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# THE APPLICABLE LAW IN INTERNATIONAL COMMERCIAL ARBITRATION

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INTERNATIONAL CONTRACTS are those which are entered into by parties belonging to different states who are sovereign entities. Therefore, each party is subject to the jurisdiction of the State and the courts of that State of which he is a national. There is no law governing such international contracts binding on both the parties except in so far as is made by the parties for themselves by means of an agreement. The established method by which the parties agree to the resolution of differences between them arising out of such international contract is arbitration. Such arbitration is firstly international and secondly it is commercial.

International arbitration is distinct from national arbitration basically because national arbitration is subject to a law while international arbitration is not except in so far as the parties by their agreement make the law of a particular nation applicable to the contract or to any part of the contract. Even when the parties agree or the rules of conflict of laws decide which national law is to apply to such a contract in preference to some other national law, further refinements have been made to this concept of the national law or the proper law applicable to the contract by virtue of the agreement of parties or by the application of the rules of conflict of laws. Consideration of these refinements will form the subject-matter of this article.

This international arbitration is called commercial so that it may be distinguished from an arbitration between two sovereign states under the rules of public international law. That is to say, international commercial arbitration would be governed by the rules of conflict of laws or the rules resulting from the agreement of parties as distinguished from the rules of public international law which result from the customs and usages of nations, the agreement of parties or multinational conventions.

## I Choice of the law

The primary consideration which determines the applicable law to such an international commercial contract which law would be followed by the

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arbitrators is the intention of the parties. For, the only law which can govern such parties which are subject to different national jurisdictions with different national legal systems is the law agreed to by the parties. Therefore the proper law of contract is understood to mean the system of law by which the parties intend the contract to be governed. Where the intention is not expressed nor can be inferred from the circumstances, the proper law would mean that system of law with which the transaction has its closest and most real connection.[1]

One would have thought that once the proper law of contract applicable to the dispute between the parties is determined the law governing the conduct of arbitration would also be determined with the help of the proper law of contract. For instance, when the proper law of contract is a national law of the state of one of the parties, such national law would contain the provisions applicable to the conduct of the arbitration also. For instance, in a contract which is governed by the laws of India either because the parties have so agreed or because this is the result of the application of the principles of conflict of laws, such laws of India would include not only the law of contract but also the law of arbitration. Hence a broader meaning of the proper law of contract would include the law of arbitration also because arbitration itself is a result of a contract, namely the arbitration agreement.

## II Arbitration agreement distinguished from the main contract

However, the agreement of arbitration, though a contract, is different in its nature from the main contract of which it may form a part. This was recognised early enough, for instance, by Lord Macmillan in *Heyman* v. *Darwins Ltd.*[2] This distinction was made only to emphasize that a breach of the obligations and liabilities arising under the main contract may bring about termination of the main contract but not of the arbitration agreement. Indeed, the arbitration agreement would be invoked only when disputes arise under the main contract including a repudiation of the main contract by any of the parties. The arbitration agreement is thus remedial while the main contract is substantive. An arbitration agreement does not create rights and obligations but provides a machinery for settlement of disputes arising out of the rights and obligations. This distinction has gone so far as to enable the Supreme Court of the United States in *Prima Paint Corporation* v. *Flood & Conklin Manufacturing Company Ltd.*[3] to hold that even when a party to the arbitration agreement alleges that the main contract was voidable because it was induced by fraud, the arbitration agreement would not be under a challenge because no fraud is alleged in the formation of the arbitration agreement as such. Therefore the jurisdiction of the arbitrator under the arbitra-

1. Dicey & Morris, *Conflict of Laws*, rule 155 (10th ed. 1980).
2. 1942 A.C. 356.
3. 388 U.S. 395 (1967).

tion agreement would cover the decision as to the voidability of the main contract also. So, the distinction between the main contract and the arbitration agreement is legitimate. It is like a distinction between different clauses of the contract according to the nature and effect of these clauses.

