Do Mandatory Rules Of Public Law Limit Choice of Law In International Commercial Arbitration?

by
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The general principle of party autonomy allows contracting parties to choose the substantive law that will govern their contract. In the international arbitration arena, arbitrators are faced with the unanswered question of whether to apply or consider relevant mandatory rules of public law which were not chosen by the contracting parties. Neither international arbitration conventions nor national arbitration laws have answered this important question. An arbitrator who decides to apply the mandatory rules of public law faces three problems: 1) party perception that mandatory rules of public law are an unnecessary interference with formation and performance of international contracts; 2) conflicts between the underlying public policy and the contracting parties' will; and 3) enforceability of the arbitration award. In this article, the author examines arbitrators' practical application of mandatory rules of public law and concludes with a discussion of how international public policy will affect an arbitrator's jurisdiction.

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I. INTRODUCTION

The principle of party autonomy gives contracting parties authority to choose the substantive law of their contract. Thus, a chosen law may be the principle law of one of the contracting parties, the *lex mercatoria*, a general principle of law, the international law of contracts, or a combination of these rules. A crucial question that may arise is whether an arbitrator should apply or take into consideration mandatory rules of public law that are relevant, but not chosen by the parties.

Although this question has been addressed in recent case law and international arbitration rules, it remains unanswered. Neither international arbitration conventions, such as the New York or Geneva Conventions, nor the more refined national arbitration laws, such as the French New Code of Civil Procedure (NCCP), have dealt with mandatory rules of law and the arbitrator's mission. Only recently have some international arbitration bodies, such as the International Chamber of Commerce (the "ICC"), and to some extent the United Nations Commission on International Trade Law (UNCITRAL),

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3. This failure may be explained by the fact that international arbitration treaties were concluded before notions of mandatory rules of public law were discussed to any significant extent.
dealt with this matter.\textsuperscript{4} Therefore, the relationship between an arbitrator's duty to apply parties' choice of law and his duty to apply the relevant mandatory rules foreign to the substantive law of the contract remains controversial and worth discussing.

Even in cases in which an arbitrator is willing to apply the relevant mandatory rules of public law, he faces some practical problems. First and foremost, the international business community perceives the application of mandatory rules of public law as a disruptive national interference in the formation and performance of international contracts. Second, the public policy reasons underlying the enactment of mandatory rules\textsuperscript{5} may often conflict with the will of the parties from which the arbitrator obtains his authority.\textsuperscript{6}

Third, the arbitrator must ensure that his award is ultimately enforceable.\textsuperscript{7} Considerations relevant to the recognition and enforcement of arbitral awards are complex. This is particularly true when the award can be executed in several jurisdictions.

This article examines the application by arbitrators of mandatory rules of public law in light of recent case law, rules of international arbitration institutions, regional arbitral treaties, and UNCITRAL arbitration efforts. Furthermore, because mandatory rules of a state are designed to protect the basic notions of morality and justice that are central to the state's public policy,\textsuperscript{8} this article will also consider how international public policy may affect an arbitrator's jurisdiction.\textsuperscript{9}

\textsuperscript{4} See infra notes 22-27 and accompanying text.
\textsuperscript{5} The purpose behind mandatory rules is to protect a nation's basic notions of morality, values, and justice. See infra note 8 and accompanying text.
\textsuperscript{6} The mandatory rules applied by national courts, by their very existence, preclude the operation of the conflicting applicable law of the contract through the forum conflict of laws rules. An arbitrator, however, does not have a forum in the same sense that a court does. Thus, the principle that the mandatory rules of a forum have a natural priority over the conflicting substantive law and should be applied by a national judge does not apply in arbitration, regardless of the chosen law of the contract. Moreover, there is no \textit{lex fori} and an arbitrator does not draw a distinction between mandatory rules of the forum and foreign mandatory rules. An arbitrator only considers the distinction between mandatory rules of \textit{lex contractus} and the mandatory rules of another legal system. See Pierre Lalive, \textit{Transnational (or Truly International) Public Policy and International Arbitration}, in \textit{Comparative Arbitration Practice and Public Policy in Arbitration}, 3 International Council for Commercial Arbitration 257, 270-71 (Pieter Sanders ed., 1986) [hereinafter 3 ICCA].
\textsuperscript{7} See, e.g., New York Convention, supra note 1, art. V(b)(2), 330 U.N.T.S. at 412 (enumerates the grounds on which a court may refuse to recognize or enforce an arbitral award); see also Stephen M. Schwebel & Susan G. Lahne, \textit{Public Policy and Arbitral Procedure}, in 3 ICCA, supra note 6, at 205.
\textsuperscript{8} The public policy principle is among the oldest and most well-established principles of private international law, developing in Anglo-Saxon jurisprudence before it appeared in continental law. See Arthur Nussbaum, \textit{Public Policy and the Political Crisis in the Conflict of Laws}, 49 YALE L.J. 1027, 1028-29 (1940). Although "public policy" generally refers to those mandatory norms that comprise a state's "most basic notions of morality and justice," the concept remains the subject of debate. See generally Robert A.J. Barry, \textit{Application of Public Policy Exception to the Enforcement of Foreign Arbitral Awards Under the New York Convention. A Modest Proposal}, 51 TEMP. L.Q. 843 (1978).
\textsuperscript{9} On the one hand, public policy may only be examined in connection with the forum. What national courts of one country consider to be contrary to public policy may be acceptable
A. The Concept of Mandatory Rules of Public Law

There are various definitions of "mandatory rules of laws." The author's preferred definition is by Professor Mayer:

A mandatory rule . . . 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. One is thus led to conclude that there is an 'approach to mandatory rules of law' different from the classical method of conflict of laws. In matters of contract, the effect of a mandatory rule of law of a given country is to create an obligation to apply such a rule, or indeed simply a possibility of so doing, despite the fact that the parties have expressly or implicitly subjected their contract to law of another country.\(^\text{10}\)

Generally, mandatory rules protect the social and economic interests of a society.\(^\text{11}\) The most commonly cited mandatory rules are: competition law,\(^\text{12}\) securities regulation,\(^\text{13}\) blockade or boycott law,\(^\text{14}\) currency control, and confiscation and nationalization.\(^\text{15}\) In cases involving foreign investment, the national law of the host country sets the requirements and provisions to national courts of another country. On the other hand, public policy plays a different role altogether for arbitration tribunals. It is necessary, therefore, to consider public policy concerns that are common to most nations.

11. See generally R. van Rooij, Conflict of Laws and Public Policy, in NETHERLANDS REPORTS TO THE TWELFTH INTERNATIONAL CONGRESS OF COMPARATIVE LAW 175, 176-77 (1986).
13. See, e.g, Scherk v. Alberto Culver Co., 417 U.S. 506 (1974) (holding that although securities issues are not arbitrable in domestic contracts, they are arbitrable in international contracts).
15. JULIAN LEW, APPLICABLE LAW IN INTERNATIONAL COMMERCIAL ARBITRATION 350 (1978). In regard to nationalization and confiscation, Mr. Lew believes that:

"[e]ven if the national rules of conflict of laws were to require the application of some foreign substantive law, those rules are unlikely to be followed with respect to the confiscation or nationalisation of foreign owned property. When a government takes over foreign private property it does so either as a result of a sudden change in government policy or in answer to an urgent economic crisis necessitating extreme measures. In both of these cases the laws giving effect to the confiscation or nationalisation are mandatory laws and have a public policy (ordre public) character. As it is a general principle accepted by every system of private international law that both mandatory legislation and public policy justifies the refusal to follow the otherwise applicable foreign law, there is very little possibility of any foreign law being held to override the confiscatory and nationalising legislation."

regarding the grant of concessions, the ratification of agreements, nullification, and enforcement of all other relevant constitutional and administrative formalities. A truly general principle of private international law justifies the application of these and similar mandatory rules.\textsuperscript{16}

\section*{B. The Applicability of Mandatory Rules}

Although party autonomy is a general principle of private international law which arbitrators should respect, party autonomy is subject to limits imposed by other equally important general principles of law and public policy.\textsuperscript{17} One general principle of law that party autonomy must contend with is the conflict of laws principle which provides that certain mandatory rules must be applied in the territory where certain activities are conducted or undertaken.\textsuperscript{18} This principle is based on the idea of national sovereignty and is designed to protect the public interest. Since this public policy justification calls for imposing certain controls over contractual relationships, the application of these controls may not be left to the parties' discretion.\textsuperscript{19} These mandatory rules may also emerge from a "truly international public policy"\textsuperscript{20} based not on national public policy concerns, but on supranational tenets of a \textit{jus cogens} nature.\textsuperscript{21}

The modern trend towards application of certain mandatory rules of public law is evidenced in the rules of international arbitration institutions, UNCITRAL, and regional treaties.

