

# MANDATORY RULES OF LAW IN INTERNATIONAL COMMERCIAL ARBITRATION

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*[Mandatory rules of law are laws that purport to apply irrespective of the law chosen by the parties to govern their contractual relations. This article examines their role in international commercial arbitration. They pose a complex and continuing problem for arbitrators because they put the interests of states and parties in direct competition. When a law says that arbitrators must apply it, yet the parties' contract excludes it, what should the arbitrators do? Where should their allegiance lie? The answer depends on the underlying nature of arbitration — and since that can be legitimately conceptualised in different ways, a principled approach to mandatory rules is impossible to provide. Nevertheless a practical solution is required. Therefore, recognising the limitations created by arbitration's uncertain nature, this paper identifies the considerations that mitigate for and against the application of mandatory rules and uses these as a basis for examining the merits of different methodological approaches currently in use. In addition, some novel suggestions are offered and analysed. Conclusions are then drawn as to which method best reconciles the interests involved.]*

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## I INTRODUCTION

Arbitration has become the preferred dispute settlement method for private parties engaged in international commercial transactions. It offers parties the possibility of a more efficient, confidential and neutral process, with easy and effective international enforcement provided by the *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*.<sup>1</sup> As arbitration is based on the consent of the parties, it also allows for flexibility over a wide range of matters, including choice of substantive and procedural law.

However such party autonomy is not without limits, as private commercial behaviour will invariably be subject to various national rules and policies. Many of the contentious areas in the theory and practice of arbitration relate to the inevitable tensions between party autonomy and state legal controls. One emerging issue is the impact on party autonomy of mandatory rules of a state with some relationship to the arbitration.

Mandatory rules are laws that purport to apply irrespective of a contract's proper law or the procedural regime selected by the parties.<sup>2</sup> In this sense, whether they are 'mandatory' does not depend on whether they will ultimately end up applying via the relevant conflict of laws analysis, but only on how the law itself defines its sphere of application. Mandatory rules can reflect states' internal or international public policy, and generally protect economic, social or

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<sup>1</sup> Opened for signature 10 June 1958, 330 UNTS 3 (entered into force 7 June 1959) ('*New York Convention*').

<sup>2</sup> Pierre Mayer, 'Mandatory Rules of Law in International Arbitration' (1986) 2 *Arbitration International* 274, 275.

political interests.<sup>3</sup> They can be either procedural, for example requiring due process, or substantive, such as certain tax, competition and import/export laws. Unsurprisingly, it is the application of substantive mandatory rules that creates the most controversy.

The role of mandatory rules in international commercial arbitration is uniquely complicated because they put the interests of states and parties in direct conflict. In addition, conflicts between states' interests can arise. Two or more states may have either conflicting mandatory rules, or conflicting interests in the outcome of an arbitration where their corporate citizens are involved.

How arbitrators should resolve the conflict between state and private party interests, and respond to the competing interests of states, are the central questions of this article. As to the first issue, the answer depends to a large degree on where arbitrators' allegiances should lie — with the parties that appoint them, or the states that support them. This, however, depends on what arbitration itself actually is — a private act between private parties, or a public function that stems from sovereign power. Scholars have debated this question since arbitration's inception. For pragmatic reasons, a compromise has emerged which recognises arbitration as a hybrid of the two extremes. However, this compromise does not prescribe the equilibrium of this hybrid, which makes it difficult to know exactly when arbitrators' allegiance should lie with the parties, and when with states. It is this first principles quandary that makes mandatory rules 'one of the most burning issues in daily international arbitration practice'.<sup>4</sup>

As to the different views of various states, this is important in international arbitration as a number of states will often have an involvement with the dispute at various stages. The parties' native states have to consider whether to forego litigation jurisdiction in the face of a valid arbitration agreement, or whether to see the subject matter of certain disputes as not capable of being arbitrated. The country in which an arbitration is held needs to consider recognition, support and supervision issues. Enforcement may be sought in a range of countries where assets are held, bringing into question the policies and attitudes of those jurisdictions as well. The contract might be wholly or partly performed in an entirely different state. The potential for various and conflicting mandatory rules from these states, and conflicting parochial views as to the application of a given rule that may harm or help a corporate citizen, is the second broad area of conceptual challenge. Where a conflict of mandatory rules occurs the answer will usually depend on finding some objective and fair means to decide between the legitimate legislative goals of different nations whose citizens engage in international commercial transactions. Once again, views as to arbitration's fundamental nature would be relevant. For example, the more one views the basis of arbitration as being jurisdictional as opposed to contractual, the less relevant the views of any country other than the particular forum becomes. On this approach, the conflict of laws rules of the seat of the arbitration would be

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<sup>3</sup> Marc Blessing, *Impact of the Extraterritorial Application of Mandatory Rules of Law on International Contracts* (1999) 5 available at <[http://www.baerkarrer.ch/Publications/1009/4\\_3\\_9.pdf](http://www.baerkarrer.ch/Publications/1009/4_3_9.pdf)> at 1 October 2005; Yves Derains, 'Public Policy and the Law Applicable to the Dispute in International Arbitration' in Pieter Sanders (ed), *Comparative Arbitration Practice and Public Policy in Arbitration* (1987) 227, 228.

<sup>4</sup> Blessing, *Impact of the Extraterritorial Application of Mandatory Rules*, above n 3, 70.

controlling. Where states' parochial views are concerned, arguably even these should be relevant to the mandatory rules debate, given that states control arbitrability and thus, to a degree, arbitration generally.

To complicate matters, mandatory rules issues are on the rise. With the ever-increasing popularity of arbitration,<sup>5</sup> expanded notions of arbitrability<sup>6</sup> and increased legislative activity in this area,<sup>7</sup> mandatory rules issues have been said anecdotally to arise in over 50 per cent of cases.<sup>8</sup>

This article aims to resolve some of the conceptual difficulties surrounding mandatory rules. To date, important work in this area has been done by Yves Derains,<sup>9</sup> Horacio Grigera Naón<sup>10</sup> and Bernd von Hoffmann<sup>11</sup> in examining the relevant case law and searching for common features in arbitrators' decisions. However, there is a notable lack of attempts to examine the issue from first principles and establish a sound theoretical framework for arbitrators to use when confronted with mandatory rules. This article seeks to fill that void. It therefore concentrates on first principles analysis, not on the emerging body of case law in the area. Part II will outline the aforementioned theoretical dilemma concerning the underlying nature of arbitration, and will explain why the hybrid view of arbitration seems currently to prevail. Part III lists the considerations relevant to the application of mandatory rules. There are various theoretical and practical considerations that should be used as a basis for determining the desirability of any approach to mandatory rules that might be adopted. Before such approaches are examined, Part IV will look for situations in which the application of mandatory rules is so well accepted that it is uncontroversial. Part V then considers what should happen outside those uncontroversial situations. In principle, arbitrators could apply all mandatory rules, they could apply none, or they could have discretion to apply certain mandatory rules in certain situations. The advantages and disadvantages of each of these will be discussed in light of the considerations mentioned in Part III. As will be seen, the success of an approach that gives arbitrators discretion will depend on how that discretion is structured and applied in practice. Two methods that have emerged for exercising this discretion are the 'special connection' and 'legitimate

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<sup>5</sup> Professor Andrew Guzman argues that '90% of certain types of large international transactions include arbitration clauses': see Andrew Guzman, 'Arbitrator Liability: Reconciling Arbitration and Mandatory Rules' (2000) 49 *Duke Law Journal* 1279, 1281.

<sup>6</sup> An arbitrable dispute is one which may be resolved by arbitration. Inarbitrable disputes must be resolved by national courts. The US, for example, now allows arbitrators to consider: federal antitrust cases (see *Mitsubishi Motors Corporation v Soler Chrysler-Plymouth Inc*, 473 US 614 (1985) ('*Mitsubishi*')); federal securities (see *Rodriguez de Quijas v Shearson/American Express Inc*, 490 US 477 (1989)); cases arising under the *Racketeer Influenced and Corrupt Organization Act of 1970*, 18 USC §§ 1961–8 (2004) (see *Shearson/American Express Inc v McMahon*, 482 US 220 (1987)); and other statutory claims.

<sup>7</sup> Gary Born, *International Commercial Arbitration: Commentary and Materials* (2<sup>nd</sup> ed, 2001) 560.

<sup>8</sup> Marc Blessing, 'Mandatory Rules of Law versus Party Autonomy in International Arbitration' (1997) 14(4) *Journal of International Arbitration* 23, 24.

<sup>9</sup> Above n 3.

<sup>10</sup> Horacio Grigera Naón, *Choice-of-Law Problems in International Commercial Arbitration* (1992).

<sup>11</sup> Bernd von Hoffmann, 'Internationally Mandatory Rules of Law before Arbitral Tribunals' in Karl-Heinz Böckstiegel (ed), *Acts of State and Arbitration* (1997) 3.

expectations' tests. These will be examined in Part VI. Finally, Part VII offers some novel suggestions, before conclusions are drawn as to which is the preferable approach.

## II THE 'NATURE' DEBATE

Most arbitrators are intimately familiar with the longstanding debate over arbitration's underlying nature. This theoretical dilemma creates real, practical problems, as different conceptions of what arbitration actually is can influence how parties' and arbitrators' rights and responsibilities are understood.<sup>12</sup> There are three main theories — contractual, jurisdictional and hybrid.<sup>13</sup> The nature of each, and the way in which they are likely to shape one's paradigm for assessing mandatory rules, will be briefly outlined in turn.

### A *Contractual Theory*

The contractual theory sees arbitration as contractual in nature. The entire arbitral process — from setting up the tribunal, to the arbitrators' powers and the binding effect of the award — is seen as a product of the parties' agreement.<sup>14</sup> Logically then, state legal systems play no role in the contractualist understanding of arbitration. The reason given is that states do not hold rights and physical liberty on sufferance,<sup>15</sup> which means that arbitration is an instrument of 'free enterprise' and isolated from the state system.<sup>16</sup> There is an exception in the event that one party tries to avoid its contractual obligations (either to submit to arbitration or carry out the arbitrators' award), but then the state only intervenes to enforce the parties' deal as an unexecuted contract.<sup>17</sup> Thus, it is easy to see how many consider it possible for arbitration to be 'unbound' from its seat<sup>18</sup> and why 'contractualists' are hostile to mandatory rules. If party autonomy is paramount under contractualist reasoning, any law that purports to apply regardless of the parties' choice will not be warmly received. Under this theory, mandatory rules should only be relevant if they form part of the *lex contractus*, or prove the invalidity or illegality of the parties' contract.

Within this paradigm there is still a conceptually challenging set of issues where parties have not clearly expressed a view as to the application of mandatory rules and cannot agree on that issue once a dispute has arisen. The obvious situation is where the parties have made no choice as to the applicable

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<sup>12</sup> Or, as Lew, Mistelis and Kröll put it, '[t]he legal nature of arbitration ... deals with [the] jurisdictional consequences resulting from party autonomy': Julian Lew, Loukas Mistelis and Stefan Kröll, *Comparative International Commercial Arbitration* (2003) 72.