## III Development of a lex arbitri

Strangely enough, a distinction has developed between the substantive law applicable to the contract and the law applicable to the conduct of the arbitration called *lex arbitri*. The only explanation for such a distinction seems to be that the situs of the arbitration may be outside the country the legal system of which is the proper law of the contract. No other explanation for the development of the concept of *lex arbitri* is available.[4] How has this result come about? The explanation seems to be historical. International commercial arbitration developed under the influence of the commercially advanced nations and the international arbitral institutions established by them. Among such institutions are the International Chamber of Commerce, Paris, the American Arbitration Association and the London Court of Arbitration, the ICC Paris being the oldest and more widely used than the others till recently. The basic practice of the ICC was that the arbitral tribunal was formed of three arbitrators. Two arbitrators were nominated by the two parties to the dispute and the chairman was appointed by the ICC Court of Arbitration. To ensure neutrality and impartiality the chairman would be chosen from a country other than the countries of the two disputants. The place of arbitration would be in the country from which the chairman was chosen. Thus, the choice of the place of arbitration by the arbitral tribunal and by the ICC Court of Arbitration was purely accidental. Such a choice could not be attributed to the intention of the parties.

## IV Influence of the place of arbitration on lex arbitri

In spite of the accidental nature of the situs of arbitration which did not reflect in any measure the intention that the arbitration be governed by the law of the place of arbitration, the economic domination of the advanced countries resulted in attributing an undeserved importance to the place of arbitration. Paris, New York or London were commonly chosen as places of arbitration by international arbitral institutions more for convenience and neutrality than with any other intention attributable to the parties to the arbitration. Nevertheless, initially the presumption was raised that the law applicable to the arbitration would be the law of the place of arbitration. Fortunately, this presumption was not understood to include the substantive law applicable to the rights of the parties.

The place of arbitration would be only one of the factors to be considered

4 Redfern & Hunter, *Law and Practice of International Commercial Arbitration* 53-54 (1986)

for determining the proper law of contract. Therefore, in *Compagnie d' Armement Maritime S.A.* v. *Compagnie Tunisienne de Navigation S.A.*[5] it was held that the proper law of contract applicable to the dispute between the two parties was the law of France even though the arbitration was held in London. But it has been argued[6] that the very fact that this decision was given by an English court showed that the law governing the arbitration proceedings as distinguished from the substantive law of contract was English law merely because the place of arbitration happened to be in London.

## V Article 1(2) of the UNCITRAL Model Law

This influence of the place of arbitration on the law governing arbitration proceedings was carried to an extreme conclusion when the UNCITRAL Model Law on International Commercial Arbitration was adopted by the United Nations Commission on International Trade Law on June 21, 1985. Article 1(2) of the Model Law is as follows:

> The provisions of this Law, except articles 8,9,35 and 36 apply only if the place of arbitration is in the territory of this State.

This means that the law to be framed by each state provides that the jurisdiction of the state over the arbitration would be lost if the arbitration were conducted in another State. In a conference held at New Delhi under the auspices of the Indian Council of Arbitration under the Charimanship of the Minister of State for Law & Justice this subject was discussed, and it was resolved to recommend to the Government of India that the UNCITRAL Model Law may be adopted by India minus Article 1(2). The place of arbitration is determined by considerations not related to the law of that place. Therefore the basic principle that the law governing the arbitration should be the same as the law governing the substantive contract and the law governing the jurisdiction of the court over the case was asserted, as against the irrational development that the law governing the arbitration proceeding would be different from the substantive law and would be generally the law of the place of arbitration.

## VI Concept of contract as a whole

To prevent the irrational separation of the contract of arbitration from the main contract between the parties, leading authors and judicial decisions have emphasized the concept of the contract as a whole including the arbitration clause thereof. Dicey and Morris,[7] after referring to the presumption

5. 1971 A.C. 572.
6. *Supra* note 4 at 54
7. *Conflict of Laws*, 537 (11th ed )

that the law of place of arbitration would govern the conduct of the arbitration, observe as follows:

> But this presumption,though strong, can be rebutted; for the House of Lords has emphasized that an arbitration clause is only one of several circumstances to be considered in determining the proper law of the contract. The presumption cannot operate if no place of arbitration is agreed in the original contract or if the place of arbitration is left to be chosen by the arbitrators or by an outside body. In such cases, the proper law of arbitration (including the arbitration clause) will be determined in accordance with the normal principles.

The learned authors also observe that:

> The proper law of arbitration agreement will determine its validity, effect and interpretation.

This observation is important because it applies directly to the practice of the international arbitral institutions such as the ICC Paris. Under the Rules of Arbitration of the ICC Paris, the choice of the place of arbitration is left to the arbitral tribunal and the ICC Court of Arbitration.