In 1980, a working group of the Commission on Law and Commercial Practices of the International Chamber of Commerce prepared a draft on the law applicable to international contracts (ICC Draft Recommendations). The draft provides for two alternatives:

Alternative 1:

\[\text{E}\]ven when the arbitrator does not apply the law of a certain country as the law governing the contract he may nevertheless give effect to mandatory rules of the law of that country if the contract or the parties have a close contact to that country and if and in so far as under its law those rules must be applied

\begin{itemize}
  \item \textsuperscript{17} See Bowett, supra note 15, at 53.
  \item \textsuperscript{18} See 2 Henri Batiffol & Paul Lagarde, Droit International Prive 277 (1987).
  \item \textsuperscript{19} See 2 Albert Dicey & John H. Morris, The Conflict of Laws 792 (1980).
  \item \textsuperscript{20} "Truly international public policy" is an expression designating a new concept of international comity. Although the precise contents of this category of public law are rather unclear, it alludes to a universal concept of justice common to civilized nations which "all have the duty to respect in order not to step out of the legal community which is the basis of private international law." Jacob Dolinger, World Public Policy: Real International Public Policy in the Conflict of Laws, 17 Tex. Int'l L.J. 167, 170 (1982). This policy may protect the interests of a foreign state even when those interests are not established in the domestic legislation of that state. The most common manifestation of international public policy is when one jurisdiction respects the public policy interests of another jurisdiction's legal system. See, e.g., id. at 187-88.
\end{itemize}
whatever be the law applicable to the contract. On considering whether to give
effect to these mandatory rules, regard shall be had to their nature and purpose
and to the consequences of their application or non-application.

Alternative 2:

Even when the arbitrator does not apply the law of a certain country as the
law governing the contract he may nevertheless give effect to mandatory rules
of the law of that country if the contract or the parties have a close contact to
that country in question especially when the arbitral award is likely to be en-
forced there, and if and in so far as under the law of that country those rules
must be applied whatever be the law applicable to the contract.22

The draft gives the arbitrator the discretion to apply a country's relevant
mandatory rules foreign to the substantive law of the contract so long as the
parties or the contract have a close contact to that country or the arbitral
award is likely to be enforced there. In exercising his discretion, the arbitra-
tor should take into consideration the purpose, nature, and the effects of these
mandatory rules.

The UNCITRAL also recently dealt with mandatory rules, which it
termed "Mandatory Legal Rules of Public Nature." In its work entitled
"Legal Guide on Drawing up International Contracts for the Construction of
Industrial Works" (the "UNCITRAL Guide"),23 UNCITRAL provided:

In addition to legal rules applicable by virtue of a choice of law by the parties,
or by virtue of the rules of private international law, certain rules of an admin-
istrative or other public nature in force in the countries of the parties and in
other countries (e.g. the country of a sub-contractor) may affect certain aspects
of the construction. These rules, which are often mandatory, are usually ad-
dressed to all persons resident in or who are citizens of the State which issued
the rules, and sometimes to foreigners transacting certain business activities in
the territory of the State. They may be enforced primarily by administrative
officials. Their purpose is to ensure compliance with the economic, social, fi-
nancial or foreign policy of the State. The parties should therefore take them
into account in drafting the contract.24

The Guide does not go as far as the ICC Draft Recommendations. It
only concerns the mandatory rules of the place of performance of the con-
tract, and puts the parties on notice of the existence of such rules.

22. See Ole Lando, Conflict of Law Rules for Arbitrators, in Festschrift für Konrad

23. UNCITRAL, LEGAL GUIDE ON DRAWING UP INTERNATIONAL CONTRACTS FOR
No. E.87.V.10 (1988); see also U.N. Economic Comm'n for Europe Geneva, Guide on
DRAWING UP INTERNATIONAL CONTRACTS ON INDUSTRIAL CO-OPERATION at 24, para. 59,
U.N. Doc. ECE/TRADE/124, U.N. Sales No. E.76.II.E.14 (1976); U.N. Economic Comm'n
for Europe Geneva, Guide for DRAWING UP INTERNATIONAL CONTRACTS ON CONSULT-
ING ENGINEERING, INCLUDING SOME RELATED ASPECTS OF TECHNICAL ASSISTANCE at 35,
Comm'n for Europe Geneva, Guide on DRAWING UP CONTRACTS FOR LARGE INDUS-
(1973).

24. See UNCITRAL, supra note 23.
The 1980 European Convention on the Law Applicable to Contractual Obligations\(^{25}\) (the "European Convention") also recognizes the application of mandatory rules of law. The Convention gives effect to the relevant mandatory rules of a foreign country whose law would not, in the absence of parties' choice of law, have been the substantive law of the contract.\(^{26}\) Article 7(1) of the European Convention provides that:

> When applying under this Convention the law of a country, effect may be given to mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract. In considering whether to give effect to these mandatory rules, regard shall be had to their nature and purpose and to the consequences of their application or non-application.\(^{27}\)

This provision is similar to and has the same effect as the first alternative of the ICC Draft Recommendations. The above discussion reveals that the international arbitration bodies not only acknowledge the applicability of relevant mandatory rules of law, but these institutions also provide some guidance as to how the arbitrators should determine which rules they may apply.

II. INTERNATIONAL ARBITRATORS’ DISCRETION IN APPLYING THE MANDATORY RULES OF PUBLIC LAW

One can argue that mandatory rules of law stem from national systems of private international law and are only applicable to litigation in national courts. An international arbitration tribunal has no national forum and hence no \textit{lex fori}: it derives authority from the agreement of the parties and therefore has an autonomous contractual status.\(^{28}\) Hence, one could contend, an arbitrator is bound only by the parties' will and, therefore, by their chosen law, not by a national system of private international law that would require an arbitrator to apply mandatory rules of law foreign to the chosen law.