<sup>13</sup> There is a fourth theory (the autonomous theory), developed by Rubellin-Devichi in 1965. However, in light of the insubstantial favour it has received it will not be considered. On this theory see generally Jacqueline Rubellin-Devichi, *L'arbitrage: nature juridique, droit interne et droit international privé* (1965); Julian Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitral Awards* (1978) 59; Lew, Mistelis and Kröll, above n 12, 81.

<sup>14</sup> Grigera Naón, above n 10, 15.

<sup>15</sup> Geoffrey Hartwell, 'Arbitration and the Sovereign Power' (2000) 17 *Journal of International Arbitration* 11, 11.

<sup>16</sup> Lew, above n 13, 57.

<sup>17</sup> *Ibid.* 56.

<sup>18</sup> Born, above n 7, 10.

substantive and procedural laws. Another permutation is where there is a general choice of law clause without an express indication of its impact on other potentially applicable mandatory rules. In each of these circumstances, is it ever appropriate to apply mandatory rules based on some implied consent theory? If so, by what evidence is that implied consent determined?

### B *Jurisdictional Theory*

The salient feature of the jurisdictional theory is its emphasis on national sovereignty. Unlike contractualists, who see arbitration as an exercise of free enterprise, ‘jurisdictionalists’ understand that every activity occurring within the territory of a state is necessarily subject to its jurisdiction.<sup>19</sup> As F A Mann has said, ‘[e]ven the idea of the autonomy of the parties exists only by virtue of a given system of municipal law’.<sup>20</sup> Flowing from this, jurisdictionalists believe that all aspects of arbitration — including the validity of the arbitration agreement, the powers of the arbitrators, and the enforcement of the award — are regulated by domestic laws. These will predominantly be the laws of the seat (for issues as to the conduct of the arbitration) and the laws of the country where enforcement is sought.<sup>21</sup> Thus in determining the law applicable to either the merits or procedure, arbitrators must, like a local judge, ultimately have recourse to domestic laws, in particular the laws of the seat. This does not mean that they are constrained from applying foreign laws, but it does mean that they must do so by recourse to conflict of laws rules. Therefore, decisions as to whether a mandatory rule should be applied should be reached via conflicts rules as well, which would begin with the conflicts rules of the seat.

### C *Hybrid Theory*

Most now agree that neither the contractual nor jurisdictional theory present a complete picture of arbitration. In reality, arbitration depends upon elements from both — it is contractual in that the parties obviously control certain elements such as the agreement to arbitrate and the selection of the arbitrators, but jurisdictional in that, to use an extreme example, it ultimately exists at the pleasure of states, who can deny arbitrability at will. Accordingly, most now accept that arbitration is a hybrid of the two theories.<sup>22</sup>

According to Okezie Chukwumerije, ‘[t]he reality is that an understanding of the concept of arbitration must acknowledge the interaction of both its consensual basis and the legitimacy and support conferred on the process by national legal systems’.<sup>23</sup> Similarly, Julian Lew recognises that while ‘the

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<sup>19</sup> See, eg, F A Mann, ‘Lex Facit Arbitrum’ in Pieter Sanders (ed), *International Arbitration: Liber Amicorum for Martin Domke* (1967) 157, 162.

<sup>20</sup> Ibid 160. Nygh has expressed similar sentiments, claiming the *lex fori* must be the starting point of the parties’ autonomy: Peter Nygh, *Autonomy in International Contracts* (1999) 33–4. See also Alan Redfern and Martin Hunter with Nigel Blackaby and Constantine Partasides, *Law and Practice of International Commercial Arbitration* (4<sup>th</sup> ed, 2004) 91.

<sup>21</sup> Okezie Chukwumerije, *Choice of Law in International Commercial Arbitration* (1994) 11.

<sup>22</sup> See, eg, *ibid* 13; Hans van Houtte, *The Law of International Trade* (1995) 384; Lew, *ibid* n 13, 57; Grigera Naón, *ibid* n 10, 17.

<sup>23</sup> Chukwumerije, *ibid* n 21, 13.

arbitration agreement is a contract and must be treated as such, the arbitration proceedings remain subject to some national law'.<sup>24</sup>

However, acceding to this growing trend solves only a small part of the problem. If the different views of arbitration's nature can be considered points along a continuum, with the contractual and jurisdictional theories at either end, there is much room in the middle for different conceptions of the hybrid view. The closer in proximity arbitrators are to the contractual end of the continuum, the less inclined they will be to deny party autonomy, and vice versa. So recognising arbitration as a hybrid does not determine what relative weight should be given to the different interests involved. An answer to this question is more difficult to find, and, as will be seen, it is this question that continually haunts mandatory rules issues.

### III RELEVANT CONSIDERATIONS

Stemming from the hybrid understanding of arbitration, and pragmatic concerns such as the survival of arbitration as an institution,<sup>25</sup> are multifarious theoretical and practical considerations that are relevant to a mandatory rules discussion. Arbitrators will want to turn their minds to all of these, and make sure their award adequately caters for each. This Part will outline the nature and relevance of the most important considerations. One aim is to identify the contradictory and irreconcilable elements they contain, and thereby achieve an appreciation of the difficulty — or perhaps impossibility — of reaching a 'perfect' solution.

More importantly, these considerations will be used to gauge the success of existing<sup>26</sup> and novel<sup>27</sup> approaches to mandatory rules. If, however, some are contradictory and irreconcilable, how will it be possible to tell when one approach is better than another? Is a balance of considerations sufficient (a question of numbers)? Or are certain considerations more important than others (a question of priorities)? The answer, unfortunately, is that until it is known what type of hybrid arbitration is, there cannot be such a precise method of assessment, as it remains unclear what weight different considerations should be given.

In addition to the overriding question as to arbitration's essential nature, there are a host of related subsidiary questions. These include when and why an arbitrator can make decisions where underlying consent is unclear; when and why such decisions can be challenged; and what deference courts in all the affected states should give to such arbitral determinations.

However, the absence of a readily identifiable formula, either at the general level or in respect of mandatory rules, does not preclude a worthwhile analysis. Often, the balance of considerations on a particular issue such as mandatory rules

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<sup>24</sup> Lew, above n 13, 58. See also Lew, Mistelis and Kröll, above n 12, 80.

<sup>25</sup> Pierre Mayer even goes as far as to suggest that arbitrators have a *duty* to the survival of international arbitration as an institution: Mayer, 'Mandatory Rules of Law in International Arbitration', above n 2, 285–6. See also Daniel Hochstrasser, 'Choice of Law and "Foreign" Mandatory Rules in International Arbitration' (1994) 11(1) *Journal of International Arbitration* 57, 70.

<sup>26</sup> See below Part IV.

<sup>27</sup> See below Parts V–VII.

will be so far skewed to one side that the correct answer will be patently clear. In other circumstances the failure to satisfy certain considerations will create jurisdictional difficulties, which will be insurmountable regardless of how the balance lies. And where the contest of considerations is closer, reasoned arguments can still be advanced for either side, provided they are read with a caveat recognising the legitimacy of different conclusions. Understanding the issues within the mandatory rules debate also allows other analysts to take those insights and seek to inductively integrate them with insights from other testing issues, such as contested jurisdiction, application of arbitration agreements to third parties, and challenges to enforcement, in order to advance the debate about the proper features of the hybrid.

The following sections look at some of the policy issues as to how the treatment of mandatory rules ought to occur.

#### A Consistency

Much of the success of any commercial dispute resolution mechanism depends on its ability to provide consistent outcomes. This is because the parties' decisions to enter a transaction, to refer a dispute to a third party, and to reach a negotiated settlement, often depend on their ability to accurately predict the legal risk in their position. As predictability can only come as a corollary of consistency, business people require that arbitration produce consistent outcomes. If arbitration cannot, it will increase the cost of dispute resolution generally, and potentially, even risk its own extinction. While it would be overly simplistic and dramatic to link arbitration's downfall with an inconsistent approach to mandatory rules, the ability of the applicable law to alter the outcome of a case makes consistency a continuing concern in the mandatory rules debate.

#### B State Legal Expansionism

The potential for state legal expansionism is obvious — if states believe that their interests can be protected in arbitration by mandatory rules, they may be encouraged to enact further mandatory rules. While there would be some advantage in this for states, it is likely to inhibit international commerce, which arbitrators, having a duty to guard the international commercial order, should take active steps to avoid.<sup>28</sup> However, fears of state legal expansionism should not be exaggerated. States may simply not think to enact further mandatory rules to protect their interests, and if they do, they might see that they too have an interest in maintaining healthy international commerce. Also, the diplomatic difficulties caused by failing to respect other states' sovereignty would be sufficient to deter many from legislating extraterritorially. And, in Europe, states are also likely to envisage that intergovernmental relations could be sorely tested if responsibilities under art 7(1) of the *Convention on the Law Applicable to Contractual Obligations* become more than what was bargained for when the

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<sup>28</sup> See Sigvard Jarvin, 'The Sources and Limits of the Arbitrator's Powers' in Julian Lew (ed), *Contemporary Problems in International Arbitration* (1986) 50, 68. See also Lew, above n 13, 540.



convention was ratified.<sup>29</sup> Nevertheless, the risk remains, and increases with the liberalness of the approach to mandatory rules.

### C *Efficiency*

It is an oft-repeated warning that if arbitration is not run efficiently, it may fall into disfavour as the preferred means of resolving international commercial disputes.<sup>30</sup> Indeed, empirical evidence is unnecessary to prove that business people want their disputes resolved as quickly and effortlessly as possible. This raises two issues — when and where mandatory rules issues should be resolved. According to Mayer, arbitration will become inefficient and thus imperilled if arbitrators refer questions concerning mandatory rules to courts rather than deciding them themselves.<sup>31</sup> But fear should be engendered by more than potential inarbitrability alone; efficiency requires that mandatory rules issues be not only dealt with by the arbitral tribunal, but dealt with in a consistent way that will minimise the risk of nonenforcement, and thus increase the incidence of voluntary compliance.

A further aspect of efficiency looks to the nature and importance of the mandatory rules themselves. Economic theory postulates that while the free market should generally guide commercial behaviour, governments should regulate to support efficient market behaviour where it would otherwise not occur. One such area is where there are negative externalities in a market transaction, in other words, adverse impacts on parties outside the commercial transaction. In such circumstances, the private traders are unlikely to properly price their transaction or take steps to minimise third party harm. An example is pollution, where manufacturers and their customers may not include the costs of environmental degradation in their product pricing formula. Here governments have a role in regulating the distribution of those costs, although they may do so in a range of ways. Similar issues arise with anti-competitive behaviour, securities transactions and insolvency. This brings in general questions of market efficiency as well as arbitral efficiency and draws attention to the differing types of mandatory rules and the goals they seek to promote. This is considered in Part VII which seeks to identify criteria by which an arbitral discretion might be validly and consistently exercised.

