CHOICE OF LAW IN INTERNATIONAL COMMERCIAL ARBITRATION

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INTRODUCTION

International commercial arbitration is a means for resolving the disputes that has arisen under the international commercial contracts. In most of the circumstances the contracts have the dispute resolution clause which is used in the situation where if any dispute arises and that matter will be solved through the process of arbitration rather than litigation. The details of the contract can be mentioned at the time of the contract such as governing law, forum etc.

The author's postulate the concern related to determination of substantive law where there is no law mentioned by the parties. The paper explores how it affects the arbitration mechanism as well as how the arbitral tribunals and State courts do the determination of applicable law. Subsequently, it reflects the situation where arbitral tribunal has given preference to transnational law.

It is with this perspective in the mind that when an arbitrator has to decide which law to apply for the solution of the dispute, there may be a contractual clause providing an express choice of law.[189] In this respect, when the party has chosen non - national law then one can consider standards like international law, international customs and transnational law. Similarly, Article 28(2) of the UNICITRAL Model Law permits the arbitrators to determine applicable law on the basis of the conflict rule of

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[189]UNCITRAL Model Law on International Commercial Arbitration art. 28(1), (1958).

their choosing. As a matter of fact, the Rome I Regulation focuses on the law that is applicable to contractual obligations where the seller has his habitual residence.[190]

The statistics from International Chamber of Commerce (ICC) has shown that 20 % of the arbitrations have not mentioned the express choice of law in the contract.[191]At present scenario we handle the international commercial contracts by deciding the place where the contract will be heard and focus is made on the laws or rules that will govern the contract. These are the two important aspects that one has to keep it in mind while considering such contracts. Indeed, it is essential to mention the choice of forum clause as well as choice of law clause in the contract. In this paper the author's postulate on the aspect of choice of law in international commercial arbitration that causes consternation because every country has its own standard as they consider it to have a fair arbitration clause.[192]

Moreover, under Rome Convention the applicable law is the law of the country where the contract will have the closest connection.[193] Similarly, the European Convention on International Commercial Arbitration of 1961 in contrast with the New York Convention as well as Article VII of the European Convention deals specially with the issue of the applicable law in international commercial arbitration.[194]

This is found that the arbitral tribunal may be authorized to decide the dispute on the general principle of fairness and justice without giving reference to a specific law. For instance, it will apply rules of law such as

[190]Rome I Regulation art. 4(1)(b), (2009).
[191]JEFF WAINCYMER, PROCEDURE AND EVIDENCE IN INTERNATIONAL ARBITRATION 992 (1st ed. 2012).
[192]Kitsuron Sangsuvan, *Small Business in International Trade*, 41 S. U. L. REV. 145 (2014).
[193]Rome Convention art. 4(1), (1980).
[194]European Convention art. VII, (1961).

Lex Mercatoria and UNIDRIOT Principles of International Commercial Contract of 2010 without giving reference to any national law.[195]

It is with this perspective the author's have briefly mentioned (Below Section II) the journey of Hague Conference on Private International Law[196]. In 2006 the attention was drawn on the issue of choice of law related to the contracts. Finally, on 19th March 2015 the final version of Hague Principles was approved.[197]

It is, therefore, interesting to study this aspect, a choice of law clause in a contract may only target the substantive contract or may well be interpreted as also covering the arbitration clause. Although, it has been argued by some that the parties' choice of an arbitral seat should be interpreted as a implied choice of law on the arbitration agreement.[198] In the case of the choice of law, the International Council for Commercial Arbitration (ICAA) mandates a more direct selection of the choice of law than contemplated in the Model Law.

Prior to tackling the core concern of application of transnational law in practice instead of applying domestic law, the discretion made by arbitral tribunal while determining the applicability of domestic law has been mentioned briefly (Below Section I) where concern has been given to arbitration conventions, laws as well as rules. It is necessary to begin with arbitral discretion in determination of the applicable substantive law in the absent choice of law by the parties and the approaches in which they are

[195]Susan Gualtier, *International Commercial Arbitration*, GLOBALEX, (Nov./Dec., 2014) , http://www.nyulawglobal.org/globalex/International_Commercial_Arbitration.html.
[196]Rolf Wagner, *Die Bedeutung der Haager Konferenz fur Internationales Privatrecht fur die international Zusammenarbeit in Zivilsachen*, 12 JURA 891 (2011).
[197]HCCH Principles on Choice of Law in International Commercial Contracts, https://www.hcch.net/en/instruments/conventions/full-text/?cid=135.
[198]Gustav Flecke – Giammarco & Alexander Grimm , *CISG and Arbitration Agreements: A Janus - faced practice and how to cope with it*, 25 J. ARB. STUD. 45 (2015).

determined. On the basis of this, the focus is made on transnational law and its significance will be described (Below Section III).