Recent arbitration practice, however, has not completely supported such a view. There are at least two reasons for this. First, as provided in the international arbitration material described in the previous section, an arbitrator may take into consideration mandatory public law rules that are foreign to the substantive law specified in the contract. An arbitrator considers

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25. 1980 O.J.(L 266) 1.
26. Article 7(1) of the Convention is a reflection of international solidarity. It indicates that states should cooperate with each other in the enforcement of relevant governmental policies. Arbitrators should encourage this solidarity by giving effect to relevant mandatory rules which are fair and reasonable. \textit{See generally} Ole Lando, \textit{The Law Applicable to the Merits of the Dispute}, in \textit{Essays on International Commercial Arbitration} 129 (Petar Sarcevic ed., 1989).
27. European Convention, supra note 25.
mandatory public laws in an effort to guarantee that his award is ultimately enforceable and also to safeguard the credibility of arbitration as an effective mechanism for the settlement of disputes arising from commercial contracts.29

Professor Bockstiegel, an expert in the field of international commercial arbitration, recently stated that "[i]n arbitrations involving State enterprises, public law rules or other mandatory law rules of the national legal system of the state enterprise30 may come into consideration more often than in contracts between private enterprises."31 An arbitrator may in fact apply such rules when there are reasonable grounds for their application. Yves Derains, the past Secretary of the ICC Court of Arbitration, has summarized the position as follows:

[A]rbitrators are not usually satisfied with indicating that a mandatory rule is foreign to the lex contractus as a reason for not applying it. Indeed, the designation of the lex contractus does not necessarily imply that the parties had intended all mandatory rules liable to affect the contract to be excluded. And arbitrators prefer to explain that there are no serious grounds for applying the mandatory rules in question in every respect.32

Second, an arbitrator’s lack of a national forum puts him in the position of an international judge. The Permanent Court of International Justice (the “PCIJ”), in the well-known Serbian Loans case,33 observed that an international judge may have to apply the lois de police of one state even if the substantive law of the contract is that of another.34 The Court stated:

[T]he law which may be held by the Court to be . . . applicable to the obligation in the case, may in a particular territory be rendered inoperative by a municipal law of this territory—that is to say, by legislation enacting a public policy the application of which is unavoidable even though the contract has been concluded under the auspices of some foreign law.35

Thus, although an international arbitrator does not have a lex fori, he has some authority in arbitral matters beyond the parties’ will. This is equally true in cases where all parties are private and in cases where one of the parties is a state.36

30. A state enterprise is generally defined as any commercial enterprise that is substantially owned or controlled by the state or its institutions, whether or not it has a separate legal personality. See Leo J. Bouchez, The Prospects for International Arbitration: Disputes Between States and Private Enterprises, 8 J. INT’L ARB. 89, 90 (1991).
32. Yves Derains, Public Policy and the Law Applicable to the Dispute in International Arbitration, in 3 ICCA 227, supra note 6, at 249.
34. Id. at 371.
35. Id.
A number of arbitral tribunals have exercised their discretion and applied mandatory rules of law foreign to the substantive law of the contract or declared their willingness to do so. Jurists in the field of international commercial arbitration increasingly support the view that arbitrators can exercise their discretionary power beyond the parties' will when the exigencies of the circumstances call for them to do so. The Rapporteurs' report to the Institut de Droit International in 1989 confirms this trend. As Professor Waelbroeck observes:

Once the principle that arbitrators may apply rules other than those specified by the parties is accepted, I would be tempted to give to the arbitrators somewhat more flexibility than does the draft resolution [of the Institut]. For instance, I would allow them to apply those rules of public policy or lois d'application immédiate that they deem appropriate in order to give a fair and satisfactory solution to the dispute. After all, any exercise of a judicial or quasi-judicial function carries with it a certain discretion; rules purporting to fetter that discretion are seldom effective.

In state contracts, arbitrators should take special caution in applying the mandatory public law rules of the state party in order to avoid results oppressive to private parties. On the whole, while arbitrators must consider conflict of laws rules, they should remain free to determine the applicable conflict of laws rules according to guidelines derived from general principles common to developed conflict of laws systems.

Thus, although the principle of party autonomy is the basic conflict of laws rule according to which the law applicable to a contract must be determined, competing conflict of laws principles may call for the application of mandatory rules, especially if they are of a public law nature. The scope of the substantive law of the contract cannot be determined in abstract. The public law nature of some contracts requires that their public law elements be governed by mandatory public law rules of the state where the agreement or contract is to be performed.


38. An arbitrator typically exercises his discretion when it is necessary for the arbitrator to ensure the enforceability of the award and/or when the party benefitting from the application of the rules so requests.


40. Id. at 188.


42. A contract of a public or administrative nature is a contract in which one of the parties to it is "governmental" or a "public" corporation and the other party an entity or individual belonging to the "private sector." See Colin C. Turpin, Public Contracts, 7 INT'L ENCYCLOPEDIA COMP. L. ch. 4 (1982).

A. Determining the Applicable Mandatory Rules

Determining the source of applicable mandatory rules is a matter of controversy. According to the traditional view, mandatory rules must be derived from the substantive law of the contract, whereas the modern approach favors a determination independent of the substantive law applicable to contractual matters. This controversy does not arise when the parties choose a substantive law which contains the applicable mandatory rules.

Real difficulties arise, however, when the relevant mandatory rules derive from a legal system outside of the chosen law of the contract. Arbitrators and experts in the field have proposed three different approaches to this situation. One approach is for arbitrators to give effect to the trade regulations and other basic economic legislation of a state where the contract will be performed. Even if these mandatory rules make the performance of the contract difficult or impossible, arbitrators may nevertheless consider applying them.

A second approach applies the mandatory rules of the prospective place of enforcement of an award. An arbitrator must ensure that the enforcement of his award does not violate the national public policy where enforcement is sought. This proposition is based on the assumption that the national courts where enforcement is sought will recognize the award by the standards of their own public policy. An arbitrator, therefore, should not

44. See supra notes 22-27 and accompanying text.
45. See infra notes 70-71 and accompanying text.
46. For a detailed discussion of this issue, see infra notes 72-108 and accompanying text.
47. Some ICC cases have adopted this approach, e.g., Case No. 2136. This case involved the performance of a license granted by a German firm to a Spanish firm. The arbitrator stated that "[e]ven though the license contract would have been subject to German law, the consequences of a failure to obtain authorization must be examined according to Spanish law." JARVIN & DERAINS, supra note 37, at 456.
48. For explanation, see infra notes 72-73. See, e.g., Dutch Buyer v. Austrian Seller, 7 Y.B. COM. ARB. 141, 142-43 (1982) (defendants urged the arbitral tribunal to void the contract on the grounds that it did not comply with the Austrian Exchange Law).
49. See Lew, supra note 15, at 537.
50. See, e.g., New York Convention, supra note 1, art. V(2)(b), at 412-13 (providing that an enforcing court may, on its own motion, refuse to enforce a foreign arbitration award if the enforcement will violate the forum's public policy). For a discussion of article V(2)(b) in U.S. and German law, see Christopher B. Kuner, The Public Policy Exception to the Enforcement of Foreign Arbitral Awards in the United States and West Germany Under the New York Convention, 7 J. INT'L ARB. 71 (1990); see also Schwebel & Lahne, supra note 7.
51. See generally Joel R. Junker, The Public Policy Defense to Recognition and Enforcement of Foreign Arbitral Awards, 7 CAL. W. INT'L L.J. 228 (1977). U.S. courts have used a balancing test, at least implicitly, when determining whether there has been a violation of public policy. See, e.g., Fertilizer Corp. of Indiana v. IDI Management, 517 F. Supp. 948, 954 (S.D. Ohio 1981), reh'g denied, 530 F. Supp. 542 (1982) (the court balanced the public policy in denying enforcement of an award rendered without full disclosure of an arbitrator's interest against the public policy favoring arbitration); see also, Note, The Public Policy Exception to the New York Convention on the Recognition and Enforcement of Arbitral Awards, 1 OHIO ST. J. ON DISP. RESOL. 365, 380 (1986) ("[i]t appears ... that the courts apply a basic balancing test of public versus private interests." The Convention allows for the use of a balancing test since enforcement is permissive and not mandatory).
render awards which violate the mandatory rules integral to the public policy of the state where enforcement of his award is likely to be sought. The second alternative of Article 9 of the ICC Draft Recommendations expressly refers to this consideration.