### D *Arbitrators' Discretion*

Guzman suggests that it is in the parties' interest to select arbitrators hostile to the imposition of mandatory rules. To the extent that business remains competitive for arbitrators, it is further suggested that the incentive for arbitrators to use any discretion to uphold party autonomy is so great that mandatory rules

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<sup>29</sup> Opened for signature 19 June 1980, [1980] OJ L 266/1, art 7(1) (entered into force 1 April 1991) (*'Rome Convention'*). Article 7(1) allows Member States' courts to apply foreign international mandatory rules irrespective of the proper law of the contract. It will be discussed at length in Part VI.

<sup>30</sup> See, eg, Harold Crowter and Anthony Tobin, 'Ensuring that Arbitration Remains a Preferred Option for International Dispute Resolution: Some Practical Considerations' (2002) 19 *Journal of International Arbitration* 301, 301.

<sup>31</sup> Mayer, 'Mandatory Rules of Law in International Arbitration', above n 2, 285.

will rarely receive more than lip service.<sup>32</sup> Certainly this is a cynical view, believing arbitrators to be more concerned with short-term personal gains than the longevity of arbitration as an institution or the protection of legitimate, threatened interests. It also leaves little scope for arbitrators who are genuinely contractualist and do what the parties tell them from a sense of professional duty, rather than for personal gain. There is even less room to accommodate arbitrators who are jurisdictionalists. The theory also fails to acknowledge that parties seeking to invoke a mandatory rule will wish to appoint arbitrators willing to apply them. However, authors' anecdotal evidence suggests that it is extremely difficult to identify cases where arbitrators have relied on the application of a mandatory rule to justify a decision other than that which would have resulted from the application of the law chosen by the parties. For example, Gaillard and Savage know of 'virtually no cases where the arbitrators have relied on the application of a mandatory rule to justify a decision other than that would have resulted from the application of the law chosen by the parties'.<sup>33</sup>

### E *Dependence on Sovereign Support*

Even the most staunch contractualists would concede that arbitration is, to an extent, dependent on sovereign beneficence. Should they so desire, states can simply legislate to contract the boundaries of arbitrability, or deny it altogether. If this occurred, it would be necessary for disputants to have a separate hearing of public law issues, creating the patently undesirable need for parallel proceedings. Thus, all must recognise that state interests have some relevance in arbitral reality, even if arbitrators' duty to protect arbitration as an institution is the theoretical vehicle for doing so.

These issues have long been debated in the context of determining what kinds of disputes are arbitrable. While many jurisdictions were formerly reluctant to allow some public protection issues such as antitrust, securities regulation and insolvency to be the subject of private arbitration, there has been a strong trend in the other direction. *Mitsubishi Motors Corporation v Soler Chrysler-Plymouth Inc* is a leading example of the confidence most national courts now have in arbitration's ability to cater for state interests.<sup>34</sup> However, it would be wrong to take this confidence for granted. It was not long ago that the United States refused to allow arbitration of securities transactions, due to the fear that arbitration would not adequately provide consumer protection for US citizens.<sup>35</sup> It is not difficult to see US courts retracting from this position. For example, consider the Court's view in *PPG Industries Inc v Pilkington plc*:

[T]he Court may, and certainly will, withdraw the reference to arbitration if US antitrust law does not govern the substantive resolution of [the plaintiff's claims]. In addition, the Court directs that any damages determination, or arbitral award, made by the arbitrators shall be determined according to US antitrust law

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<sup>32</sup> Guzman, above n 5, 1284.

<sup>33</sup> Emmanuel Gaillard and John Savage (eds), *Fouchard, Gaillard, Goldman on International Commercial Arbitration* (1999) 856–7. See also the awards referred to by Blessing, 'Mandatory Rules of Law versus Party Autonomy in International Arbitration', above n 8, 24–6.

<sup>34</sup> 473 US 614, 634 (1985).

<sup>35</sup> See, eg, *Wilko v Swan* 346 US 427 (1953).

irrespective of any conflict that may exist between those laws and the laws of England. Finally, the Court will retain jurisdiction over this matter in order to ensure that the arbitration directed by this Order is conducted in accordance with the Order.<sup>36</sup>

Conversely, it must be recognised that the hands that feed can be many. Just as arbitration depends on state support for its survival, it equally depends on the willingness of parties to submit their disputes to its process. If it is felt that arbitrators give too much weight to state interests, parties may begin to look elsewhere to resolve their disputes. Of course parties who are averse to the application of mandatory rules would only be better off in court if they could find a jurisdiction that would be less inclined to apply the relevant mandatory rules. This is likely to depend on which state's mandatory rules are in issue.

#### F *Enforceability*

Arbitrators' duty to render an enforceable award is referred to in arbitral awards, national laws, institutional rules, ethical codes and scholarly writing.<sup>37</sup> Its relevance is well known — under the *New York Convention* an award need not be enforced if it violates the public policy of the forum where enforcement is sought<sup>38</sup> or has been set aside by courts of the seat.<sup>39</sup> Thus, any mandatory rule that reflects either of the two fora's public policy should give rise to enforceability concerns.<sup>40</sup> While faith in the arbitration system and desire to avoid the publicity related to enforcement proceedings<sup>41</sup> may often lead parties to comply voluntarily with awards, this cannot be relied upon, for when enforcement proceedings arise and fail, the costs — for the parties, the arbitrators, the institutions, the states and the system as a whole — are enormous.<sup>42</sup>

One problem for arbitrators seeking to evaluate the potential for enforcement to be successfully challenged is that the *New York Convention* does not define 'public policy'. Most states regard 'public policy' as referring to international public policy but this view is not uniform.<sup>43</sup> Where the view applies, it may be that a domestic mandatory rule does not fall within the relevant definition of public policy. There may also be different views as to the content of such policy and the likely application to particular facts.<sup>44</sup>

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<sup>36</sup> 825 F Supp 1465, 1483 (D Ariz, 1993).

<sup>37</sup> See generally Günther Horvarth, 'The Duty of the Tribunal to Render an Enforceable Award' (2001) 18 *Journal of International Arbitration* 135.

<sup>38</sup> *New York Convention*, above n 1, art V(2)(b).

<sup>39</sup> *Ibid* art V(1)(e).

<sup>40</sup> However, as Fumagalli notes, 'public policy is a much narrower concept than that of mandatory rules, [therefore] an arbitral award will not be set aside [on public policy grounds] merely because the arbitrators did not properly apply the mandatory rules of law': Luigi Fumagalli, 'Mandatory Rules and International Arbitration: An Italian Perspective' (1998) 16 *ASA Bulletin* 43, 57.

<sup>41</sup> Nathalie Voser, 'Mandatory Rules of Law as a Limitation on the Law Applicable in International Commercial Arbitration' (1996) 7 *American Review of International Arbitration* 319, 347.

<sup>42</sup> Horvarth, above n 37, 135.

<sup>43</sup> Voser, above n 41, 334.

<sup>44</sup> See generally Audley Sheppard, 'Interim ILA Report on Public Policy as a Bar to Enforcement of International Arbitral Awards' (2003) 19 *Arbitration International* 217.

In addition, authors consistently express caution about what weight to give to enforceability concerns, primarily because when parties have assets in different countries it is difficult to predict the place of enforcement.<sup>45</sup> Other concerns include the vague nature of the public policy exception, the potential for encouraging state legal expansionism,<sup>46</sup> and the risk of giving effect to parochial and unjustified interests.<sup>47</sup>

Such fears are often exaggerated. For example, the difficulty caused by predicting the place of enforcement can be overcome by adopting a pragmatic approach. Derains prefers to allow arbitrators to give enforcement concerns weight only if they can envisage the probable place or places of enforcement.<sup>48</sup> This seems sensible. If assets are only in one state, then this should be a compelling reason to apply that state's mandatory rules. If there are assets in multiple jurisdictions that could meet the award, and only one promulgates a mandatory rule, enforceability does not compel it to be considered. However, if mandatory rules of all those states purport to apply, then weight may be given to at least one. Which that is and whether it would ultimately be applied would depend on the methodology adopted to assess the applicability of mandatory rules.<sup>49</sup> In this context, the tribunal would have to resolve the conflict between each relevant state and the parties, and also the conflict between the states competing for application of their laws.

Regarding the potential for state legal expansionism to be encouraged, it will be rare that enforceability concerns per se will justify the application of a mandatory rule, so it is unlikely that enforceability concerns will increase legislative activity. Further, this fear must be balanced against the parties' legitimate expectation that the tribunal take reasonable steps to render an enforceable award. Regarding the potential to give effect to parochial and unjustified interests, this will depend on whether the methodology adopted to deal with mandatory rules allows assessment of the content of the law. This will be discussed in Parts IV–VI below. Whether enforceability concerns should compel mandatory rules of the seat of arbitration to be applied will be discussed in Part IV.

### G Party Autonomy

In *ICC Case No 1512* it was said that few principles are more universally recognised in private international law than the principle 'according to which the law of the contract is the law chosen by the parties'.<sup>50</sup> Arbitral tribunals, international conventions and national laws accord a primary place to the will of the parties when deciding the applicable substantive and procedural law to an

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<sup>45</sup> See, eg, Serge Lazareff, 'Mandatory Extraterritorial Application of National Law' (1995) 11 *Arbitration International* 137, 140; Horvarth, above n 37, 148; Grigera Naón, above n 10, 46–7; Voser, above n 41, 335.

<sup>46</sup> See, eg, Lazareff, above n 45, 140–1.

<sup>47</sup> Voser, above n 41, 335.

<sup>48</sup> Derains, above n 3, 255.

<sup>49</sup> See below Parts IV–VI.

<sup>50</sup> '*ICC Case No 1512 (Preliminary Award)*' (1971) 1 *Yearbook: Commercial Arbitration* 128, 128–9.

arbitration.<sup>51</sup> However, as Maniruzzaman reminds us:

Although the parties' freedom of choice is a general principle of private international law and is to be respected in principle, it should operate within the limits imposed by such equally important general principles of law or subject to any restraint of public policy.<sup>52</sup>

The difficulty (and goal of this article) is in deciding just when party autonomy should be trumped. To answer this question we must know what weight party autonomy deserves in each factual scenario. This will usually be dictated by one's understanding of the nature of arbitration. The more that contractualist arguments are favoured, the greater the inclination will be to uphold party autonomy, and vice versa.

Aside from its theoretical importance, party autonomy also has practical significance. As previously outlined, the favoured status arbitration currently enjoys in international commerce is due — at least in part — to the opportunity it affords parties to design proceedings to suit their needs.<sup>53</sup> Arbitration therefore depends upon party support for its survival. This should provide even those jurisdictionally inclined with an incentive to balance party autonomy against state interests, even if, again, it arises out of a sense of duty to arbitration as an institution.

#### H *Justice*

It seems trite to say that arbitrators will always strive to ensure that their award is just — surely this is the implicit aim of every legitimate system of dispute resolution. But arbitration complicates this issue by its unresolved nature. Contractualists might argue that arbitration is a private system of dispute resolution that should be unfettered by national interests, and therefore that private justice between the parties is all that arbitrators should aim for. However, some arbitrators might see themselves akin to judges of the forum, so would consider themselves bound to do justice not only between the parties but also to the wider community. Upholding party autonomy will satisfy contractualists, while, arguably, applying more mandatory rules will place greater emphasis on the interest of the wider community. The correct balance depends, of course, on the type of hybrid arbitration is considered to be.