Once the parties to the arbitration agreement agree that the arbitration will be governed by the ICC Rules, the ICC Rules become incorporated in the arbitration agreement. It could be argued, therefore, that though the parties have not made a choice of the place of the arbitration directly, they have done so indirectly by submitting to the ICC Rules of Arbitration which Rules would give the power to choose the place of arbitration to the arbitral tribunal and the ICC Court of Arbitration. Such an argument is fallacious. For, the ICC Rules of Arbitration do not give any indication to the parties as to the place of arbitration. It is only when the ICC Court of Arbitration chooses the chairman of the arbitral tribunal that the place of arbitration is determined. Since neither the parties nor the arbitral tribunal nor the ICC Court of Arbitration are aware at the time the parties agree to be governed by the ICC Rules of Arbitration, of the place from which the chairman would be chosen, it cannot be said that the parties directly or indirectly had the intention that any particular place would be the place of arbitration. This is why Dicey and Morris have emphasized that the system by which the place of arbitration is chosen either by the arbitral tribunal or by an outside body is different from the system by which the place of arbitration is chosen by the parties themselves.

This concept of the contract as a whole to include the arbitration agreement results in the proper law of contract being applicable to the conduct of the arbitration also. The overwhelming academic and judicial opinion favours the application of the proper law of contract or the national law of the country of the proper law of contract to apply to the conduct of the arbitra-

tion proceedings and particularly the jurisdiction of the court over the arbitration proceedings.

Mustill and Boyd[8] state:

> Problems arising out of an arbitration may, at least, in theory, call for the application of any one or more of the following laws--
> (*i*) The law governing the contract which creates the substantive rights of the parties, in respect of which the dispute has arisen,
> (*ii*) The law governing the obligation of the parties to submit the disputes to arbitration, and to honour an award,
> (*iii*) The law governing the conduct of the individual reference,
> (*iv*) The law governing the contract which regulates the individual reference to arbitration.

The learned authors further state:[8a]

> In the absence of contrary indications, law (*ii*) will be assumed to be the same as law (*i*) (*i.e.* the proper law of the substantive agreement). An express choice of law (*ii*) will rarely be found.

Therefore, when the parties have chosen the proper law of contract to be the national law of a country, such a choice will include not only (*i*) the law governing the substantive rights of the parties under the contract, but also, (*ii*) the law governing the obligation of the parties under the arbitration agreement. This cuts at the very root of the theory that the *lex arbitri* would be different from the proper law of contract which may be *lex loci contractus* or *lex situs* or *lex causae* etc.

In *Naviera Amazonica* v.*Campania International*[9] Kerr L.J., in the Court of Appeal states:

> All contracts which provide for arbitration and contain a foreign element may involve 3 potentially relevant systems of law -- (1) the law governing the substantive contract, (2) the law governing the agreement to arbitrate and the performance of that agreement, and (3) the law governing the conduct of the arbitration. *In the majority of cases, all three will be the same.*

Klein[10] observes:

> Of course, as mentioned already the arbitration clause is in principle

8. *Law and Practice of Commercial Arbitration in England*, 63 & 64.

8a. *Id.* at 65.

9. (1988) 1 Lloyd's L.R. 116 at 119.

10. "The law to be applied by the arbitrators to the substance of the dispute" in *The Art of Arbitration* 192.

> independent. This, however, does not signify that it must necessarily be governed by a law other than the one governing the main contract. One might presume legitimately that the party did not intend needlessly to complicate matters. Certain standard arbitration clauses and arbitration rules provide that the law governing the arbitration should be the same. According to the rules of the German National Arbitral Institution, German law is in principle applicable both to the substance and to the procedure. The same was true for the London Court of Arbitration. The clause recommended by this institution provided for the application of English law to the contract and to the procedure. This clause was modified after the enactment of the Arbitration Act 1979 and it is now recommended that the parties designate the applicable law.

Dicey and Morris[11] state:

> Advantages of the proper law doctrine--The same law applies to all aspects of the contract: It is open to the parties to agree that one aspect of the contract shall be governed by the law of one country and another aspect by the law of another country. There is no authority to the effect "that there can be but one proper law in respect of any given contract," but, "it is doubtless true to say that the courts of this country will not split the contract readily and without good reason."[12]

Therefore, normally, parties specify only one proper law to govern the contract as a whole and do not specify one proper law for the contract and another proper law for the arbitration clause of the contract. Unless the parties themselves split the contract like this, the courts will not split it and will apply the same proper law to the contract and to the arbitration clause in it.