The third approach applies the mandatory rules of a state if the contract or the parties have close contact with that state and if, in view of the circumstances, application of such rules is called for. Article 7(1) of the European Convention and Article 9 of the ICC Draft Recommendations illustrate this approach.

B. Grounds for Applying Mandatory Rules of Public Law

The main policy reason for applying mandatory rules is the need to advance a nation's public interest. Most nations have recognized the importance and development of public interests. A number of United Nations resolutions and declarations on this subject have affirmed this need. Although it may be argued that an arbitrator is not entrusted with the mission of defending the public interest, and is instead entirely at the service of the litigants, he should not disregard the state's mandatory public law rules. An arbitrator should keep in mind the fate of his award as well as the credibility of arbitration as an institution in general.

When deciding whether to apply relevant mandatory rules, an international arbitrator must be mindful of the award's enforceability. Article 26 of the 1976 ICC Rules of Arbitration emphasizes this issue by providing that the arbitrator "shall make every effort to make sure that the award is enforceable at law." This means that the arbitrator should be aware not only of the law

52. Cf. Lando, supra note 26, at 158.
53. See supra note 22 and accompanying text.
54. See, e.g., BATIFFOL & LAGARDE, supra note 18, at 280.
55. See supra text accompanying notes 22, 27-28 and accompanying text.
57. For example, in Deutsche Schachthou-und Tiefbohrgesellschaft MBH v. R'As Al-Khaimsh Nat'l Oil Co., 38 W.L.R. 1023, 1035 (1987), the English Court of Appeal, in the context of an award given in an oil concession case in Geneva under the ICC arbitration rules, allowed enforcement, but Sir John Donaldson noted that there are some general requirements that awards must fulfill if they purport to apply a law other than a system of municipal law of some state.
of the place of arbitration and the legal views prevailing in the state where
the enforcement of an award is sought, but also the mandatory laws of the
place of the contract's enforcement.

Commenting on this topic, Professor Lando states that "[t]he arbitrator
must also give effect to mandatory rules of a country closely connected with
the contract." He proposes that arbitrators should give effect to such
mandatory rules when it is fair and reasonable under the circumstances to do
so.

Some scholars have emphasized that arbitrators should consider the in-
terest of arbitration as an institution in rendering their awards. Lando be-
lieves that the arbitrator will have to consider not only the interests of the
parties but also those of international commercial arbitration considered as
an institution. Arbitration today, he asserts, still enjoys the prestige which
has induced the liberality shown to it by most Western countries. If it be-
comes known that arbitration is being used as a device for evading the public
policy of States which have a governmental interest in regulating certain busi-
ness transactions, its reputation may suffer. Arbitration, Lando concludes,
can only survive as long as it is tolerated by the States.

An arbitrator should take into account the public interests of all the
communities involved in the arbitration, otherwise his decision may be ig-
ored. Professor Mayer also emphasizes that the enforcement of arbitra-
tion awards requires that arbitrators give serious consideration to the
mandatory rules of public law:

[A]rbitrators should pay heed to the future of their award. They should con-
sider that if they do not apply a mandatory rule of law, the award will in all
likelihood be refused enforcement in the country which promulgated that rule.
It often turns out that that country is the one, or at least one of several, exercis-
ing a de facto control over the situation; it is not reasonable to disregard its
attitude.

Finally, Professor Mayer concludes that an arbitrator should give effect
to mandatory rules of law out of a sense of duty to the continuation and
development of international arbitration as an institution.

The Institut de Droit International has recently considered the application
of mandatory rules of public law in international commercial arbitration.

59. K. Lipstein, International Arbitration Between Individuals and Governments and the
Conflict of Laws, in Contemporary Problems of International Law, Essays in Honor
60. See Lando, supra note 26, at 157. The country where the contract is performed nor-
mally has the closest connection with the contract.

61. Lando proposes that "[t]he arbitrator should also consider whether the contract has
such a connection with the economy of the enacting country that it would be fair and reasonable
to give effect to the mandatory rule in question." Id. at 158.
62. Id. at 170.
63. Id.
64. Id.
65. Mayer, supra note 10, at 284.
66. Id. at 285-86.
Many members of the Institut seemed to favor the application of mandatory public law rules from the practical point of view. Professor Riad declared:

I am fully aware of the importance of the project's [the Institut's project on Arbitration Between States and Foreign Enterprises] attempt to create such an international or supra-national forum to settle disputes between states and foreign enterprises. The achievement of this scheme requires that states first accept without reservation arbitration as a substitute to national jurisdiction for the settlement of such disputes. By allowing arbitral tribunals to disregard 'public policies' and 'lois de police,' even those of the state party to the arbitration agreement or of the state to which the dispute has the closest link, our 'projet provisoire résolution' might be defeating its own purpose owing to the threat of infringement which this proposition implies, not only on the state's legislative sovereignty, but also on their basic legal foundations.67

This view goes one step further than the previous views by substituting arbitration for national courts68 and proposes that arbitral tribunals should have authority to deal directly with the issues of public policy.

III. SHOULD ARBITRATORS APPLY MANDATORY RULES OF RELEVANT NATIONAL LAWS

A. The Problem

Do contract disputes remain arbitrable, or does a contract remain valid, if a party claims that enforcement of the contract will violate the mandatory rules of law?69 This issue is often raised as a defense for noncompliance or breach of contract. The plaintiff either demands performance or damages for nonperformance, while the defendant alleges that the contract is unenforceable or void because its enforcement violates mandatory rules of law.70

Generally, an arbitrator's decision whether to consider or give effect to the mandatory rules of law depends on one of the following conditions: whether (a) the parties have chosen the substantive law of the contract and the mandatory rules are part of it; (b) the parties have chosen the substantive law, but the mandatory rules are not part of it; or (c) the parties have left the choice of substantive law to the arbitrator.

I. Mandatory Rules Are Part of the Substantive Law

There is no real difficulty when the mandatory rules are part of the substantive law chosen by the parties because an arbitrator is bound to apply such law in its entirety. Thus, an arbitrator must apply such substantive law

67. Observations of Mr. Fouad A. Riad, 63-1 Annuaire de L'Institut de Droit International 179-80 (1989).
68. Cf. supra notes 37-55 and accompanying text.
69. The author has assumed that there is a valid arbitration agreement providing for the settlement of all disputes by arbitration.
70. The application of the mandatory rules may be raised as an incidental issue or the main issue of the case.
including its mandatory rules, even if they run contrary to the contractual stipulations of the parties.\textsuperscript{71} The only exception to this rule is when giving effect to all provisions of the chosen substantive law would violate truly international public policy.\textsuperscript{72} In such a situation, the arbitrator should explore the parties' intentions regarding the effects of their chosen law. The arbitrator's decision should be guided by the parties' power to choose the most appropriate law to meet their needs, and to exclude the application of unfavorable national laws. The parties, however, may also restrict beforehand the scope of the application of substantive law by stipulating that the chosen law should apply only to certain parts of the contract.

2. Mandatory Rules Are Not Part of the Substantive Law

a. Generally

Different considerations prevail if the relevant mandatory rules are not part of the substantive law.\textsuperscript{73} In such situations two types of arbitrations should be distinguished. The first type merely requires the arbitrator to take notice of the mandatory rules of law, without actually applying them. For example, a Greek seller who is a party to a contract governed by French law may argue that his failure to deliver goods sold for export was due to an embargo decree in Greece. The embargo decree is a mandatory rule, but it is invoked as a simple fact that has made the performance of the contract impossible, that is, an incident of \textit{force majeure}.