#### IV UNCONTROVERSIAL APPLICATION OF MANDATORY RULES

Before these considerations are used to assess the merits of different possible approaches to mandatory rules issues, it is worthwhile identifying situations in which the application of mandatory rules is (or should be) so well accepted that it can be categorised as uncontroversial. Potentially, there are four such categories:

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<sup>51</sup> Chukwumerije, above n 21, 199. This was reiterated by the International Law Institute in 1989 when it was stated that: '[t]he parties have full autonomy to determine the procedural and substantive rules and principles that are to apply in the arbitration': International Law Institute, *Resolution on the Autonomy of Parties in International Contracts between Private Persons or Entities* (1989) art 6 ('*Resolution on the Autonomy of Parties*').

<sup>52</sup> A F M Maniruzzaman, 'International Arbitrator and Mandatory Public Law Rules in the Context of State Contracts: An Overview' (1990) 7(3) *Journal of International Arbitration* 53, 54.

<sup>53</sup> Chukwumerije, above n 21, 199.

*force majeure*; transnational public policy; mandatory rules of the *lex contractus*; and rules of the seat.

#### A Force Majeure

The principle of *force majeure* allows arbitrators to take into account mandatory rules which make performance of contractual obligations impossible — provided they were neither foreseeable nor provided for in the parties' contract.<sup>54</sup> It should be noted, however, that the mandatory rule is not applied, but rather considered under the *lex contractus* as an element of fact.<sup>55</sup> The arbitrator merely needs to identify the applicable rules of *force majeure* and then decide if the terms and practices of the mandatory rule in issue satisfy that test. Thus, the *force majeure* category is uncontroversial, as it requires arbitrators to do no more than apply the law chosen by the parties.

For example, if a contract governed by English law for the shipment of goods from the US to Guatemala were interrupted by US trade sanctions, the sanctions may constitute a *force majeure* under the *lex contractus*. They would not, however, be applied directly. This also means that not all cases will deal with *force majeure* in the same way, as its scope and ramifications will vary according to the national legal history and policy of the country whose law governs the dispute.

#### B Transnational Public Policy

Transnational public policy reflects the fundamental values, the basic ethical standards, and the enduring moral consensus of the international business community.<sup>56</sup> Examples are human rights (such as opposition to racial, sexual and religious discrimination and slavery), *bonos moros* (including opposition to corruption, terrorism, genocide and paedophilia), fair hearing and due process.<sup>57</sup> It is uniformly accepted that arbitrators must apply any mandatory rule that reflects transnational public policy in order to maintain minimum standards of conduct and behaviour in international commercial relations.<sup>58</sup> As the Cour d'appel has put it, '[t]he security of international commercial and financial relations requires the recognition of a public policy that is, if not universal, at least common to the various legal systems'.<sup>59</sup> And, since transnational public policy represents values that are superior to those of particular national systems, and arbitrators owe a paramount duty to the international community, they should refuse to apply any mandatory rules that conflict with transnational public policy.<sup>60</sup> They should also refuse to apply parties' chosen laws that conflict with

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<sup>54</sup> Gaillard and Savage, above n 33, 849; Mayer, 'Mandatory Rules of Law in International Arbitration', above n 2, 281; Blessing, 'Mandatory Rules of Law versus Party Autonomy in International Arbitration', above n 8, 33–4; Jean-François Poudret and Sébastien Besson, *Droit comparé de l'arbitrage international* (2002) 647.

<sup>55</sup> Gaillard and Savage, above n 33, 849.

<sup>56</sup> Pierre Lalive, 'Transnational (or Truly International) Public Policy and International Arbitration' in Pieter Sanders (ed), *Comparative Arbitration Practice and Public Policy in Arbitration* (1987) 257, 285–6.

<sup>57</sup> See Gaillard and Savage, above n 33, 853.

<sup>58</sup> Chukwumerije, above n 21, 192.

<sup>59</sup> As cited (in translation) in Lalive, above n 56, 278.

<sup>60</sup> Chukwumerije, above n 21, 193.

such policies.<sup>61</sup> The International Law Institute's *Resolution on the Autonomy of Parties* supports this view, stating that '[i]n no case shall an arbitrator violate principles of international public policy as to which a broad consensus has emerged in the international community'.<sup>62</sup> This statement also makes it clear that the justification for this approach lies not in the mandatory rules doctrine but in that of international public policy, which explains why this category is uncontroversial.<sup>63</sup>

The difficulties with transnational public policy are, first, for parties, the evidentiary difficulty in establishing a given principle's universality; and second, for arbitrators, uncertainty as to the degree of universal acceptance required before the principle becomes 'truly international'.<sup>64</sup> Finally, there is the question of how arbitrators should respond if an express choice by the parties conflicts with an established international public policy. While an arbitrator should not ignore the latter, the arbitrator may find it difficult to maintain jurisdiction when the express choice is to be ignored.

### C *Mandatory Rules of the Lex Contractus*

It is necessary to distinguish between two situations, one in which the *lex contractus* has been chosen by the parties, and another, in which the *lex contractus* has been chosen by the arbitrators.

#### 1 *The Lex Contractus Has Been Chosen by the Parties*

It is generally agreed that if the *lex contractus* has been chosen by the parties, its mandatory rules must be applied — provided, of course, they are not contrary to transnational public policy.<sup>65</sup> However, since some have dissented from this view, their opinions are worth exploring.

First, Derains argues that if the parties did intend for a mandatory rule of the *lex contractus* to be excluded, the arbitrator ought to respect their will, as they could just as easily have chosen a law that did not contain the relevant mandatory provision.<sup>66</sup> This is true if it is believed that the only limit to the parties' control over the applicable law is transnational public policy. If, on the other hand, it is accepted that mandatory rules may be applied even when not wanted by the parties, such intent will be a relevant but not decisive factor in the arbitrators' decision. The arbitrators will have to undertake the type of assessment discussed in Parts V and VI below.

This all needs to be considered in the broader context whereby an arbitrator cannot ever do anything contrary to an express agreement of the parties without some other source for such a mandate. For example, if an arbitrator thinks a

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<sup>61</sup> Gaillard and Savage, above n 33, 860–1.

<sup>62</sup> *Resolution on the Autonomy of Parties*, above n 51, art 2.

<sup>63</sup> Gaillard and Savage, above n 33, 850.

<sup>64</sup> It is worth noting that proponents of the application of mandatory rules even when the rules do not reflect transnational public policy, tend to adopt a restrictive view of transnational public policy: see, eg, *ibid* 851.

<sup>65</sup> See, eg, von Hoffmann, above n 11, 3; Mayer, 'Mandatory Rules of Law in International Arbitration', above n 2, 280; Derains, above n 3, 255; Gaillard and Savage, above n 33, 848; Lazareff, above n 45, 138; Chukwumerije, above n 21, 184.

<sup>66</sup> Derains, above n 3, 255. See below Part VI(B) for further analysis of Derains' views.

mandatory rule must apply but the parties say not to apply it as between them, an arbitrator might distinguish between situations where there are negative externalities which the mandatory rule addresses and those where there are not. In the latter situation, there seems little reason to interfere with party autonomy where the parties are both fully knowledgeable as to their rights. In the former case, where third party rights are involved and the mandatory rules are for their benefit, an arbitrator faced with an express demand to ignore such laws could have chosen not to have accepted the appointment in the first place but cannot inherently do something outside the limited mandate in the arbitration agreement. Similarly, if an arbitrator decides to apply a mandatory rule based on implied consent and the parties then expressly revoke that consent, the arbitrator would be entitled to stand down as opposed to ignoring the law if he or she felt so compelled, but would not be entitled to ignore the parties' directions.

Second, Voser has argued that parties do not choose a law according to its public policy provisions, but according to how it balances competing private interests.<sup>67</sup> Therefore, automatically applying mandatory rules of the *lex contractus* does not give effect to party expectations and so gives undue advantage to the public policy goals of the state that provides the *lex contractus*. Consequently, mandatory rules of the *lex contractus* should be in no better position than those of other countries.

While there is certainly some appeal to this argument, the contrary position is equally tenable. For example, the fact that many mandatory rules protect private party interests could, by itself, be sufficient to influence choice of law. There are a range of permutations of implied consent in such circumstances. For example, the mandatory rule might protect buyers against sellers, in which case the buyer could have impliedly consented, but not the seller. It is also at least possible that both consented freely, which means that Voser's presumption is going too far. And, in an age where there is increasing pressure on corporations to consider community welfare, it is not inconceivable that a law's public policy provisions may also have some relevance to choice of law. Further, such a narrow construction of the parties' intentions seems contrary to current interpretive trends — Craig, Park and Paulsson suggest that '[w]hen parties now use the Model clause, it is understood that they intended to make a comprehensive reference to the ICC mechanism'.<sup>68</sup> Thus the reason for Voser's criticism is logical, but her subsequent suggestion — denying this category entirely — seems disproportionate. It would be safer to presume that the parties intended for the law to be applied in toto, and allow them to alter their arbitration agreement and the arbitrators' mandate in the event they change their minds.

Third, it has been argued that only the mandatory rules of the *lex contractus* that have been invoked by one of the parties are applicable, as arbitrators' jurisdiction only extends to issues raised by the parties.<sup>69</sup> Again, however, contrary arguments are imaginable. For example, arbitrators' duty to meet the parties' legitimate expectations could be a source of obligation, because, as

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<sup>67</sup> Voser, above n 41, 339–40.

<sup>68</sup> William Craig, William Park and Jan Paulsson, *International Chamber of Commerce Arbitration* (3<sup>rd</sup> ed, 2000) 88–9.

<sup>69</sup> Mayer, 'Mandatory Rules of Law in International Arbitration', above n 2, 291; cf Lazareff, above n 45, 138.



discussed above, it is arguable that the parties' original expectations were more likely than not for the law they chose to be applied in toto. Alternatively, jurisdiction could be invoked through arbitrators' duty to render an enforceable award. Here, however, there are a range of scenarios. If the duty is seen as being owed to the winner, and if the winner was warned of the issue but still did not want the mandatory rule raised, should an arbitrator be paternalistic and do it anyway, and, if so, on what grounds? Or could it be argued that the duty to render an enforceable award is also owed to 'arbitration as an institution' (the more unenforceable awards that go around, the worse arbitration's reputation will be ...)? Both parties could promise that they would not challenge the award on that basis, but enforceability concerns will always be greatest when the loser's assets are located in the state that promulgates the law, and such a state would be reluctant to respect an agreement not to apply its mandatory rules.

It is readily conceded, however, that there are germs of truth in these dissenting voices. One solution that would placate their concerns, though radical, is to change this category from the *lex contractus* to the 'parties' expectations', assessed objectively. If the parties have expressly agreed on the proper law there would be a presumption in favour of applying its mandatory provisions. The parties would then have to adduce evidence to overcome this prima facie position. This would be simple if alongside the choice of *lex contractus* sits an express exclusion of its mandatory provisions. Generally, however, overcoming the presumption is likely to be difficult. Even if the parties were unaware of a particular mandatory rule or any other substantive law of a country, if they choose a body of law to govern their contract they should be taken to submit to all its provisions. To establish that the law should not apply, relevant evidence might include, for example, a documented mutual pre-contractual desire to avoid the rule in question. Alternatively one party may have made reference to the importance of not breaching a particular law, where the other party did not object. Some laws expressly excluded might even demonstrate an intention to exclude others.

