Applicable Substantive Law

Simon Greenberg

October 2014

CLIFFORD
CHANCE

Introduction

- Everything about governing law in international arbitration
- Focus on substantive law after identifying types of choice of law issues
- **NB**: very different in ICSID arbitration

Types of conflict of law issues in International Arbitration

- Very interesting subject[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.

- But not at all as complex in IA!
- Difference between *lex fori* and *lex arbitri*. (NB: this is relevant to entire course, not just applicable law)

[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.*

Types of conflict of law issues in International Arbitration

- Many more choice of law issues can arise in IA 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:
  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?

Determining the law applicable to the substance of the dispute

- Is a law necessary?
- Compare ML Art 28 and ICC Art 21
- *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.
  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.

Freedom of parties to choose the law

- Most important principle.
- No need for any connection between substantive law and underlying dispute, unlike traditional approach in domestic courts
  - Some restrictions for domestic arbitrations in certain jurisdictions
  - Restriction of “mandatory laws”
- Usually parties do choose it: about 90% of the time (has been gradually increasing in time)

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

- *'Conflict of laws rules' and 'direct' approaches*
- Compare ML and ICC provisions.
- Conflict of laws methodology is adopted
  - NB: this is often not given sufficient attention by arbitrators, but the decision on governing law can have an important impact on the parties' substantive rights
  - NB 2: a different law may apply to non-contractual claims (see book p. 114 *et seq.*)
  - Unfortunately not enough time to go into these interesting matters further in class

Mandatory laws and public policy

- Imperative provisions of law that are imposed on arbitrating parties regardless of their choice of law.
- Very rare in practice but something to be aware of
- Examples?
- Procedural?
- Substantive?
  - Need close connection between the underlying facts and the law itself

Mandatory laws and public policy

- Pierre Mayer explains that[2]:

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

[2] *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.*

Mandatory laws and public policy

- Article 9 of EU Rome Regulation provides useful definition of mandatory laws:
  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 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.

Mandatory laws and public policy

- See examples, book p 122. High burden to establish applicability

- Issue of application of mandatory laws based on a party's request, or on the arbitral tribunal's own initiative. Raises question about an arbitral tribunal's role, and the limitations of its functions

Content of the applicable law

- Needs to be proved, similarly to the position in common law courts
- However it is not a question of fact – or is it? Is there any distinction between questions of law and fact in international arbitration?
- Also, no presumption of law of the forum if the parties do not prove that the governing law has a different content
- Often happens that some or all arbitrators are not experts in the applicable law. Even possible there are no counsel who are experts in it
- So how it is established?
- No strict rules – but what must always be respected?
- What about *iura novit curia*?

Content of the applicable law

- ILA Report:

  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.

Trade usages

- A peculiarity in international arbitration
- Can arise in practice
- Article 28(4) ML ‘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’.
- Possibly even general trade usages for international dealings which are similar to the *lex mercatoria*.

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

- Distinguish from trade usages
- Distinguish from *ex aequo* et *bono/ amiable compositeur*
- Lex mercatoria = law of merchants
- Analogous to customary international law, but for private/ commercial dealings
- Purely *domestic* legal systems may not be suitable for *transnational* cases

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

- **Choice of the *lex mercatoria* by the parties**
  - possibility is implicitly recognised in ML (also in ICC Rules for example). Article 28(1) ML:

    > 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)

  - Contractual example:

    > *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.*

  - Some doubt as to the content of any such general principles, so it may not always be a good idea to choose it.

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

- **Choice of the *lex mercatoria* by the arbitral tribunal**
  - theoretically possible for an arbitral tribunal to decide to apply non-national law
  - See Art 28 ML again; distinction between "rules of law" and "the law". So is it possible?
    - AT generally should not choose it
    - But can use it for gaps/ general guidance
    - As a trade usage as discussed above?

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

- **Discussion of the *lex mercatoria***
  - Interesting and "*romantic*" perhaps? Much academic discussion about what it is, i.e. its content
  - Importantly it is a law, and not an excuse for the AT to decide the case as it wishes

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

- Lord Mustill[3]:

  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 juridical 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] *M Mustill, 'The New Lex Mercatoria: The First Twenty-five Years', (1988) 4(2) Arbitration International 86, at p. 103.*

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

- UNDROIT Principles of International Commercial Contracts,
- Criticism that it is a bit too European. In any event that the content may vary between regions[4]:

> 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.

[4] A Rogers, 'Contemporary Problems in International Commercial Arbitration', (1989) International Business Lawyer 154, at p. 158.

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

- It In any event its content is probably overly Westernised

- Can be useful where it is impossible to agree on a governing law or where one is considered really unnecessary

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

- **Deciding cases without law: *Ex aequo et bono and amiable compositeur***
  - '*ex aequo et bono*' and '*amiable compositeur*' are much the same
  - Very different from *lex mercatoria* as it means deciding without law at all
  - A possibility that does not exist in arbitration
  - But rarely used in practice
  - Not quite clear, or no universal definition, of what it means and how to apply it
  - Can be handy where it is considered essential to preserve the business relationship, e.g. long term contracts

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

- Express authorisation needed, AT cannot apply it of their own accord : Article 28(3) ML

  '*the arbitral tribunal shall decide ex aequo et bono or as amiable compositeur only if the parties have expressly authorized it to do so*'.

- *Hewitt v McKensey example*[5]. Doubt about whether there was an agreement for the arbitrator to act as amiable compositeur[6]:

  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.*

[5] *Hewitt v McKensey [2003] NSWSC 1186 (16 December 2003).*

[6] *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.*

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

- The judge found that the sole arbitrator had misconducted himself. The request to set aside the award was ultimately rejected as no prejudice (there would not have been a different decision).

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

- **Must the contract be applied?**
  - The positioning of Article 28(4) numerically after Article 28(3) suggests that Article 28(4) applies to and limits Article 28(3).
  - Quebec case on Art 28(1). Question whether the arbitrator had exceeded his mandate of *amiable compositeur* when he decided to ignore two provisions of the parties' contractual accounting formula.
  - Although an arbitrator is entitled to a certain degree of discretion[7] 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.

[7] *Ibid., see particularly at para 95.*

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

- ***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.*

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

- ***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.*

- International arbitration is essentially contractual so arbitrators should, so far as possible, limit themselves to what the parties have agreed.

Applicable Substantive Law

CLIFFORD
CHANCE

www.cliffordchance.com

Clifford Chance, 9 Place Vendôme, CS 50018, 75038 Paris Cedex 01, France