Here, the seller merely wants the \textit{force majeure} incident to be taken into consideration, although the substantive law of the contract is not Greek law. The arbitrator would not, however, be able to apply the Greek embargo decree by reason of its very nature. He will only consider its effects on the contract when he decides the dispute under French law, the substantive law of the contract.\textsuperscript{74}

\textsuperscript{71} Even when the parties have excluded the application of some of the mandatory rules of their chosen law, the arbitrator should still apply the chosen law in its entirety. Unlike domestic public policy, the application of mandatory rules of public law is not dependent on the parties' choice of substantive law. \textit{See generally} Dolinger, supra note 20, at 184-85.

\textsuperscript{72} \textit{For example, the provisions of the municipal law of a state entity may provide for limitations upon the state entities as to the substance of the contract, but not upon private entities. It may provide that public entities must buy certain goods only from national sources, must be subject to price limitations, and/or that payment must be made only in national currency. \textit{See} Bockstiegel, supra note 31, at 30. In such a case the arbitrator bases his decision on the spirit of the law rather than its literal meaning. For a definition of "truly international public policy," see supra note 20.}

\textsuperscript{73} This situation raises the most difficult problem for international arbitrators.

\textsuperscript{74} Few ICC cases have involved the issues of export restrictions and exchange controls, while the mandatory rules were not part of the substantive law of the contract. The tribunals took the same approach as here. \textit{See, e.g.,} ICC Case No. 2216/1975, 2 INT'L ARB. 281 (1986) (abstract); Case No. 2138, 4 INT'L ARB. 112 (1988)(abstract); Jarvin & Derains, supra note 37, at 23 (discussing ICC Case No. 2139/1974. In this case, the tribunal rejected the defendant's \textit{force majeure} defense on the ground that the events were foreseeable).
Rearranging the facts of the above example illustrates the second type of arbitration in which the arbitrator will apply the Greek mandatory rules rather than merely considering them. Assume the Greek seller alleges that the sale contract was void because he failed to obtain a prior authorization from the relevant authorities before he entered into the contract. The arbitrator then has to decide whether he can declare a contract subject to French law void by application of a Greek mandatory rule.

In most cases, the principle that requires an arbitrator to apply the law chosen by the parties is sufficient to prevent him from having to give effect to a foreign mandatory rule. An award of the Court of Arbitration of the Chamber of Foreign Trade of the German Democratic Republic (G.D.R.) illustrates this situation. This decision involved the validity of a license contract between a firm in the G.D.R. and a firm in the Federal Republic of Germany (F.R.G.). The contract provided that all disputes should be decided under G.D.R. law.

A dispute arose and the F.R.G. firm argued that the contract was void under its own country's competition law and Article 85 of the Treaty of Rome. Rejecting the argument and giving effect to the parties' choice of law clause, the arbitrators held that "[t]he validity of the agreement must be judged under the law of the GDR designated in the arbitral clause as the law applicable to the agreement." Choosing the substantive law, however, does not necessarily imply that the parties intend to exclude all mandatory rules which may affect their contract. In such cases, arbitrators should analyze the parties' intentions and the surrounding circumstances in light of truly international public policy, in order to decide whether to apply such mandatory rules. An arbitral tribunal may refuse to give effect to the mandatory rules of law of the parties' respective countries when such rules are foreign to the substantive law of the contract. In an ICC arbitration involving a dispute between Swedish shipyards and a Libyan buyer, the arbitral tribunal refused to apply Libyan laws and regulations relating to the boycott of Israel, because the contract was subject to Swedish law. The tribunal stated that "[t]he application of the Swedish law leads to the obvious consequences that the Libyan boycott law and regulations cannot apply to those contracts—except if a special reference is made in the contract to this boycott law."

Although there is no unanimous view among arbitrators as to the applicability of mandatory rules foreign to the substantive law of the contract,
most scholars seem to favor the application of the mandatory rules of the place of performance of the contract.\textsuperscript{82} Opinions are much more divided on the question of the mandatory rules of the parties' respective countries.\textsuperscript{83}

One way of resolving these conflicting views is to resort to the theory of truly international public policy. If the object of the mandatory rules of law is to guarantee respect of the principles considered by the arbitrator as forming part of truly international public policy, the arbitrator should apply such principles over the will of the parties.\textsuperscript{84} For example, it is unlikely that an arbitrator would find a mandatory rule of municipal law providing that a corporation shall not contract to pay for its obligations in foreign currency to be a provision coming within the ambit of truly international public policy.\textsuperscript{85}

A well-known case illustrating the respect which courts hold for truly international public policy was decided by the House of Lords in 1956.\textsuperscript{86} The case involved a contract between a Swiss middleman, the plaintiff, and an Indian seller of jute sacks which were to be shipped to South Africa via an Italian port. Indian law prohibited the export of jute to South Africa. The contract was governed by English law and the defendant failed to deliver the jute. Deciding in favor of the defendant, the House of Lords stated that "[j]ust as public policy avoids contracts which offend against our own law, so it will avoid at least some contracts which violate the laws of a foreign State, and it will do so because public policy demands that deference to international comity . . . ."\textsuperscript{87}

In this case, the truly international public policy was the opposition to racial discrimination. In the case discussed below, however, the U.S. Supreme Court adopted a much more parochial approach when it set out to defend the inviolability of American antitrust laws.

b. The Mitsubishi Case

The case of Mitsubishi Motors Corp. \textit{v.} Soler Chrysler-Plymouth Inc.\textsuperscript{88} illustrates the situation in which the parties specifically exclude the application of mandatory rules of public law of the place of performance of the con-

\textsuperscript{82} \textit{See} \textsuperscript{Jarvin} \& \textsuperscript{Derains}, \textit{supra} note 37, at 33, 58 (reporting ICC Case Nos. 3033/1978 and 1512/1967).


\textsuperscript{84} It should be noted that, in practice, situations that are this simplistic are seldom encountered. It is often very difficult for an arbitrator to analyze the foreign mandatory rules and adequately assess the policy and purpose behind their enactment.

\textsuperscript{85} As mentioned earlier, the provisions of this public policy would contain fundamental rules of natural law, the principles of universal justice, the general principles of morality accepted by most civilized nations, and \textit{jus cogens} in public international law. \textit{See} \textit{Lev}, \textit{supra} note 15, at 534.


\textsuperscript{87} \textit{Id.} at 489-90. The lower court had found that the contract was unenforceable because the parties intended to break the Indian law by overcoming the export prohibition of jute to South Africa. \textit{Id.}

\textsuperscript{88} 473 U.S. 614 (1985).
tract by an exclusive choice of law clause.\textsuperscript{89} The arbitration agreement in \textit{Mitsubishi} provided that all disputes be arbitrated in Japan under the rules of the Japan Commercial Arbitration Association.\textsuperscript{90} The agreement also contained a choice of law clause which read "[t]his Agreement is made in, and will be governed by and construed in all respects according to the laws of the Swiss Confederation as if entirely performed therein."\textsuperscript{91}

The cornerstone of arbitration is that the arbitrator's jurisdiction is controlled by the agreement of the parties.\textsuperscript{92} The above clause was, by any standard, a clear and unambiguous choice of law agreement.\textsuperscript{93} Thus, the arbitrators would be expected to decide all disputes under Swiss law.