In addition to the parties' conduct, other relevant factors are likely to include their experience, the amount and quality of their advice, the foreseeability of the particular law and arbitral trends. For example, in construction disputes it may be relevant that the *UNCITRAL Legal Guide on Drawing up International Contracts for the Construction of Industrial Works* encourages parties to take mandatory rules into account when negotiating contracts.<sup>70</sup> Generally it will be relevant that there has been a proliferation of mandatory rules in recent arbitral practice,<sup>71</sup> and the potential relevance of mandatory rules in international arbitration has been made widely known through cases such as *Mitsubishi*.

This suggests that often, parties should be aware of the potential for mandatory rules issues to apply to any dispute resolution proceeding, and should

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<sup>70</sup> According to the Guide, '[s]ome legal systems may have mandatory rules governing contracts entered into by a purchaser with a group of enterprises integrated into an independent legal entity, and the parties may need to take these rules into account in negotiating the contracts.'

<sup>71</sup> As said above, Blessing even believes mandatory rules issues arise in up to 50 per cent of cases: Blessing, 'Mandatory Rules of Law versus Party Autonomy in International Arbitration', above n 8, 24.

take active steps to avoid them if that is their wish.<sup>72</sup> So if highly experienced parties with expert legal advice choose the widest possible words in drafting their arbitration agreements and choice of law clauses, they should be taken to expect a wide range of mandatory rules to apply.

Certainly the category is thus broadened, allowing laws not even mentioned in the *lex contractus* to be applied; however it better accords with party autonomy than the alternative, and thus ensures the arbitrators' jurisdiction even when a law is not raised by either party. It also increases fairness between the parties, and placates states. In cases where the evidence is ambiguous it might prove more controversial, however no more controversial than any other determination of fact an arbitrator is required to make. For the purposes of this article, it will be assumed that this approach is an accepted category.

## 2 *The Lex Contractus Has Been Chosen by the Arbitrators*

Parties often fail to select a law to apply to their relations, either because they cannot agree on a law, they had incompetent lawyers who omitted a choice of law clause, or because they are more concerned with making a deal than planning for its undoing.<sup>73</sup> When this occurs, arbitrators can generally either select the conflicts rules,<sup>74</sup> or directly choose the substantive law<sup>75</sup> they consider appropriate. Either way, however, commentators agree that arbitrators should, and do, choose the law that best accords with the parties' legitimate expectations (although there may be a difference between expectations as to ultimate substantive law and expectations as to applicable conflicts principles).<sup>76</sup> Once the substantive law has been determined, the orthodox approach is for arbitrators to then automatically apply all of this law's mandatory rules.<sup>77</sup> In addition,

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<sup>72</sup> Grigera Naón, above n 10, argues:

[I]t would be relevant that there has been a proliferation of the mandatory rules in recent arbitral practice. It can hardly be maintained that sophisticated and experienced parties — as most subjects of international economic relations are — can be deemed to ignore the eventual application of international mandatory rules of national origin having some connection with the transaction, especially if they currently use or have easy access to the advice of international law firms with branches or correspondents all over the world: at 68.

<sup>73</sup> See, eg, 'ICC Case No 2977' (1980) 6 *Yearbook: Commercial Arbitration* 133, 134, where a choice of law clause was omitted.

<sup>74</sup> See, eg, *European Convention on International Commercial Arbitration*, opened for signature 21 April 1961, 484 UNTS 364, art 7(1) (entered into force 7 January 1964); *United Nations Commission on International Trade Law: Model Law on International Commercial Arbitration*, UN GAOR, 40<sup>th</sup> sess, Supp No 17, art 28(2), UN Doc A/40/17 (1985) ('*Model Law*'); *United Nations Commission on International Trade Law: Arbitration Rules*, UN GAOR, 31<sup>st</sup> sess, Supp No 17, art 33, UN Doc A/31/17 (1976) ('*UNCITRAL Rules*').

<sup>75</sup> See eg, *Rules of Arbitration of the International Chamber of Commerce* art 17.1 ('*ICC Rules*'); Australian Chamber for International Commercial Arbitration, *Arbitration Rules* art 34.1. A number of commentators criticise this approach, arguing that an arbitrator exercising such a discretion must have some cogent reason for the choice made, which in turn will be identical to some conflicts principle.

<sup>76</sup> Chukwumerije, above n 21, 125; Derains, above n 3, 245.

<sup>77</sup> Note, however, that the opposite view was taken in 'ICC Case No 4123' (1985) 10 *Yearbook: Commercial Arbitration* 49, 50–1. Mandatory rules of the *lex contractus* were placed on the same footing as all foreign mandatory rules claiming to be applied.

foreign mandatory rules are applied more readily than where there is an express choice of law.<sup>78</sup>

The merits of this can be debated. By indirectly consenting to the arbitrators choosing the applicable law the parties may have intended no more than for the arbitrators' choice to be treated as if it were the parties' own. This would make it difficult to justify applying foreign mandatory rules more readily than situations where a choice of law clause is present. On the other hand, by leaving it up to the arbitrators to choose the applicable law, it may be that the parties do not care as much about which law applies. This would mean that in balancing all relevant considerations, arbitrators may consider there to be less party hostility to the relevant mandatory rule. It may even have been that the mandatory rule in question could have been part of the *lex contractus* had the arbitrator chosen a different conflicts system. This approach fits logically with — even supports — the 'parties' expectations' category as argued for above.<sup>79</sup> If such a category were adopted, the distinction between party and arbitrator choice of the *lex contractus* would become superfluous.

#### D *Rules of the Seat*

Jurisdictional purists believe that arbitrators' powers derive from the law of the seat, so will automatically apply its mandatory rules. Conversely, contractualist purists deny the relevance of the seat, so would in theory be reluctant to apply its mandatory rules — at least where they relate to substantive, as opposed to procedural, issues. Where procedural issues are concerned, selecting the seat should at least imply acceptance of the *lex arbitri*. In regard to the substantive rules, the analysis may be affected by the procedural rules that are selected. For example, the *ICC Rules* indicate that when the ICC International Court of Arbitration scrutinises arbitrations under its control, 'it considers, to the extent practicable, the requirements of mandatory rules at the place of arbitration'.<sup>80</sup> While this does not require mandatory rules to be applied and while the Court is generally reluctant to interfere in the substantive parts of awards,<sup>81</sup> this would be some evidence of consent in an ICC arbitration.

Another relevant factor is that most national arbitration statutes provide some grounds for setting aside awards made within their territory,<sup>82</sup> and the *New York Convention* allows nonenforcement if an award has been set aside or suspended by a competent authority of the country in which it was made.<sup>83</sup> Enforceability concerns should therefore give mandatory rules of the seat a strong claim to be

<sup>78</sup> Voser, above n 41, 342; Derains, above n 3, 245.

<sup>79</sup> See above Part IV(C)(1).

<sup>80</sup> *ICC Rules*, above n 75, app 2, art 6.

<sup>81</sup> See *ICC Rules*, above n 75, art 27, which states:

Before signing any Award, the Arbitral Tribunal shall submit it in draft form to the Court. The Court may lay down modifications as to the form of the Award and, without affecting the Arbitral Tribunal's liberty of decision, may also draw its attention to points of substance. No Award shall be rendered by the Arbitral Tribunal until it has been approved by the Court as to its form.

<sup>82</sup> See Craig, Park and Paulsson, above n 68, 499–500.

<sup>83</sup> *New York Convention*, above n 1, art V(1)(e).

applied, at least insofar as they reflect the relevant public policy.<sup>84</sup> Some argue that because the *New York Convention* is only discretionary, party autonomy should be preferred where the two conflict.<sup>85</sup> Insofar as procedural mandatory rules are concerned, this makes little sense. Given the widespread adoption of the *Model Law*<sup>86</sup> many countries would have the same mandatory procedural rules for arbitrations. If an award violates such a provision at the seat, jurisdictions that have enacted the *Model Law* are unlikely to then grant enforcement.

Where substantive mandatory rules are concerned the issue is less clear. Given that there are some, although not many, jurisdictions known to enforce awards that have been set aside at the seat,<sup>87</sup> situations are imaginable in which enforceability concerns would not be great. One example is where there is no relevant substantive mandatory rule issue from either party's home country or the enforcement country but one arises from the seat, the seat does not provide the proper law of the contract, and the probable place of enforcement is a particularly pro-enforcement country.

In any event, contractualist arguments in this context are difficult to accept. If a sovereign state directs an arbitrator to apply a law he or she must obviously do so. Where the direction is aimed at the parties and the arbitrator is entrusted with giving effect to it via a mandatory rule, the same would be true. Otherwise, the arbitrator would be facilitating evasion of the state's direction. As a matter of law this cannot be permissible. One exception may be substantive rules that are expressed as mandatory, that were not really intended to apply to the specific fact situation of the dispute. For example, if mandatory competition or antitrust rules, designed to protect a state's domestic market, are worded broadly enough to prohibit a relationship which has only a tenuous connection to that market, and the parties are foreign and have chosen the seat purely for convenience, then it is arguable that the law need not be applied.

In light of this exception and the prominent voices that advocate against the automatic application of all relevant mandatory rules of the seat,<sup>88</sup> it would be going too far to consider their application entirely uncontroversial.

## V POSSIBLE APPROACHES TO MANDATORY RULES

Outside the above categories, the competing interests are more difficult to balance, so the appropriateness of applying mandatory rules is more contentious. This Part will introduce different possible approaches, and discuss their advantages and disadvantages based on the considerations discussed in Part III. Speaking generally, there are three possible approaches — an extreme position

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<sup>84</sup> Poudret and Besson, above n 54, 647; von Hoffmann, above n 11, 9.

<sup>85</sup> Patrik Schöldström, *The Arbitrator's Mandate: A Comparative Study of Relationships in Commercial Arbitration under the Laws of England, Germany, Sweden and Switzerland* (1998) 290.

<sup>86</sup> Legislation based upon the *Model Law* has been enacted in 50 countries: see UNCITRAL, *Status of the Model Law on International Commercial Arbitration* (2005) <[http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/1985\\_Model\\_arbitration\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985_Model_arbitration_status.html)> at 1 October 2005.

<sup>87</sup> Austria, Belgium, France and the US have recognised and enforced awards set aside at the seat of arbitration, although this has often been done under local law, not the *New York Convention*: see generally Redfern et al, above n 20, 452–70.

<sup>88</sup> Voser, above n 41, 338, 340.

that would apply either *all* mandatory rules or *none* (apart from the accepted categories), or an intermediate position that gives the arbitrators some discretion. Another mid position might be to make it mandatory for arbitrators if certain conditions are satisfied.

