THE CHOICE OF THE LAW GOVERNING THE ARBITRATION PROCEEDINGS

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INTRODUCTION

The past few decades have witnessed an unprecedented growth of international trade and commerce which has generated the need for more efficient methods of dispute resolution. Initially, arbitration was considered the best way of satisfying this need. Compared to court litigation, arbitration was cheaper and faster. Arbitration also offered secrecy, procedural simplicity, and technically competent decision makers.

Today, however, many of the original reasons for using arbitration in international disputes have disappeared. Arbitration is no longer necessarily less expensive than court litigation; nor is it faster. Moreover, resort to arbitration may deprive the parties of summary procedures available in courts of law. Finally, the use of so-called 'professional' arbitrators—often lawyers with no business experience—casts doubts on the technical competence of arbitrators.[1] Nevertheless, arbitration remains an attractive alternative to national courts, primarily because it allows the parties to avoid the uncertainties and complexities of foreign litigation.[2] Also, arbitration serves as a means of obtaining jurisdiction over foreign parties which, though unwilling to submit to the jurisdiction of foreign courts, might agree to international arbitration. Equally important is the fact that arbitration provides a certain and neutral forum.[3] Finally, in arbitration, parties have more influence in determining applicable law than they do in court litigation.

A carefully drafted arbitration clause is the prerequisite for taking advantage of all the benefits of international arbitration. Indeed, insertion of an apparently simple arbitration clause in the contract can seem an easy way to provide a cheap, quick and fair way of judging any eventual contractual disputes. With an apparently innocuous arbitration clause in place, the parties can get on to the 'important' parts of their negotiations and

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

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

[3]Park, *Ibid* 1, at 117

avoid haggling over details of the proceedings which they believe will never occur.'[4] Unfortunately, however, this basic fact is often forgotten by those negotiating international contracts. For instance, rarely do the contracting parties take advantage of the power to designate the applicable law. Even when they do, they often fail to specify whether the designated law should govern the substance of the dispute, the arbitration procedure, or the arbitration clause itself. It is then left to the arbitrator to resolve the choice of law questions left open by the parties.

An analysis of international arbitration must take two factors into account: the sovereign's power to control arbitration and the needs of the international business community. Significantly, the sovereign's power to control arbitration includes the power to determine whether an arbitration decision will be given effect. For example, by refusing to enforce the arbitral award, the sovereign can deprive the arbitration of any practical importance. The sovereign also has an interest in the development of international arbitration as a means of promoting trade and commerce. Usually, the business community has a similar interest. Since promoting the state's interests and honouring the parties' intentions are not necessarily antithetical goals, an arbitrator who balances these goals can produce enforceable awards that satisfy the parties' expectations.

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

1. THE CHOICE OF THE LAW GOVERNING THE ARBITRATION PROCEEDINGS

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

Assuming that in international arbitration the *lex causae* may, or should be, segregated

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

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

2. THE SCOPE OF THE *LEX ARBITRI*

Although the problem of the scope of the law of the proceedings has been addressed in numerous legal writings, there is no generally accepted catalogue of the issues governed by the *lex arbitri*. According to Wilner, the issues governed by *lex arbitri* include the conflicting rules which determine the *lex causae*, the need to give reasons for the award, the need to base an award upon substantive rules of law, and judicial review of the arbitrator's decision.[5] According to Metzger, the *lex arbitri* governs the first two issues submitted by Wilner, as well as the nationality of the award and the law applicable to the arbitration agreement.[6] The scope of the *lex arbitri* was broadened by Hirsch, who added the following to Wilner's and Metzger's lists: The ability to arbitrate a given issue; the court's power to stay judicial proceedings and order arbitration; the methods by which arbitrators are appointed and the opportunities for challenging their mandate; the possibility of resorting to a court during the arbitration; and, finally, whether, and to what extent, the parties determine the procedural rules to be applied by the arbitrator.[7] Recently, Smedresman criticized these lists as overly inclusive. He proposed that the scope of the *lex arbitri* should be limited to all aspects of procedure in arbitration, including the conduct of the arbitrator, and, crucially, the extent of judicial supervision of the arbitration.[8]

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

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

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

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

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

3. THE CHOICE OF THE *LEX ARBITRI* BY THE ARBITRATOR

If the parties to the arbitration choose the *lex arbitri*, whether in the arbitration clause or in the compromise, the arbitrator should abide by this decision. In many instances, however, the parties either neglect to choose the law governing the arbitral proceedings or are unable to agree on the applicable law. In these cases, the *lex arbitri* must be determined by the arbitrator who may approach the problem by inquiring into the implied intent of the parties.[9] However, the arbitrator cannot always follow this approach. For example, when the parties cannot agree on the applicable law, it would be senseless for the arbitrator to inquire into the parties' intent. The arbitrator also faces a difficult task when there is no evidence of the parties' intent. The ensuing question of which law should govern the proceedings in the absence of any explicit or implied choice by the parties is considered next.

