.10 of the Quebec Code of Civil Procedure is almost identical to Article 28 of the Model Law except that it omits Article 28(1).
155 Ibid., see particularly at para 95.
156 Ibid., see particularly at paras 82–87 and 98.
157 Authors' own translation from the original French.

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International arbitration is essentially contractual so arbitrators should, so far as possible, limit themselves to what the parties have agreed. That is true regardless of the applicable law or whether the arbitral tribunal has been authorised to decide *ex aequo et bono*. In general the parties' true intentions should prevail over the plain language of a contractual clause, a rule of contract interpretation that is recognised in some form in most legal systems. But it would seem to us that only in an extreme case of unfairness should an arbitrator deciding *ex aequo et bono* ignore or modify the terms of the parties' contract, unless the arbitrator has been explicitly authorised to do so.

3.170 As also indicated in the extract from Judge Bich's judgment above, there are other legal limits to what an arbitrator deciding as *ex aequo et bono* can do. He or she is of course still limited by public policy and mandatory rules of law, just as an arbitrator applying the law is so limited.

3.171 In practice, parties very rarely expressly empower an arbitral tribunal to decide *ex aequo et bono* or similar.[158] Perhaps parties and their legal advisors prefer the structure and perceived predictability of the law and are comforted by the fact that international arbitrators will generally strive to ensure that the outcomes of their decisions are fair. Nonetheless, *ex aequo et bono* clauses may be to the distinct advantage of parties where the law is not well suited to their relationship. More guidance – such as that from the Quebec decision mentioned above – may provide parties with increased confidence in *ex aequo et bono* in the future.

158 The ICC International Court of Arbitration received approximately three new arbitrations each year from 2003–2008 where the parties agreed that the arbitrator would decide the case *ex aequo et bono* or similar. In one ICC case in 2010, the parties decided to change their choice of law (originally a state law) for amiable composition mid way through the arbitration proceedings, after a partial award had been issued but before a final award was issued.