#### A *Apply All Mandatory Rules*

One advantage to an approach that would see the application of all mandatory rules — regardless of their nature, origin or connection with the dispute — is that it would ensure that state interests were protected, and therefore that state support for arbitration remained.

Another potential advantage is that it would lead to consistency and, presuming the parties are aware of every potentially applicable mandatory rule, predictability. However, mandatory rules' numbers are already on the rise.<sup>89</sup> If they were to be applied regardless of the strength of the connecting factors, it may become difficult, and thus inefficient, for parties to have knowledge of every potentially applicable law. In turn this may cause inequality between the parties, as inexperienced parties unable to afford expert legal advice may be unaware of relevant mandatory rules. On the other hand, mandatory rules aimed at protecting weaker parties would always apply, as would those that protect third parties. Therefore, the overall degree of detriment the parties would suffer is difficult to predict.

One disadvantage is that arbitration may lose favour in the business community, as it would be likely that national legal systems would offer greater chance of avoiding third countries' mandatory rules. Another is that state legal expansionism would be encouraged. To the extent that this fear should be given weight,<sup>90</sup> it can be said that it is more pronounced under this approach than any other, as states would be guaranteed that their mandatory rules would be applied (unless there is a conflict of mandatory rules). Also, it aggravates other problems — for example, the more states expand legally, the more difficult it is for parties to be familiar with potentially applicable laws.

The most significant problem with this approach, however, is its denial of party autonomy. Even if those with contractualist leanings accept that arbitrators should not blindly follow the parties' directions, they would be entirely justified in criticising an approach that effectively leaves states in complete control. Party autonomy, though not as powerful as it is often fabled to be, remains a cornerstone of arbitration.<sup>91</sup> Legitimate questions arise as to the tribunal's jurisdiction and authority to adopt an approach which makes no attempt to balance this against the other competing considerations.<sup>92</sup>

This approach does not even fit neatly under jurisdictionalist reasoning. A jurisdictionalist would owe allegiance to the mandatory rules of the seat, but would only consider foreign mandatory rules if permitted by the seat's conflict of laws rules. Conflicts could not permit application of all foreign mandatory rules, particularly where they might reflect parochial and unjustifiable state interests,

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<sup>89</sup> Guzman, above n 5, 1281.

<sup>90</sup> See above Part III(B).

<sup>91</sup> Blessing, 'Mandatory Rules of Law versus Party Autonomy in International Arbitration', above n 8, 40.

<sup>92</sup> Born, above n 7, 28.

perchance even laws contrary to transnational public policy. Therefore, it is not difficult to see why there is almost no academic support for this approach.

### B *Apply No Mandatory Rules*

There is significant academic support, however, for an approach that would apply no mandatory rules, other than in the non-controversial categories listed above.<sup>93</sup> The main advantage is that arbitrators are left with little discretion, which means that certainty and consistency are enhanced, and criticisms of arbitrariness disappear. It also withdraws the enticement for state legal expansionism.

It is more consistent with contractualist ideals, allowing parties wide autonomy to avoid mandatory rules more or less as they please. Gaillard and Savage have even argued that the reason this is the preferred approach is that under any other, arbitrators run the risk of exceeding the terms of their brief, thus leaving their award vulnerable to an action to set aside in certain jurisdictions.<sup>94</sup> This is not clear-cut. The arbitrators' brief allows them to do what is within the legitimate expectations of the parties. It has been argued that arbitrators' duty to meet the parties' legitimate expectations can be validly construed broadly enough to act as a basis for justifying the application of mandatory rules, even those expressly excluded by the parties' contract.<sup>95</sup>

One disadvantage is that less protection is afforded to state interests, which raises the prospect of a denial of arbitrability, leading to parallel proceedings and thus an inefficient arbitral system. Here it is desirable to distinguish between two meanings of arbitrability; the first meaning being whether the issue was ever capable of being subject to arbitration (ie the plain meaning of the word), and the second being whether the parties' arbitration agreement encompasses the disputed issue on its proper interpretation in the instant case. An inarbitrable dispute, using the first meaning, would allow litigation regardless of an arbitration agreement. The second pertains to the scope and interpretation of the agreement, raising a question as to whether the arbitration agreement should be treated as ousting the courts on all issues, even a mandatory rule that is outside the scope of the arbitration clause. It also means that arbitration affords parties the ability to avoid state attempts to control the activities that occur within their territorial limits. This not only undermines state sovereignty, but also has the potential to do injustice to the wider community. Further, it does not justify application of a mandatory rule based on enforceability concerns, from which negative cost consequences associated with failed enforcement proceedings could flow.

### C *Apply Mandatory Rules at Arbitrators' Discretion or under an Objective Formula*

Most authors seem to advocate an approach that gives arbitrators discretion to apply mandatory rules. Where there are competing considerations, discretion seems intuitively desirable, as it allows the relevant considerations to be

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<sup>93</sup> See above Part IV.

<sup>94</sup> Gaillard and Savage, above n 33, 858.

<sup>95</sup> Derains, above n 3, 234. This will be explored further in Part VI(B).

delicately balanced against each other. However, without knowing what weight each consideration deserves, there is the potential for such an approach to be applied inconsistently. Conferring discretion also makes it possible for decisions to be based on arbitrators' personal moral values or self-interested desire to uphold party autonomy, which compounds fears of inconsistency. So in Part VI, when different methods of exercising discretion will be analysed, their ability to provide consistency will be a principal touchstone. A related position that looks for a set of required preconditions for mandatory rules to be applied will also be examined.

## VI METHODS OF EXERCISING DISCRETION

There are two broad methods of exercising discretion worth exploring: the 'special connection' test and the 'legitimate expectations' test. This Part will discuss the nature of each, and critically assess their ability to account for the considerations discussed in Part III, particularly consistency. In light of the problems caused by arbitration's unresolved nature, the easiest way to increase consistency is to structure arbitrators' discretion, and give guidance as to the weight that party autonomy and the laws of the seat deserve.

As a secondary thought, it is worth noting that if this can be done, each test may point to a particular hybrid conception of arbitration. In some respects the two tests can be conceptualised as having roots in opposite ends of the 'arbitral ideology' continuum. The 'special connection' test is based on courts' analysis of mandatory rules issues, and the 'legitimate expectations' test is based on party autonomy. The extent to which each has departed from its end of the continuum and approximated the other may even indicate the degree of overall consensus regarding arbitration's nature.

### A *Special Connection*

When considering how a discretion to apply mandatory rules should be exercised, it is logical to look at the approach taken by national courts. Therefore, it is not surprising that one of the popular methods for determining mandatory rules' applicability is based on art 7(1) of the *Rome Convention*, which governs the application of foreign mandatory rules for many courts in European Union countries. This test — which has become known as the 'special connection' test — determines the applicability of a particular mandatory rule as a function of its purpose and content. Article 7(1) provides as follows:

When applying under this *Convention* the law of a country, effect may be given to the mandatory rules 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.

To examine the merits of the test it is worth looking at the elements of art 7(1) in detail. There are three limbs to consider. First, there must be a 'close connection' to the dispute at hand. Second, the laws must actually be mandatory rules, and third, the arbitrator must have regard to the 'application-worthiness' of the mandatory rule, being the nature and purpose of the law, and the consequences

of its application or non-application.<sup>96</sup> Therefore the application-worthiness limb contains two elements which require individual consideration.

### 1 *Close Connection*

According to the *Giuliano and Lagarde Report*,<sup>97</sup> the original, preliminary draft of the *Rome Convention* did not specify the sort of connection required. The requirement of a ‘close’ connection was added due to fears that without it, a large number of different and potentially contradictory laws could be taken into account, which would increase complexity, prolong proceedings and allow dilatory tactics.<sup>98</sup>

For there to be a close connection between the situation (the contract as a whole<sup>99</sup>) and the mandatory rule, usually there must be acts committed or required acts omitted in the territory of the enacting state.<sup>100</sup> The available literature does not mention the *closeness* of the connection as a relevant consideration, so every law that meets the threshold requirement of a close connection seems to have an equal claim to being applied (although questions of degree could come up when considering the application-worthiness of the mandatory rule). While the need for acts and omissions within the enacting state would imply that extraterritorial legislation would rarely qualify, van Houtte argues that it may when prescribed by public international law.<sup>101</sup> One example is exchange regulations, which have a ‘close connection’ with a transaction if the currency of the enacting state is affected by the transaction.<sup>102</sup>

In addition to addressing the concerns raised by the preliminary draft to the *Rome Convention*, requiring a close connection has the benefit that states are discouraged from venturing beyond the limits of their legitimate legislative jurisdiction. However, since it does not deter legislatures from enacting laws within territorial boundaries, fears of a proliferation of mandatory rules are not entirely allayed.

In arbitration, there are two additional issues that would not arise before national courts — whether mandatory rules of the seat and the laws of the potential places of enforcement have a close connection.

#### (a) *Mandatory Rules of the Seat*

Clearly laws of the seat have a sufficient connection so far as national courts are concerned, but whether the same is true in arbitration is disputed.<sup>103</sup> Mandatory rules of procedure are agreed to have a close connection, but some

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<sup>96</sup> This is Blessing’s terminology: see Blessing, ‘Mandatory Rules of Law versus Party Autonomy in International Arbitration’, above n 8, 32.

<sup>97</sup> Mario Giuliano and Paul Lagarde, *Report on the Convention of the Law Applicable to Contractual Obligations* [1980] OJ C 282/1 (*Giuliano and Lagarde Report*).

<sup>98</sup> *Ibid* 27.

<sup>99</sup> *Ibid*.

<sup>100</sup> *Ibid*; Voser, above n 41, 346.

<sup>101</sup> Hans van Houtte, ‘Trade Sanctions and Arbitration’ (1997) 25 *International Business Lawyer* 166, 167–8.

<sup>102</sup> Voser, above n 41, 346.

<sup>103</sup> See Pippa Read, ‘Delocalisation of International Commercial Arbitration: Its Relevance in the New Millennium’ (1999) 10 *American Review of International Arbitration* 177, 179; Voser, above n 41, 346; cf Lew, above n 13, 587.



argue that mandatory rules of substance may not.<sup>104</sup> The reason given is that each state has a legitimate interest in guaranteeing minimal standards of adjudication.<sup>105</sup> Such reasoning makes it questionable whether the distinction between rules of procedure and substance is justified. It is based on the legitimacy of a state's interest, not the closeness of the connection — and the legitimacy of a state's interest should be assessed under the application-worthiness limb of the test. (Even then the distinction is questionable — why is it legitimate for a state to protect standards of adjudication but not, say, its environment?) If, then, the objection to substantive mandatory rules satisfying this limb of the test is not ideological (that is, originating in contractualist arguments), the distinction seems arbitrary. If the objection is ideological, it should be tempered by the concerns discussed in Part III, including enforcement and the need to respect sovereign directions. There is, however, an argument against applying mandatory rules based on severability that may work in this context; namely, because an arbitration agreement is severable it can have a separate applicable law. Under a closest connection test for that separate agreement, being a dispute settlement contract, arguably the closest connection is with the seat. Parties can expressly choose a different external procedural law if they wish, although this is usually undesirable.<sup>106</sup>

(b) *Mandatory Rules of Potential Places of Enforcement*

Laws of potential places of enforcement do not have a close connection in theory because they are not actually linked to the parties' contract.<sup>107</sup> They are accepted, however, to be applicable as an exception under the special connection test, if the place of enforcement can be predicted in the manner described in Part III. In addition, enforcement commonly occurs in one of the parties' jurisdiction, which is often where some contract performance took place.