3.1 *LEX FORI*

In discharging his or her duties, an international arbitrator must be guided by the objective of producing an enforceable award[10] and consequently the *lex arbitri* must be chosen with this objective in mind. In *B.P. v Libyan Arab Republic*[11] arbitration, this consideration led the arbitrator to adopt Danish law to govern the arbitration proceedings.

By providing for arbitration as an exclusive mechanism for resolving contractual disputes, the parties to an agreement must be presumed to have intended to create an effective remedy. The effectiveness of an arbitral award that lacks nationality is generally smaller than that of an award founded on the procedural law of a specific legal system

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

[10]Paulsson, *Ibid* 25, at 376.

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

and partaking of its nationality. Moreover, even where the arbitrators do, as the Tribunal does in this instance, have full authority to determine the procedural law of the arbitration, the attachment to a developed legal system is both convenient and constructive.[12]

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

The B.P. arbitration award should not be interpreted to mean that considerations of convenience and effectiveness will always lead to application of the *lex fori*. One of the main characteristics of international arbitration is its multi-jurisdictional character. An international arbitration usually involves at least two jurisdictions: The forum state and the state in which the award will be enforced. Legal proceedings may be instituted in a third jurisdiction, for example, the home state of one of the parties. It is also possible that a party might seek redress in the courts of the state whose law governs the merits of the dispute.[13] The legal system of any of these jurisdictions could serve as the *lex arbitri* .Perhaps the main reason that arbitrators choose the *lex fori* more often than another law is that the place of arbitration is the most likely forum for court proceedings concerning the arbitration.

In *James Miller*, a majority of the four Lords held that when the parties fail to choose the *lex arbitri*, the proceedings should be governed by the law of the state where the arbitration is held because that law usually is most closely connected to the proceedings.[14] Where the arbitration has no substantial contacts with the forum, however, local courts might decline to assert jurisdiction, as in Götaverken; therefore, adopting forum law to govern the arbitral proceedings would serve no purpose.

3.2 DENATIONALIZED *LEX ARBITRI*

Finally, an arbitrator might decide not to follow any particular *lex arbitri* but to conduct the proceedings under general principles of procedure or international rules prepared by one of the international institutions such as the I.C.C. or the United Nations Conference for International Trade Law (UNCITRAL). If one of the parties is a sovereign

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[12] *Ibid.* at 309.

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

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

state, the arbitrator may also have the option of conducting the proceedings based on principles of public international law. In all these cases, the arbitrator would render an award unattached to any national legal system, a so-called 'floating' or 'drifting' award.[15] An example of a floating award is found in the *Texaco Overseas Oil Co. v Libya* arbitration.[16] The seat of the tribunal was Geneva. The arbitrator specifically rejected Swiss *lex arbitri* and declared that the proceedings would be governed by public international law. Another floating award was rendered in the Götaverken arbitration,[17] in which the proceedings were conducted under the I.C.C. Rules.

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

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

The denationalization of arbitration proceedings is further complicated by the multijurisdictional character of international arbitration. While some jurisdictions recognize floating awards, others do not. Because the arbitrator cannot foresee where the prevailing party will seek to enforce the award, detaching the proceedings from national law might result in an unenforceable award. For this reason, some scholars

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

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

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

strongly criticize the concept of proceedings based on non-national rules.[18]

In support of arbitration proceedings detached from national law, it is argued that 'it is both pointless and misleading to create a link between the arbitrator and some national law just in case one of the parties wishes to resort to the courts.'[19]Also, in support of detached proceedings is the experience of the international business community which has successfully carried on arbitral proceedings detached from national legal systems.[20]

A substantial number of arbitration proceedings are governed by a *lex arbitri* other than the *lex fori*. One commentator notes that arbitral proceedings detached from national legal systems constitute the major portion of international commercial arbitration.[21]Denationalized arbitration has been successful for two reasons. First, the majority of arbitral awards are implemented voluntarily so their validity and enforceability is never litigated. Second, a number of states, recognizing the needs of the international business community, permit enforcement of floating awards.[22]

One obstacle to the development of the denationalized arbitration, however, is lack of uniformity in national arbitration rules. This difficulty might be overcome by an international convention confirming the parties' right to choose the *lex arbitri.*[23]A more urgent subject for an international convention, however, is the need to ensure that proceedings conducted outside the national legal systems will be recognized and floating awards will be enforced.

CONCLUSION

In the past it has been assumed that the state always has an interest in regulating the administration of justice within its territory. This assumption explains why arbitrators, while permitted to apply foreign substantive law, have been required to apply the

[18]See, e.g., Wetter, *ibid* 9, at 273, who regards the concept of proceedings based on non-national rules as 'excessive and without support in law.'

[19]J. LEW, *ibid* 20, at 253.

[20]*Ibid*

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

[22]See Delaume, L'Arbitrage Transnational et les Tribunaux Nationaux, 111 CLUNET 521, 546 (1984).

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

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

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

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

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

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