Soler made various claims relating to division of market.\textsuperscript{94} Division of the market made the agreement illegal under U.S. antitrust law,\textsuperscript{95} though the agreement was valid under Swiss competition law.\textsuperscript{96} It appears that the parties chose arbitration and stipulated to the use of Swiss law in order to avoid U.S. antitrust law, in other words, to avoid the mandatory rules of the place of performance, the United States.\textsuperscript{97}

The U.S. Supreme Court did not attempt the difficult task of reconciling U.S. and Swiss antitrust laws, but noted in a footnote that:

"This Agreement is made in, and will be governed by and construed in all respects according to the laws of the Swiss Confederation as if entirely performed therein." App.56. The United States raises the possibility that the arbitral panel will read this provision not simply to govern interpretation of the contract terms, but wholly to displace American law even where it otherwise would apply. Brief for United States as \textit{Amicus Curiae} 20. The [ICC] opines that it is "[c]onceivable[ ], although we believe it unlikely, [that] the arbitrators could consider Soler's affirmative claim of anti-competitive conduct by CISA

\textsuperscript{89} This case involved a dispute between Mitsubishi which was the product of a joint venture between Japanese and Swiss auto manufacturers, and a Puerto Rican dealer, Soler. Soler failed to meet its minimum sales requirements in Puerto Rico and Mitsubishi prohibited Soler from re-exporting the cars, and later suspended shipment of additional vehicles. Differences also arose regarding responsibility for cars stored in Japan. Mitsubishi filed a suit in U.S. District Court to compel arbitration of the disputes. \textit{Id.} at 619-20.

\textsuperscript{90} \textit{Id.} at 617.

\textsuperscript{91} \textit{Id.} at 637.


\textsuperscript{94} \textit{Mitsubishi}, 473 U.S. at 619-20.


\textsuperscript{96} The Swiss competition law sanctions restraints of trade only to the extent that they are shown to be conducive to results judged as abusive according to various criteria developed by Swiss enforcement authorities. See B6 \textit{WORLD LAW OF COMPETITION, SWITZERLAND} ch. 3 (Julian O. van Kalinowski ed., 1984).

and Mitsubishi to fall within the purview of this choice-of-law provision, with the result that it would be decided under Swiss law rather than the U.S. Sherman Act." Brief for [ICC] as Amicus Curiae 25. At oral argument, however, counsel for Mitsubishi conceded that American law applied to the antitrust claims and represented that the claims had been submitted to the arbitration panel in Japan on that basis. Tr. of Oral Arg. 18. The record confirms that before the decision of the Court of Appeals the arbitral panel had taken these claims under submission. See District Court Order of May 25, 1984, pp. 2-3. We therefore have no occasion to speculate on this matter at this stage in the proceedings, when Mitsubishi seeks to enforce the agreement to arbitrate, not to enforce an award. Nor need we consider now the effect of an arbitral tribunal's failure to take cognizance of the statutory cause of action on the claimant's capacity to reinitiate suit in federal court. We merely note that in the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy . . . .

The vital message expressed by the Court at the end of the footnote is that international antitrust claims can be arbitrated as long as arbitrators apply U.S. law to the merits regardless of the parties' choice of law. Otherwise, courts in the United States might refuse to enforce the award on public policy grounds. In other words, an arbitrator is obliged to give effect to the mandatory rules of U.S. law regardless of the substantive law of the contract.99

Although the Court's view appears to be in harmony with recent trends in international commercial arbitration, the Court's approach has its problems. First, the court assumes that arbitrators will give effect to American antitrust law without having any strong evidence that they will do so. The United States, acting as amicus curiae, complained that the arbitrators would read the choice of law clause "not simply to govern interpretation of the contract terms, but wholly to displace American law . . . ."100 Generally, the international nature of a contract substantially increases the risk that an arbitrator will not apply rules of public law.101 Arbitrators derive their power from the parties, and they are generally bound to give effect to the parties' will, except when doing so would violate truly international public policy, whether this is explicitly stated in the contract or implied in the choice of applicable rules. Moreover, the Court failed to discuss whether the arbitra-

98. 473 U.S. at 637 n.19.
99. The Court made this view more obvious in another part of its decision when it stated that: "[t]he tribunal . . . is bound to effectuate the intentions of the parties. Where the parties have agreed that the arbitral body is to decide a defined set of claims which include, as in these cases, those arising from the application of American anti-trust law, the tribunal therefore should be bound to decide that dispute in accord with the national law giving rise to the claim." Id. at 636-37.
100. Id. at 637 n.19. The ICC, also as amicus, opined that the arbitrators probably would decide the anti-trust claims "under Swiss law rather than the U.S. Sherman Act." Id.
101. Mayer, supra note 10, at 279.
tors' failure to give effect to American antitrust law would violate truly international public policy.

Second, assuming that the plaintiff wants to enforce the award in the United States, American courts have no way of determining whether the arbitrators have applied Swiss or American law. The United States is a party to and bound by the New York Convention. It is the animating principle of the New York Convention that the courts before which the enforcement of foreign awards is sought may only review arbitration awards for procedural regularity, and must resist inquiry into the awards' substantive merits. Article V of the New York Convention deals with the enforcement of foreign arbitral awards, and provides a limited task for the enforcing courts. This limitation responded to the need of the international business community for final and binding awards that are not subject to appellate review by the courts of the country where enforcement is sought. Even a defendant's claim that the arbitrator applied the wrong substantive law did not, in the opinion of a German court, bar the enforcement of the award under the Convention. The ease of enforcing a foreign arbitral award, as opposed to enforcing a foreign court judgment, is often cited as one of the greatest advantages of international commercial arbitration.

Third, if the arbitral tribunal refuses to give effect to U.S. law, the Court failed to consider that Mitsubishi could enforce the award outside the United


104. Art. V of the New York Convention sets the exclusive grounds upon which a contracting state court can refuse to recognize, enforce, or modify foreign arbitral awards. See, e.g., Moseley, Hallarten, Estabrook & Weeden v. Ellis, 849 F.2d 264, 267 (7th Cir. 1988); FDIC v. Air Fla. Sys., Inc., 822 F.2d 833, 842 (9th Cir. 1987).

105. The advantages of using carefully structured arbitration, as opposed to court proceedings, to settle international commercial disputes can include lower costs, faster proceedings, and less rigid formalities. See George T. Yates III, Arbitration or Court Litigation for Private International Dispute Resolution: The Lesser of Two Evils, in RESOLVING TRANSNATIONAL DISPUTE THROUGH INTERNATIONAL COMMERCIAL ARBITRATION 224, 229 n.14 (Thomas Carbonneau ed., 1982) (sixth Sokol colloquium).

106. See Dutch Seller v. German Buyer, 4 Y.B. COM. ARB. 262 (1979) (abstract).

107. This case involved the enforcement of a Dutch arbitration award against a German buyer. The court held that "[w]hether the arbitrators were right or wrong in not applying German law to the merits of the case is not subject to control by the Court." Id. at 263.

States. If Mitsubishi did this, the foreign court might enforce the award even though the arbitrators did not give effect to American competition law.\textsuperscript{109}

The users of international arbitration are highly unlikely to welcome the Mitsubishi decision. The decision limits the parties' freedom to choose the \textit{lex contractus} and to extend U.S. substantive law to where, until recently, it had no place, that is, in international arbitration proceedings held outside the United States under an arbitration agreement excluding the U.S. law as the governing law.

The Mitsubishi decision is also an important example of the relationship between an arbitrator's right to apply mandatory rules and the duty to do so. The Court seems to assume that the arbitrators are obligated to apply the rules. The Mitsubishi case, therefore, is clearly notable to those considering the question of whether an arbitrator has a duty to give effect to mandatory rules.

3. The Parties Have Failed to Provide for the Substantive Law

If the parties have failed to provide for the substantive law of the contract, and the arbitrator has not elected one, all laws that affect the contract have equal weight.\textsuperscript{110} An arbitrator should, however, limit the application of the substantive law by excluding from its operation those questions which he considers to be subject to mandatory rules of another relevant law. The other relevant law he should consider is generally the mandatory rules of the country where the contract is going to be performed.\textsuperscript{111}

Thus, although there is nothing to prevent an arbitrator from applying the relevant mandatory rules of law foreign to the law he has selected as the substantive law, the arbitrator should not apply a law whose mandatory rules will frustrate the parties' intention. The arbitrator has the obligation to respect the legitimate expectations of the parties who could have chosen any law, a-national or national law, or even a combination of several laws, as the substantive law.