CHOICE OF LAW DISCRETION- APPLICATION OF DOMESTIC LAW

Since the article examine the specific matters in relation to determination of the applicable substantive law in the absence of choice of law by the parties. There are three approaches, which are followed in such context.

PRINCIPLE APPROACHES

In situation where recognition of arbitral discretion is broadly done while determining the applicable substantive law is not mentioned by the parties in such circumstances there are three different approaches that will be followed. To illustrate, an arbitral tribunal will apply closest connected test, recourse to the conflict of law norms which are appropriate and by directly applying the law or rules of the law through arbitral tribunal which are considered to be appropriate and do not require any particular choice of law rule to be referred. For instance, the arbitral tribunals shall apply the law of the state that is most clearly connected to the subject matter of the proceedings.[199]One can apply appropriate conflict of laws norms through arbitral tribunal. Article 28(2) of Model Law depicts that the law determined by the conflict of laws rules that the arbitral tribunal considers appropriate will be applied. On the basis of this reasoning, the French Code of Civil Procedure on the failure of determination by the parties the arbitral tribunals will decide the dispute as per the rules of the law that they consider appropriate.[200]

[199]German Arbitration Act, §1051(2), (1998).
[200]French Code of Civil Procedure, art. 1511 (2011).

ICC Rules under Article 21(1) states that the parties shall be free to agree upon the rules of law to be applied by the arbitral tribunal to the merits of the dispute. Additionally, in the absence of any such agreement, the arbitral tribunal shall apply the rules of law which it determines to be appropriate. Moreover, Article 22(3) LCIA rules [201]is also drawn on same grounds. Subsequently, Vienna International Arbitral Centre rules[202] also shows that if the parties have not determined the applicable statutory provisions or rules of law then in such circumstance the arbitral tribunal shall apply the applicable statutory provisions or rules of law which it considers appropriate.

PRINCIPAL METHODS APPLIED BY ARBITRAL TRIBUNALS

This part of the article explores the principle methods applied by the arbitral tribunal while determining the applicable substantive law in the absence of an agreement with the parties.

CUMULATIVE APPLICATION

The arbitral tribunal uses its direction in determining substantive law when it consists of cumulative application of the domestic conflict norms which are required to be identical or at least focuses on the same domestic law and can be applied when there is convergence between the associated conflict norms. In this the arbitrator will apply the law that is mentioned by both conflict norms. This was applied in a case when there was Irish and French conflict rules in a dispute related to a manufacture who was French and the

[201]LCIA Rules art. 22 (3), (2014) The Arbitral Tribunal shall decide the parties' dispute in accordance with the law(s) or rules of law chosen by the parties as applicable to the merits of their dispute. If and to the extent that the Arbitral Tribunal decides that the parties have made no such choice, the Arbitral Tribunal shall apply the law(s) or rules of law which it considers appropriate.
[202]VIAC Rules art. 27(2), (2013).

distributor of Irish origin.[203]In ICC Case No. 5118, it was also observed on the same grounds as there was an Italian and Tunisian conflict norms between the Tunisian manufacture with two Italian agents.[204]A similar ground has been applied, when there were conflict rules between Egyptian, French and Yugoslav where Yugoslav was the seller as well as the buyer was Egyptian the above mentioned cases were considered under the ambit of cumulative application.[205]

In ICC No. 6149,[206] the arbitral tribunal has applied the law which is designed as the power law by the rule of conflict which they considered appropriate in relation to the old ICC Arbitration Rules. In this the tribunal decided two different conflicts rules. Since it is found that one set comprised of the conflicts rules of the jurisdiction which is mostly connected with the contract and on the another hand, in general principle of conflicts of law which is substantive law mostly connected with the contract that will be applied.[207]The arbitral tribunal compared the conflicts rules of four jurisdictions with Hague convention under Article 3(1) and Article 4 of Rome Convention that focused on the same substantive law.[208]This demonstrates that where all the conflict rules converge then focus is made on same substantive law. In order to decide the choice of law the methodology is directly followed as it provides solution in easier cases.[209]

ii) **Place of Arbitration**: The arbitral tribunal applies the conflict norms of seats when they can be qualified as the general norms in nature related to