**VII Arbitration law in Europe**

The overwhelming majority of the European countries including the UK have opted for the law that even such procedural law is to be left to the choice of the parties and the mere fact that the place of arbitration is fixed by the ICC Court of Arbitration in any of these European countries does not mean that the procedural law of that country will apply to such a foreign arbitration. The laws of the several European countries reproduced in a book published by the ICC[12a] emphasize that the choice not only of the substantive law but even of the procedural law governing the arbitration is left to the

11. *Supra* note 1 at 748-749.
12. *Kahler* v. *Midland Bank*, 1950 A.C. 24 at 42.
12a. *Arbitration Law in Europe* (1981).

parties and no presumption is raised in favour of the applicability of the law of the place of arbitration since it is recognized that the place of arbitration is chosen for convenience and not with the intention of applying to the arbitration the law of that place.

## VII Jurisdiction of the courts

Once the proper law of contract is determined either by the choice of the parties or by the rules of conflict of laws applicable, the proper law will contain the provisions giving jurisdiction to the courts of that country whose legal system is the proper law of the contract. For instance, section 28 of the Indian Contract Act 1872 and section 2(c) and section 31 of the Indian Arbitration Act, 1940 state the court which would have jurisdiction over a particular arbitration. These provisions are applicable not only to domestic arbitration but also to international commercial arbitration because the provisions of the Indian statutes dealing with international commercial arbitration are not exhaustive. The Geneva Protocol on Arbitration Clauses 1923 and the Geneva Convention on Execution of Foreign Arbitral Awards 1927 have been implemented by the Arbitration (Protocol and Convention) Act, 1937. The New York Convention, 1958 on the Recognition and Enforcement of Foreign Arbitral Awards has been implemented in India by the Foreign Awards (Recognition and Enforcement) Act, 1961. But both these enactments provide in effect in their respective sections 4 that the provisions of the domestic law of arbitration would apply to the international commercial arbitration also where these statutes are silent.

Once the jurisdiction of the court is ascertained, it necessary follows that the conduct of arbitration would have to be in accordance with the law under which the jurisdiction of the court is exercised. This is substantive law, and not procedural law. Mustill and Boyd[13] make this clear in the following observation:

> The law of arbitration is thus mainly procedural in content. But it does also deal with certain substantive aspects of the arbitral process, in the sense that it creates and regulates the jurisdiction of the court to intervene in the event of an erroneous decision by the arbitrator on some issue or issues arising in the dispute which is submitted to him pursuant to an agreement to arbitrate.

If the jurisdiction of the court is a part of the substantive law of the contract and if the court having jurisdiction is bound to follow the procedure governing that court, the inevitable result would be that the conduct of arbitration under the jurisdiction of such a court would also be governed by the same procedure which is applicable to the exercise of the jurisdiction of the

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13. *Commercial Arbitration in England*, 121 (1982).

court. This is why the arbitration statutes, American, English or Indian, contain two distinct sets of provisions. On the one hand, they set out the procedure to be followed by the arbitrator in the conduct of the arbitration. On the other hand, they set out the jurisdiction of the court in assisting and controlling arbitration. They demonstrate, therefore, that the substantive law of arbitration cannot be separated from the procedural law of arbitration.

## IX The result

The discussion leads to this conclusion: that the proper law of contract either chosen by the parties or determined in accordance with the rules of conflict of laws would include not only,

(*i*) the law governing the substantive contract, but also
(*ii*) the law governing the arbitration agreement and the enforcement of that agreement, and
(*iii*) the law governing the conduct of the arbitration

as was observed by the Court of Appeal in *Naviera Amazonica*[14] and in accordance with the overwhelming academic opinion illustrated above. It is hoped,therefore, that in future in the conduct of international arbitration the proper law of contract will be applied uniformly to cover not only the rights and obligations of the parties but also the arbitration agreement and the conduct of the arbitration. This will have the advantage of a uniform application of the same legal system to the whole of the arbitral process and will harmonize with the exercise of the jurisdiction of the courts over such arbitration in accordance with the same law. This will then recognise that the choice of the place of arbitration is merely for the convenience of the parties without raising any presumption that the law of the place of arbitration was to apply either to the substantive rights of the parties or to the arbitration agreement or to the conduct of arbitration.

14. *Supra* note 9.