2 *Mandatory Nature of the Law*

This limb merely ensures that the particular rule is by definition mandatory — it must impose itself irrespective of the law(s) chosen by the parties. One should also be satisfied that the promulgating authority wanted the rule to apply to that situation. More contentious is the question whether it is a control which applies regardless of the parties or a rule which is protective that still needs to be raised by one of the parties. In the latter event, if fully informed and equal parties want to avoid its operation, there seems little reason to subvert this wish.

3 *Application-Worthiness*

In arbitration, different usages of the application-worthiness limb of the test have emerged. Before exploring these it is worth looking at how this limb

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<sup>104</sup> Voser, above n 41, 346.

<sup>105</sup> *Ibid.*

<sup>106</sup> It should be noted that art 7(1) of the *Rome Convention*, above n 29, was not intended to be used with laws of the seat, this being covered by art 7(2), which states that '[n]othing in this Convention shall restrict the application of the rules of the law of the forum in a situation where they are mandatory irrespective of the law otherwise applicable to the contract'. This makes sense for courts who must follow their own mandatory rules.

<sup>107</sup> *Ibid.*

operates in national courts. First, judges should consider the nature and purpose of the mandatory rule. During negotiations for the *Rome Convention*, it was suggested that this should be established by internationally recognised criteria, for example, similar laws existing in other countries or which serve a generally recognised interest.<sup>108</sup> This idea was not disapproved of, but was not included in the wording of art 7(1) due to, *inter alia*, the difficulty in identifying such international criteria.<sup>109</sup> Second, judges should consider the consequences of the application or non-application of the particular mandatory rule. This did not appear in the preliminary draft, and was designed in particular for cases where there is a conflict of mandatory rules.<sup>110</sup>

Such a conflict raises important conceptual questions as to which should prevail and why, or alternatively, whether arbitrators should apply each and let the bottom line rest where it does. This is where the conflict between states' interests is critical. If each mandatory rule deserves to apply when analysed individually, the better approach might be to apply both rules to the extent that they can apply simultaneously.<sup>111</sup>

In regard to the nature and purpose of a mandatory rule, in arbitration there are two schools of thought as to what weight this should be given. One adopts a liberal approach and considers it an essential aspect of the special connection test;<sup>112</sup> the other takes a more restrictive stance and gives it little weight.<sup>113</sup>

(a) *Group 1 — Liberal Approach*

According to the first group, the nature and purpose of the mandatory rule is the 'most important' and 'most critical' aspect of the special connection test.<sup>114</sup> There are two main difficulties with accepting this. First, there is a notable lack of functional criteria to used to guide the discretion, and second, party autonomy is given little weight.

In regard to the lack of functional criteria, this raises the spectre of uncertainty, which is more ominous in arbitration than in national courts because, in addition to allowing subjective value judgments, it increases the risk of decisions being based on different understandings of arbitration's nature or arbitrators' self-interested desire to uphold party autonomy. However, experienced practitioners have argued that this danger exists more in theory than in reality.<sup>115</sup> To test this, we can look at the three categories that Voser has identified to explain which mandatory rules can satisfy the special connection

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<sup>108</sup> *Giuliano and Lagarde Report*, above n 97, 27.

<sup>109</sup> *Ibid.*

<sup>110</sup> *Ibid.*; Grigera Naón, above n 10, 93.

<sup>111</sup> On this issue see Voser, above n 41, 352–4.

<sup>112</sup> See, eg, Voser, above n 41, 324; Blessing, 'Mandatory Rules of Law versus Party Autonomy in International Arbitration', above n 8, 31–2.

<sup>113</sup> See, eg, Gaillard and Savage, above n 33, 852; see also Pierre Mayer, 'La règle morale dans l'arbitrage international' in *Études offertes à Pierre Bellet* (1991) 379, as cited (in translation) in Gaillard and Savage, above n 33, 852.

<sup>114</sup> Blessing, 'Mandatory Rules of Law versus Party Autonomy in International Arbitration', above n 8, 32.

<sup>115</sup> Blessing, *Impact of the Extraterritorial Application of Mandatory Rules*, above n 3, 70.

test.<sup>116</sup> By examining which laws fall within and outside these categories it may be possible to appreciate whether fears of uncertainty are unfounded.

(i) *Transnational Public Policy*

The first category is transnational public policy. As discussed above, the application of mandatory rules that reflect transnational public policy is desirable and uncontroversial.<sup>117</sup> Arbitrators often find it difficult to determine the degree of universal acceptance required before the principle becomes ‘truly international’,<sup>118</sup> which has the potential to lead to inconsistency, but this is unavoidable.

(ii) *Universally Recognised Legally Protected Interests*

This category contains mandatory rules that reflect a ‘common concern’ for particular values, with ‘[t]he enactment of similar laws and/or the adherence to international conventions to strengthen the protection of these values [being] indicators for this common concern’.<sup>119</sup>

While the Working Group responsible for drafting the *Rome Convention* had concerns about including such a method for identifying a common concern, uncertainty was not listed as one of them.<sup>120</sup> This may be telling. On the other hand, the list is not exhaustive.

Common sense suggests that the proposed method would be problematic, purely because of its imprecision. For example, how many countries must enact similar laws before a concern is common? How many countries must adhere to obligations under international conventions? How many countries must have ratified those conventions? Clearly, arbitrators could legitimately justify significantly different answers, which makes uncertainty a very real concern. Further, given the thousands of conventions in existence, more liberal answers could lead to an exponential increase in the number of applicable mandatory rules. Given the devastating impact mandatory rules can have on contractual relationships, the business community and the interests of international trade generally would be better served if a more even balance were achieved between state interests and party autonomy. In addition, difficulties regarding the practical application of this approach are also foreseeable. For example, what if conventions are inconsistent (eg trade cf environment)?

As will be discussed below, the idea of looking at international conventions and similar laws in other countries can be very helpful in determining the universality of a particular concern.<sup>121</sup> But if it is to be used as a category for determining the applicability of mandatory rules, it appears that more structure is required.

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<sup>116</sup> Voser, above n 41, 348–54.

<sup>117</sup> See above Part IV(B).

<sup>118</sup> Gaillard and Savage, above n 33, 851.

<sup>119</sup> Voser, above n 41, 351.

<sup>120</sup> *Giuliano and Lagarde Report*, above n 97, 27.

<sup>121</sup> See below Part VII.

(iii) *Strong Public Interest of Concerned States or Supranational Entities*

This category concerns laws that are connected with one specific state and cannot be regarded as commonly shared. The ‘prototype’ of such mandatory rules are antitrust and competition laws.<sup>122</sup> While Voser considers those laws to be applicable, beyond that it is unclear how ‘strong’ a public interest must be before it receives recognition. Interpreted broadly, this category could include every mandatory rule not covered by the above two categories. This is obviously not what was intended. Again, therefore, it must be said that more functional, guiding criteria are required before such categories as these provide a workable framework for applying mandatory rules.

As mentioned above, another problem with the liberal approach of Group 1 is that this approach seems to give little weight to party autonomy. Blessing does say that one relevant consideration is the ‘impact which the application of the interested norm will have on the particular contractual relationship’,<sup>123</sup> but this is only a vague reference to party autonomy, if one at all. Regardless, it appears to be a secondary consideration.

Certainly the *Giuliano and Lagarde Report* does not specify party autonomy as relevant.<sup>124</sup> For national courts, that is perhaps to be expected. Article 7(1) is an expression of intergovernmental solidarity, with states believing that it is mutually beneficial to assist each other with the implementation of policy.<sup>125</sup> This explains why courts determine the applicability of a foreign mandatory rule without reference to party autonomy, and so may be reason enough for a jurisdictionalist to do the same. But, for arbitrators working under a hybrid system of arbitration, legitimate questions as to jurisdiction (and thus enforceability) arise if mandatory rules are applied without seriously considering the parties’ wishes.

It would not, however, be difficult for the special connection test to provide for this. The second part of the application-worthiness limb is worded extremely broadly. It says that an arbitrator is to have regard to the consequences of the application or non-application of the mandatory rule.<sup>126</sup> There is no reason in theory why this should not extend to all the considerations listed in Part III, including party autonomy. Modifying the special connection test to allow for this would make it more appropriate and adapted for international commercial arbitration. If parties have selected a different law, that reduces the connection, and vice versa. Of course, the perennial question of what weight it should be prescribed would remain unresolved, which only compounds existing fears of inconsistency. However, if the test were read in light of the principles to be outlined in Part VII, perhaps these fears could be minimised sufficiently for the test to be viable.

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<sup>122</sup> Voser, above n 41, 325.

<sup>123</sup> Blessing, ‘Mandatory Rules of Law versus Party Autonomy in International Arbitration’, above n 8, 32.

<sup>124</sup> See *Giuliano and Lagarde Report*, above n 97, 25–7.

<sup>125</sup> See Ole Lando, ‘The Law Applicable to the Merits of the Dispute’ in Petar Sarcevic (ed), *Essays on International Commercial Arbitration* (1989) 129, 159; Maniruzzaman, above n 52, 55.

<sup>126</sup> *Rome Convention*, above n 29, art 7(1).

(b) *Group 2 — Restrictive Approach*

As has been seen, the focus of the special connection test for Group 1 is the nature and purpose of the mandatory rule. Group 2, on the other hand, appears more wary of the potential for such an approach to lead to uncertainty. Because of this, they argue that the content of the mandatory rule should not be the basis for determining its applicability.<sup>127</sup> So their focus moves to the first limb of the test — whether there is a close connection:

it is impossible to base the application of mandatory rules solely on a value judgment; the essence of the [special connection test] is to base it on the existence of a *close connection* between the rule and the legal situation.<sup>128</sup>

The strength of the legislature's intention is also recognised as important.<sup>129</sup> It is not clear, however, whether applicability increases with the strength of the legislature's intent, or whether there is a threshold requirement which is satisfied by the law expressing itself to be mandatory. While the former seems logical, the evidentiary difficulty of discerning shades of legislative intent makes the latter more probable.