[203]ICC Case No. 7319, JEAN JACQUES ARNALDEZ *et al*, COLLECTION OF ICC ARBITRAL AWARDS 1996 - 2000 300, 304 (2003).
[204]ICC Case No. 5118, SIGWARD JARWIN *et al*, COLLECTION OF ICC ARBITRAL AWARDS 1986 - 1990 318, 319 (1994).
[205]*Id.* at 394, 399.
[206]Seller v. Buyer, ICC Case No. 6149, ALBERT JAN VAN DEN BERG, YEARBOOK COMMERCIAL ARBITRATION 41 - 57 (1995)
[207]*Ibid.*
[208]Seller, *supra* note 18, at 46.
[209]GARY B. BORN, INTERNATIONAL COMMERCIAL ARBITRATION 2649 (2nd ed. 2014).

conflict norms of the country of the seat. Sometimes in such situation it can be related with specific conflict norms which are mentioned as the arbitration law of that country[210]. For instance, ICC Case No. 5460[211], it was held that under these conflict norms it was found that South African law was the proper law of the contract instead of Austrian law. In this case a sole arbitrator was sitting in London who heard the matter between an Austrian franchisor and South African franchisee. It was observed that the place of arbitration was London so any question of choice of law will apply rules of private international law of England.

GENERAL PRINCIPLES OF CHOICE OF LAW

For example, if a party considers that the arbitrator has not applied the parties' choice of law then in such situation the approach would be similar to the challenge for failure to follow the parties' remedial limitations. When the parties' are clear about the choice of law then the court would concentrate on this issue whether it is apparent that the arbitrator has followed the parties' choice of law from the face of the award.[212]

It has been stated that it would be more appropriate to apply the general principles of international private law according to international conventions that focuses on sale of movable goods. In ICC case No. 6527, an arbitral court sitting in France considered the dispute between a Turkish seller and a buyer who didn't mentioned his nationally. While determining the applicability of substantive law the tribunal rejected the approach and held that arbitral tribunals are bound by the conflict norms of the seat.[213] One

[210]SAI RAMALI GARIMELLA & STELLINA JOLLY, PRIVATE INTERNATIONAL LAW: SOUTH ASIAN STATES' PRACTICES 22 (1st ed. 2017).
[211]Austrian Franchisor v. South African Franchisee, ALBERT JAN VAN DEN BERG, YEARBOOK COMMERCIAL ARBITRATION 104 (1988).
[212]Sarah Rudolph Cole, *Curbing the Runway Arbitrator in Commercial Arbitration: Making exceeding the power count* , SSRN , 52 (May, 2016) https://ssrn.com/abstract=2773657.
[213]Buyer v. Seller, ALBERT JAN VAN DEN BERG, YEARBOOK COMMERCIAL ARBITRATION 44 - 46 (1993).

particular aspect of most importantly, while considering the choice on the ground the law that governs the contract should be chosen by the parties.[214] And as mentioned above, there are also few principles that are more universally admitted in private international law.[215]

HAGUE PRINCIPLES ON CHOICE OF LAW

One of the keystone is Hague principles, when we look at the objective behind Hague Principles on Choice of Law of 2015 in International Contracts the focus is made on to improve the possibilities of choice of law in commercial contracts as well as emphasis is made on to encourage legal certainty. Within the perspective of this article, in such position the parties should be free to decide on a certain applicable law that can be also during the court procedure and where there is additional costs for the court that are bourne by the parties. From this we can understand that their choice should not be limited to certain sets of rules neither being state made nor private. There should be implied agreements in certain situations in order to improve and develop the predictability.[216]

APPLICABILITY OF TRANSNATIONAL LAW

It is essential to know the significant role played by transnational laws defined in this concept of choice of law in international commercial arbitration. It shows the legal recognition of the right of arbitral tribunal in order to apply transnational law (Below Section A and B).

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[214] Indian Company v. Pakistani Bank, ICC Case No. 1512, ALBERT JAN VAN DEN BERG, YEARBOOK COMMERCIAL ARBITRATION 128 (1976).
[215] *Id.* at 130 .
[216] Andreas Schwartze, *New trends in parties' options to select the applicable law? The Hague principles on choice of law in international contracts in a comparative perspective* 12 U. ST. THOMAS L. J. 99 (2015 - 2016).

LEGISLATIVE RECOGNITION

It is essential to note that the arbitral tribunal should not be obligatory to apply a conflict of laws rules. The second situation, which does not follow under such circumstances, is where the acceptance is the recognition of the right to apply transnational rules instead of specific domestic law. Under French law if the choice of law is not mentioned then arbitral tribunal will apply the rules of law that they consider it to be appropriate[217]. The arbitral tribunal while applying rules of ICC under Article 21(1), Article 27(2) in the VIAC as well as Article 22(3) in the LCIA it is found that it applies even similar applicability.