While exercising his best effort to give effect to the parties' legitimate expectations, it is appropriate for an arbitrator to decide the applicability is-

\textsuperscript{109} Although a national court is generally inclined to ignore, to the extent required by the law of the forum, the parties' choice of law and apply the forum public law rules, the court may not do the same in regard to foreign public law rules. See van Rooij, \textit{supra} note 11, at 175. Accordingly, it is unlikely that a national court will deny the enforcement of an arbitral award which has been rendered in violation of foreign mandatory rules of a municipal law of another country. Of course, such an award should not violate truly international public policy.

\textsuperscript{110} These generally include respective national laws of the parties, those of the place of performance, or those of the place of formation of the contract.

\textsuperscript{111} See, e.g., ICC Case No. 4132/1983, 10 Y.B. COM. ARB. 49 (1985) (abstract). This case involved a dispute between an Italian supplier and a South Korean buyer. The contract did not contain a choice of law clause. The tribunal applied not only the Korean competition law rules as the substantive law of the contract, but the provisions of the Treaty of Rome because the contract was performed in Italy which was a party to the treaty. The arbitrator took the view that he had to apply these policy laws automatically. See \textit{Jarvin & Derains}, \textit{supra} note 37, at 164.
sue of mandatory rules of law before determining the substantive law of the contract. He should directly apply the mandatory rules of law if he thinks that their operation falls within the reasonable expectations of the parties. The arbitrator may also apply the conflict of law rules of the place of performance of the contract to accomplish this task.

A reasonable view would consider the application of mandatory rules with reference to the legitimate expectations of the parties. This approach also guides the arbitrator in deciding the lex contractus. Moreover, such a view suffices to explain the arbitrator’s decision in applying the mandatory rules of the place of performance of the contract. International practice respects mandatory rules of the country where a contract is going to be performed. These rules come within the domain of the contract. If the contract does not contain a stipulation to the contrary, the parties are entitled to expect the arbitrators to assume that the parties’ agreement did in fact incorporate the mandatory rules of the place of performance of the contract.

There is, however, an exception to the general rule that an arbitrator will apply the mandatory rules of the place of performance. If the mandatory rules of the place of performance are incompatible with truly international public policy, an arbitrator can exclude their application.

IV.
INTERNATIONAL PUBLIC POLICY AND THE ARBITRATOR'S JURISDICTION

The authority and jurisdiction of arbitrators depend, in every instance, upon two factors: the autonomy of the parties and the laws of the competent national jurisdictions. On a practical level, a question that may arise is how international public policy affects an arbitrator’s jurisdiction? One party may challenge the arbitrator’s jurisdiction on the ground that the main contract is void ab initio as contrary to international public policy, thus rendering the arbitration agreement void as well.

112. See German Co. v. Greek Co., [ICC Case No. 953] in Craig et al., supra note 28, at 1, 2 (abstract).
113. Id.
114. See Derains, supra note 32, at 232-34.
116. International conventions and the conflict of laws of some states support this approach. See, e.g., Gotaverken, 6 Y.B. Com. Arb. 133, 136-37. In the Gotaverken Case, the parties, a Swedish company and a Libyan company, did not designate the law applicable to the contract. The applicable law was to be defined by international convention and the conflict of laws rules of the place of arbitration. The panel considered both the Hague Convention of June 15, 1955, and French conflict of laws rules. In this case, the place of construction, delivery, and payment, among other things, demanded the application of Swedish law as the law of the place of performance.
As in all other cases where his jurisdiction is challenged, the arbitrator must examine the facts of each case and determine whether the contract is contrary to some principle of supranational public policy. This is particularly true where international public policy is alleged to deprive the arbitrator of jurisdiction. The fact that the main contract is unenforceable because its purpose violates supranational public policy should not, however, render the arbitration agreement invalid.118 In recent years, the laws of most countries consider an arbitration clause as an agreement independent from the main contract.119 The principal result is that the invalidity of the main contract does not render the arbitration clause invalid.120

A. The Problem

What should an arbitrator do when he is called on to enforce an agreement that may violate international public policy?121 This problem presents two separate questions. First, should the arbitrator raise the issue of international public policy on his own motion if the parties fail to raise the point and wish the matter to be considered on its merits? Second, if the arbitrator finds that the contract violates international public policy, should he decline jurisdiction or proceed with arbitration and render an award on the merits?

Generally, the issue of international public policy in a particular transaction may become apparent either because the arbitrator identifies it as a major influence on the contract or the object of the contract, or because one of the parties specifically raise the issue in the arbitration.

I. The Arbitrator Raises the Issue

An arbitrator raises the issue when he refuses to enforce the agreement on the grounds that the enforcement will violate international public policy. This situation arose in a now well-known Argentinian bribery case.122 In this case the arbitrator was asked to determine a claim for a commission on a contract obtained by a British Company in Argentina, based on an earlier agreement between the plaintiff and the company. The agreement provided that the claimant was to receive ten percent of the value of the contract.123

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118. Adam Samuel, Separability in English Law—Should an Arbitration Clause Be Regarded as an Agreement Separate and Collateral to a Contract in Which It Is Contained?, 3 J. INT'L ARB. 95, 103-04 (1986).
119. This is known as the doctrine of separability of the arbitration clause—also called "separability" in the United States, or "autonomy" in France and Germany. See id. at 98-100; see also BERG, supra note 102, at 145.
120. See generally Samuel, supra note 117.
121. International public policy emerged along with the special status that developed in regard to international commercial arbitration. It has a more limited scope than national public policy, and national courts have accepted arbitration of international contracts that would have been unenforceable under domestic law. See, e.g., Mitsubishi, 473 U.S. 614; see also Kuner, supra note 50, at 79-80.
123. Id.
The arbitrator deemed that a major portion thereof was to be used to bribe employees of the incumbent Argentinian government. Although neither party raised the issue of public policy and both parties wanted the matter to be considered on its merits, the arbitrator found the contract to be void. He stated that the object of the contract was bribery, which was contrary to the public policy of all the systems of law involved. The arbitrator therefore refused to make an award on the merits.

2. One of the Parties Raises the Issue

One of the parties may argue that the arbitrator should not decide the case because the contract is against international public policy. This situation occurred in an ICC case. The case involved an Iranian plaintiff who sought commissions for obtaining contracts with the Iranian Government for the Greek defendant. The defendant claimed that the agreement was void as the plaintiff's function had been to influence Iranian Government officials through secret commissions and payments.

Although there was no evidence to support the allegations that the plaintiff had attempted to or bribed officials of the Iranian Government, the arbitrator took note of the endemic corruption of the previous Iranian regime and the success of the plaintiff's efforts on behalf of the defendant. Referring to the Argentina bribery case, the arbitrator held that the main contract was void and refused to order the payment of the commission to the plaintiff.

The above decisions reflect the obligations of arbitrators, accepted as private guardians of international commercial transactions and the developments of the lex mercatoria to uphold the fundamental and accepted standards of international trade. Arbitrators should perform their duties and enforce international practices in light of and in conformity with prevailing applicable law and accepted international commercial standards. In this capacity, the arbitrator is justified in reacting to a manifest violation of international public policy, even though the issue has not been raised by either party.

The arbitrator's obligation to raise the issue of violation of public policy arises from arbitrator's duty to ensure that his award is ultimately enforceable.