APPLICATION IN PRACTICE

In the absence of choice of law by the parties the arbitral tribunal have applied transnational law and the court decisions are reflected through application of three doctrines among of which is tronc commun where one should apply rules common to the parties legal system. According to the doctrine of tronc commun the arbitral tribunal will apply rules that are common to the parties. When it is agreed by the parties in such situation it is easily applicable another wise it results in independent decision making of the arbitral tribunals. However, it has limitation in practice as it can be only effective if relevant rules are applied. It consists of cumulative application of the parties' respective laws. This method is helpful in relation to state contracts since the unbalance between the respective positions of the parties increases the need for substantive neutrality.[218] It will turn to and adopted by the arbitral tribunals while deciding the disputes between private parties. For example, the arbitral tribunal decided to apply the rules common to Belgian and Italian law for solving the dispute relating to Italian patent holder with a

[217]French, *supra* note 12.
[218]D. W. Rivkin, *Enforceability of Arbitral Awards based on Lex Mercatoria*, 9 ARB. INT' L. 67 (1993).

Belgian manufacturer.[219] In the second case, the rules which were common to French and Tunisian Law in the dispute which was related several European buyers and a number of Tunisian seller was considered under this ground.[220] It is used when relevant rules are identical in nature. Even the rules that were common to Yogoslav and German law were applied in situation where dispute was in concern to commercial agency agreement that was between these two parties.[221] In this regard, because of practical difficulties with this method and increasing availability of transnational law codifications have encouraged the arbitral tribunals to follow this approach.

By applying *tronc commun* or general principle, such methodology is considered to be accord with party autonomy since the provisions of home law of one contracting party would not necessarily be known to let alone consented to by the other party instead both the parties can be expected to be conversant with the provisions of the law common to both of them.[222]

On the another hand, arbitral tribunal also applies International Institute for the unification of Private law (UNIDROIT) Principle objective is to constitute the applicable law that may be used to interpret or supplement the applicable law and serve as legislative model. This principle will be applied where parties have failed to mention the applicable law as well as law not chosen by the parties. Similarly, they are considered no threat to the national legal system and due to non-binding nature as well as no influence caused by the government.[223]

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[219]ICC Case No. 2272, SINGVARD JARVIN & YVES DERAINS, COLLECTION OF ICC ARBITRAL AWARDS 1974 - 1985 11(1990).
[220]ICC Case No. 5103, *supra* note 16, at 361.
[221]ICC Case No. 2886, *supra* note 31, at 332.
[222]B. Ancel, *The Tronc Commun Doctrine: Logic and Experience in International Arbitration*, 7 J. INT'L. ARB. 67 (1990).
[223]Henry Deeb Gabriel, *The UNIDROIT Principles of International Contracts as a Basis for Teaching Law Reform and Other Legal Skills in the Course on Transnational Law* , ELTE L. J. 130 (2015).

From this we can understand that its effort for making a balance set of rules meant for the worldwide use irrespective of the legal traditions and the economic as well as political conditions of the countries in such situation they are applied.[224] With this principle it provides freedom of contract that is significant in relation to international trade.[225] It focuses on set of model rules for the parties to choose as the governing law for their contract without giving concern to the relation that the parties may have with a particular country.[226]

As mentioned above, ICC case No.10422 has given importance to have neutrality. Also, the general principles and international contracts will be applied such as in this case where there was dispute between European manufacture and Latin American distributor and the parties have not decided the applicable law although they have agreed that such law has to be neutral in nature between the parties. Finally, decision was made by applying the UNIDROIT Principle with exception to restatement of the rules which the business persons are engaged in international trade in order to fulfill the requirements of their needs and expectations.[227]

It is essential to understand UNIDROIT Principles of International Commercial Contracts as if we see from this angle, it is clear that it encourages the practice of fairness and balance as there is less necessity to accommodate the various legal traditions or domestic laws much less accommodate powerful lobbying interests.[228] For example, when we observe it comes to the conclusion that the UNIDROIT Principles are often

[224]UNIDROIT Principles of International Commercial Contracts (2010), http://www.unidroit.org/english/principles/contracts/principles2010/integralversionprinciples20l0-e.pdf.
[225]*Id.* at art. 1.1.
[226]Mo Zhang, *Rethinking Contractual Choice of Law: An Analysis Of Relation Syndrome* ,44 STETSON L. REV. 873 (2014 - 2015).
[227]UNILEX on CISG & UNIDROIT, http://www.unilex.info/case.cfm?id=957.
[228]Henry, *supra* note 35, at 131.

invoked to fill gaps in the CISG.[229] It is indirectly applied to contracts this is because the tribunals invoke them as embodiments of general principles of international private law.[230]

Moreover, the arbitral tribunal applies the U.N. Convention on Contracts for the International Sale of Goods (CISG), it is a convention which is applied to all contracts for the sale of goods made between the parties situated in different signatory states.[231] The convention will be applied when the parties are domiciled in different states that have each ratified the convention and choice of law analysis leads to the law of one of those states. This can be done by ratifying the convention where each state agrees that it will apply to contracts between parties from that state and parties from another state party.[232]

In sale of goods cases arbitral tribunal have applied CISG's provisions because it is part of general principles of international commercial law and it is required to be examine whether it is fulfilling the requirements set by CISG. It is mostly adopted treaty that provides substantive contract rules. The 84 CISG states have contributed more than 75% of world trade.[233] Its scope is limited to commercial contracts for cross border sale of goods under Article 1-5.Where as Article 6 emphasis on the contractual parties may opt out of the CISG. This shows that it will apply to the contracts concluded by the parties from two or more CISG states under Article 1(1)(a). Under Article 1(1)(b) it will govern contracts between the parties from two or more states where rules of private international law is applicable to law of CISG .For instance, most of the cases where the parties

[229]Joshua D. H. Karton, *Party autonomy and choice of law: Is International Arbitration leading the way or marching to the beat of its own drummer?*, UNB L. J. 7 (2010).
[230]Joshua, *supra* note 41.
[231]*Id.* at 6.
[232]CISG art. 1(1), (1980).
[233]Cyril Emery, *International Commercial Contracts*, GLOBALEX, (March, 2016), http://www.nyulawglobal.org/globalex/International_commercial_contracts.html.

have chosen the law of a CISG state to govern the contract. As far as arbitral tribunal will apply CISG where parties have to choose on its own and without any reference to state law. Therefore, on its own initiative the arbitral tribunal may apply CISG such as part of Lex Mercatoria under Section 3.3.3.[234].It is globally accepted by 83 parties in 2015 and its usage in actual transactions has risen in last 35 years.[235]

SIGNIFICANCE OF TRANSNATIONAL LAW

In this we can reflect the important role transnational law has played instead of apply domestic law by the arbitral tribunal. One need to make it clear that the arbitral tribunal applies transnational law because of following advantages it comprise of such as it is found that parties are kept at same level in matters like costs incurred in the performance of the legal research. Interestingly, the accessibility related to legal authorities and understanding of original language in their applicable legislation as well as case law makes it more favorable. These illustrations demonstrate that due to familiarity with the applicable law and it is considered to be more practical in nature.

NEUTRALITY

Of course, on this side of the spectrum we can understand that it gives a better solution to the problem of neutrality by the application of transnational law. Firstly, the decision have been followed in case of third country where the application of law encourages the situation that no parties consider itself to be superior while applying the applicable law.[236] It is crucial for the parties to have choice of law decision in arbitral tribunals. It has been observed by the arbitral tribunals that the law should be neutral. In

[234]Cyril, *supra* note 45.
[235]Henry, *supra* note 35, at 128.
[236] Ole Lando, *The Lex Mercatoria in International Commercial Arbitration* , 34 ICLQ 747, 748 (1985).

ICC Case No. 10422, it was held that the parties that have not agreed on the applicable law but have encouraged the practice of law should be neutral.[237]

INTERNATIONAL TRADE AND COMMERCE

It has been considered suitable for governing international trade and commerce transactions as compared to domestic laws. It helps in developing and improving business transactions.

It is submitted that domestic laws may interfere with the party autonomy. It is interesting to notice that the domestic law may have unpredictable rules that may lead to unfavorable and unexpected results. Secondly, such above observations have been made while considering decisions made by arbitral tribunal such as in German Federal court the case based on validity of clauses which comprised in standard forms was considered to be void clauses in relation to consumer contracts as well as contracts in connection to domestic and international merchants also.[238] The transnational law includes norms and usages that are globally accepted in large numbers.

CONCLUSION

When choice of law is not mentioned by the parties in the contract in such situation the international arbitral tribunal will exercise wide discretionary power for determining the substantive law. It has been observed that arbitral tribunals have applied transnational law and the arbitral tribunals have appreciated it as it gives a secure outcome. It encourages the practice of neutrality as well as they are considered to be more suitable rules. In order to encourage the practice of trade and commerce globally it is essential to

[237] Sai, *supra* note 22, at 35.
[238] KLAUS PETER BERGER, THE CREEPING CODIFICATION OF THE NEW LEX MERCANTORIA 28 - 29 (2nd ed. 2010).

have rules that are acceptable largely and helps in maintaining good relationship with another nation.