124. Id. (generally, bribery may be raised before arbitrators by a plaintiff who would have benefitted from the bribery had it been successful and seeks to recover money owed, or by a defendant when a plaintiff claims commissions to which he is entitled under an agency contract and the defendant alleges that the contract, even if successful, was therefore illegal).
125. Id. at 555.
126. The arbitrator first referred to French law and French public policy, as the law of the place of arbitration, then to Argentinian law. Id. at 554-55.
127. Id. at 555.
128. JARVIN & DERAINS, supra note 37, at 507 (discussing ICC Case No. 3916/1982).
129. Id.
130. Id.
131. Id.
in a national court.\textsuperscript{134} The arbitrator must pay special attention to the public policy of the country where the parties are likely to seek enforcement of the award.\textsuperscript{135} He should also consider whether the contract has such a connection with the economy of the enacting country that it would be fair and reasonable to give effect to the mandatory rules in question.\textsuperscript{136}

A number of recent cases illustrate how arbitrators have dealt with the issue of public policy when it has been raised by one of the parties. \textit{Northrop Corp. v. Triad Financial Establishment}\textsuperscript{137} involved the payment of commissions to an agent with respect to arms sales to Saudi Arabia.\textsuperscript{138} Saudi Arabia then passed Decree No. 1275 of September 17, 1975, forbidding intermediaries in arms contracts.\textsuperscript{139} Thus, the payment of commissions was contrary to both the U.S. Foreign Corrupt Practices Act and to Saudi Arabian law.\textsuperscript{140} The arbitrators had found that the main contract was valid and ordered payment of the commission to the agent under the contract.\textsuperscript{141} The arbitrator's decision was based on the legality of the commission arrangement under the governing law of the agreement and U.S. international public policy.\textsuperscript{142} Rejecting Northrop's claim, the arbitrator observed that, under California law, only a factual impossibility would excuse non-performance.\textsuperscript{143} In enforcing the award, the Court observed that "[t]o justify refusal to enforce an arbitration award on grounds of public policy, the policy 'must be well defined and dominant.'"\textsuperscript{144}

One recent award in which arbitrators sought to uphold international public policy involved several interrelated contracts between Yugoslavian, Dutch, and Swiss entities.\textsuperscript{145} One of these contracts was fictitious, its sole purpose being to provide a means for escaping the restrictions of Yugoslav foreign exchange controls. The arbitrators held:

These fictitious operations, giving rise to a credit which is itself fictitious, are contrary not only to Yugoslav legislation but also to ethical and moral standards. In general, any contract having an object contrary to the imperative laws or public policy, to ethics and moral standards is null and void absolutely.

\textsuperscript{134} Karl-Heinz Bockstiegel, \textit{Public Policy and Arbitrability}, 3 ICCA, supra note 6, at 177, 187.

\textsuperscript{135} See 1976 ICC Rules of Arbitration, supra note 58, at 185, 196 (Article 26 provides that "[i]n all matters not expressly provided for in these Rules, the Court of Arbitration and arbitrator shall act in the spirit of these Rules, and shall make every effort to make sure that the award is enforceable at law").

\textsuperscript{136} See Dolinger, supra note 20, at 190.

\textsuperscript{137} 811 F.2d 1265 (9th Cir. 1987).

\textsuperscript{138} \textit{Id.} at 1266.

\textsuperscript{139} \textit{Id.}

\textsuperscript{140} The contract provided that the agreement was governed by California law. \textit{Id.} at 1267.

\textsuperscript{141} \textit{Id.} at 1268.

\textsuperscript{142} \textit{Id.}

\textsuperscript{143} \textit{Id.} at 1270-71.

\textsuperscript{144} \textit{Id.} at 1270. Another U.S. court also rejected the argument that enforcement of an award in favor of Libya, a state known to sponsor international terrorism, would violate public policy. See National Oil Corp. v. Libyan Sun Oil, 733 F. Supp. 800, 819-20 (D. Del. 1990.)

\textsuperscript{145} Lalive, \textit{supra} note 6, at 292 (discussing ICC Case No. 2730/1982).
It is so according to the Austrian General Civil Code, Article 879 . . . and according to the Yugoslav law on contractual obligations . . . . This principle is admitted in every country and all laws. It constitutes an international rule, an element of common law of contract in the international domain.\textsuperscript{146}

In another arbitration proceeding the arbitrators were not deceived by the lawful appearance of a contract of commission and decided that the payment of bribes by a British firm was the cause of the obligation undertaken by a French firm.\textsuperscript{147} Finding the contract to be null and void, the panel pointed out that "[t]his solution is not only in keeping with internal French public policy, it is also dictated by the concept of international public policy as is recognized by the majority of States."\textsuperscript{148} The arbitrators accordingly held that all the related contracts were void due to the invalidity of the fictitious contract.\textsuperscript{149}

V.

CONCLUSION

Until recently, international commercial arbitration practice showed itself imaginative in its determination to apply the relevant mandatory rules foreign to the substantive law of the contract. An examination of the arbitral jurisprudence reveals a body of decisions that all have a common denominator: the desire of the arbitrators to meet the legitimate expectations of the parties for whom they act. Arbitrators felt that they were not the guardians of public policy, with the primary function of remedying unlawful situations. Rather, they were the private judges of the concerned parties whose mission was to settle the disputes according to the law chosen by the parties.

International arbitrators have realized, however, that they should apply relevant mandatory public law rules on reasonable grounds or at least take them into consideration to promote the survival of international commercial arbitration as an institution and the respect for international comity. Most importantly, they have observed that their awards may not be enforced if they do not so proceed. Because mandatory public law rules of a state are meant to protect its social-economic interest, they should be applied when a certain contractual relationship has substantial relevance to such rules in respect of formation, performance, or enforcement of the contract. Therefore, among

\textsuperscript{146} Jarvin & Derains, \textit{supra} note 37, at 494; Laminoirs \textit{v.} Southwire Co., 484 F. Supp. 1063 (N.D. Ga. 1980) is the only U.S. case in which the court refused to enforce part of a foreign arbitral award on the grounds that it violated the public policy of the country where enforcement was sought. The arbitral award provided for a five percent surcharge if payment of the award was delayed. The court found that the surcharge amounted to a penalty, and refused to enforce that portion of the award. \textit{Id.} at 1069.

\textsuperscript{147} Lalive, \textit{supra} note 6, at 292 (discussing ICC Case No. 3913/1981).

\textsuperscript{148} \textit{Id.}

\textsuperscript{149} This award appears to give national laws an international or supranational effect which is similar to the English doctrine prohibiting the enforcement of a contract contrary to the law of a foreign and friendly state. See Regazzoni \textit{v.} K.C. Sethia, 2 All E.R. 487 (1956). As a general rule, the principle may be too widely construed.
the relevant mandatory public law rules that an international arbitrator may apply are: (i) those which necessarily affect the performance of a contract; (ii) those which form part of the public policy of the state in which enforcement of an award is likely to be requested; and (iii) those of the countries closely connected with the contract.

Although in contractual matters the principle of party autonomy is the basic conflict of laws rule according to which the law applicable to a contract must be determined, mandatory rules, especially if they are of a public law nature, follow their own conflict of laws principles. An arbitrator applies mandatory rules of a state as foreign *lois de police* or foreign rules of public law, since he has no national forum and hence no *lex fori*.

Finally, the primary role of an arbitrator should be to screen and interpret the mandatory rules, define the substantive law, correlate the laws of the place of performance, and decide disputes. There is little doubt that an arbitrator will not apply mandatory rules of public law when the following three conditions are met: the mandatory rules are part of the substantive law of the contract, the parties have not expressly excluded their application, and one of the parties has invoked the rules before the arbitrators. In cases where the mandatory rules are foreign to the substantive law of the contract, the present trend is, at least under American law, that an arbitrator has a duty to give effect to the mandatory rules of public law, that is, to limit the parties' freedom to choose the substantive law of their contract.