Proponents of this approach recognise its limitations. According to Mayer, by not undertaking an independent assessment of the rule, it 'may be no more compatible with good morals than the *lex contractus*, and it may even lead to a more inequitable result'.<sup>130</sup> In addition, this approach also has many of the limitations discussed when considering the desirability of 'applying all mandatory rules'.<sup>131</sup> In particular it has the potential to encourage state legal expansionism and, more fundamentally, as with Group 1's approach, Group 2 pays inadequate attention to party autonomy, which leads to the same problems discussed above.<sup>132</sup>

## B *Parties' Legitimate Expectations*

Another way of approaching this issue is to begin from the contractualist side of the arbitral ideology continuum. The contractualist extreme is inappropriate, because, as noted in Part II, it is an inaccurate reflection of modern arbitral reality. As Maniruzzaman argues:

The application and non-application of [mandatory] rules cannot possibly be left to the parties' discretion since their purpose is to impose upon contractual agreements certain controls in the interest of third parties or the public at large.<sup>133</sup>

So where, then, should the analysis begin? Even with mandatory rules to one side, the applicable law is never left entirely to the parties' discretion. Derains argues that the true basis for every major method of determining the applicable law is not the parties' will, but their legitimate expectations.<sup>134</sup> By virtue of the

<sup>127</sup> See, eg, Gaillard and Savage, above n 33, 852–3.

<sup>128</sup> Mayer, 'La règle morale dans l'arbitrage international', above n 113, 16 (emphasis added).

<sup>129</sup> Gaillard and Savage, above n 33, 852.

<sup>130</sup> Mayer, 'La règle morale dans l'arbitrage international', above n 113, 16.

<sup>131</sup> See above Part V(A).

<sup>132</sup> See above Part VI(A)(3)(a)(iii).

<sup>133</sup> Maniruzzaman, above n 52, 53. See also von Hoffmann, above n 11, 11.

<sup>134</sup> Derains, above n 3, 233.

word ‘legitimate’, there is a retraction from the contractualist extreme. So, Derains postulates, the parties’ legitimate expectations may also be an appropriate vehicle for determining the fate of mandatory rules.<sup>135</sup> If this suggestion is to be taken further, it would require an arbitrator to look first at what law the parties expect the arbitrators to apply; and then second, at whether these expectations are legitimate. The answer to this latter question will ultimately depend on how far back towards the jurisdictional end of the continuum this approach should lie — that is, the type of hybrid arbitration is considered to be.

### 1 *Identifying the Parties’ Expectations*

There are different ways in which ‘the parties’ expectations’ can be interpreted. There would be a need to concentrate on objective, rather than subjective, factors as it would be too problematic to try and draw subjective conclusions. The next question is whether there must be an express reference to a law in the parties’ contract? Or is it enough for there to be a mandatory rule which purports to apply which the parties should be aware of, and did not exclude in their choice of law clause? This issue was examined in Part IV.<sup>136</sup> The approach that was argued for, for the reasons there listed, should also be taken here.

### 2 *Establishing the Legitimacy of the Parties’ Expectations*

The next question is, by what criteria should an arbitrator determine whether an expectation is legitimate? Two different scenarios can arise, either the parties expect a law to apply, or they expect a law not to apply.

#### (a) *Laws within the Parties’ Expectations*

The only clear limit to the parties’ choice of law is transnational public policy.<sup>137</sup> Beyond that, it is not clear how much the requirement of ‘legitimacy’ entitles arbitrators to interfere with the parties’ expectations. It is probable, however, that the answer should be ‘not at all’. This is because when parties want mandatory rules to apply, they align their interests with those of states, so the conflict between party autonomy and state interests that besets the rest of the mandatory rules debate largely disappears. This is not to say that such a blanket approach is perfect — there is, for example, potential for injustice, as laws may be contrary to notions of morality yet not contrary to transnational public policy. However, such laws are likely to be few in number — few, at least, have appeared in the literature, case law and arbitral awards surveyed for this article.<sup>138</sup> In any event, many of those that do exist are likely to be of little appeal to commercial entities, and would not be within the parties’ expectations.

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<sup>135</sup> Ibid.

<sup>136</sup> See above Part IV(C)(1).

<sup>137</sup> Derains, above n 3, 251.

<sup>138</sup> Mayer does refer to boycott legislation, however he uses the example of boycott laws which establish restrictions on the grounds of race or religion: Mayer, ‘Mandatory Rules of Law in International Arbitration’, above n 2, 291. While these would be contrary to transnational public policy, it is possible to envisage boycott laws with ‘immoral’ bases that would fall outside the category of transnational public policy.

Finally, it is difficult to envisage an exception that would not be guided by personal moral judgments, and would lead to criticism of arbitrariness.

(b) *Laws Avoided by the Parties*

A very liberal interpretation of the phrase ‘parties’ legitimate expectations’ is necessary in order for it to justify applying laws the parties intended to avoid. Certainly a commonsense grammatical construction of the phrase — noting the ownership link between the words ‘parties’ and ‘expectations’ — makes such an interpretation questionable. However, according to Derains:

[T]he express or implied choice by the parties of the law applicable to the merits of the case does not preclude the possibility in some cases for it to be legitimate to expect the arbitrator to take account of the operation of a rule that the parties had not specified as applying to the contract, or indeed had *deliberately excluded from it*.<sup>139</sup>

The comment is confusing and is ambiguous enough to potentially cover two situations, only one of which is likely to be right. For example, if two parties are transacting, and the government of one of the parties has an embargo against the very essence of the contract and the other does not, and they expressly choose the non-embargo state’s law to apply, an arbitrator could, on Derains’ view, apply the embargo law anyway. In this circumstance the parties have deliberately chosen a different rule, however, still left a gate open to an arbitrator concerned with legitimate expectations. In the other case, where the parties expressly preclude an arbitrator from applying the law of the embargo state, the question is one of jurisdiction rather than applicable law. Here, the arbitrator should accept the constraint or refuse to accept the case.

The important situation is the first. If we accept that in certain circumstances the mandatory rule could apply (and we must, if this method of dealing with mandatory rules is to be viable), essentially, arbitrators then decide objectively according to what the parties *should* expect, were they to act legitimately. But how do you tell what parties acting legitimately should expect? What factors are relevant and what weight should be given to each? Certainly transnational public policy would act as a limit, but what beyond that? Problematically, answers will depend on arbitrators’ personal moral values and ideological understanding of arbitration. Leaving them with an unstructured discretion is therefore undesirable. One possibility would be to apply any mandatory rule that would naturally apply but that the parties have tried to avoid; however, this may be overly simplistic. For example, what if the government is legislating beyond its legitimate legislative reach? Or what if the law is unreasonable and does not deserve to be applied? So then, how should the discretion be structured? Part VII attempts to address these issues.

## VII INTERPRETIVE PRINCIPLES

It is clear that neither test offers a perfect solution to mandatory rules problems. The special connection test pays insufficient attention to party autonomy and is likely to lead to uncertainty, and the legitimate expectations test

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<sup>139</sup> Derains, above n 3, 234 (emphasis added).

fails to provide sufficient structure to arbitrators' discretion. The imprecision in both tests also makes it impossible to achieve what was the (slightly utopian) aim of identifying the type of hybrid each stands for, and thus appreciating the degree of overall consensus regarding the nature of arbitration.

The goal of this Part is to see if this situation can be improved. Unless and until the status of arbitral theory is resolved, a theoretically ideal solution that prescribes precise weight to different considerations will remain unreachable. But does this mean that there can be no methodology to exercising discretion? Is the only solution to cite relevant considerations and then tell arbitrators to balance them? Hopefully not. As will be seen, a commonsense interpretation of these considerations reveals that inherent in many of them is an indication as to how they should be applied. For example, it was shown in Part III(F) that a pragmatic approach to enforceability concerns reveals the situations in which they should be given most weight. From such analyses, a set of principles can be discerned which should give some structure to arbitrators' discretion.

The problem is that while the evolution of these principles from relevant considerations may give them theoretical credibility, the practical difficulty in their application makes the utility of some of them questionable. This, however, does not strip them of value. At the very least they should add a degree of sophistication to understanding of mandatory rules issues; perhaps they may sharpen perceptions of the nature of arbitration. Ideally, some will even prove sufficiently workable to be applied in daily arbitral practice, and help increase the certainty in arbitrators' exercise of discretion.

#### A *General Presumption*

As a preliminary point, it is worth noting that since mandatory rules should be construed strictly,<sup>140</sup> they should be presumed not to apply. The principles considered in Part VII(B) below only become relevant when assessing whether this presumption should be displaced. It is worth remembering, however, that since mandatory rules should always be applied when they fall within the parties' expectations,<sup>141</sup> this presumption will only arise when mandatory rules and the parties' expectations conflict.

It is also worth recognising that even when the presumption does arise, there are situations in which it should never be displaced. Such a situation might be when governments participate in international arbitration through public sector entities that possess their own legal personality. If that occurred it would be legitimate for the other contracting party to assume that the entity has government permission to avoid the law — indeed this may be one of the reasons for entering the contract. Similarly where the parties agree in their contract to exclude a law, an arbitrator should either not apply it or stand down, as he or she lacks jurisdiction to do otherwise.

What about situations where the mandatory rule is not being invoked bona fide? For example, one party might be aware of a particular mandatory rule and know that the other party is not, yet fail to inform the other party of the existence and nature of the rule. There seems a distinct lack of good faith in such

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<sup>140</sup> Voser, above n 41, 349.

<sup>141</sup> See Parts III and IV.



behaviour, and to allow it could encourage morally questionable conduct in the future. On the other hand, these concerns must be balanced against the ultimate reason for applying mandatory rules contrary to the parties' expectations, which generally is to give effect to state interests. This is what it is hoped will ensure arbitrability, enforceability and public justice. This suggests that in such a situation, a blanket rejection of mandatory rules' applicability would be inappropriate.

### B *Displacing the General Presumption*

Some authors have sought to set out a criteria-based formula for when mandatory rules must be applied. This approach tends towards a narrow category. For example, Mayer suggests that they should always be applied when part of the *lex contractus*, the parties have not expressly excluded them, and one is expressly invoked before the arbitrator.<sup>142</sup> Other authors have sought to inductively identify the common features when arbitrators have exercised a discretion positively.<sup>143</sup> This section instead looks at the entire range of potentially relevant considerations and seeks to identify their respective and relative utility. The principles in this section thus aim to help arbitrators decide when the general presumption against mandatory rules' applicability should be displaced.

As a preliminary point it should be noted that the principles are not strictly listed in order of importance. While those that will be most important are listed first, and certainly those towards the end are the least likely to be used by arbitrators on a daily basis, the utility of most will depend on the facts of the case. Some will be highly important in one factual scenario and irrelevant in another, and there will be a myriad of positions in between.

#### 1 *Parties' Hostilities towards Mandatory Rules*

It will always be essential to examine the parties' attitudes to a mandatory rule. Generally speaking, the more hostile parties are to a mandatory rule prior to the dispute, the less arbitrators should be willing to apply it. Clearly, the degree of parties' hostility to a law can vary dramatically. For example, a contract may contain an express inclusion, or it may make no reference to any law, and there are many factual permutations in between.

However, the parties' attitude to the rule once a dispute has arisen will only be relevant if both seek to avoid application of the law. Here, jurisdictional issues can arise. Where only one seeks application of the law, and the parties are experienced, had legal advice before entering into the contract, and consented freely to the choice of law clause (or lack thereof), there is little reason to consider their wishes once they are in dispute. Most probably the party relying on the rule is trying to avoid part or all of the obligations to which it freely agreed. In such a situation the applicability of the rule should be determined by the principles that follow.

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<sup>142</sup> Mayer, 'Mandatory Rules of Law in International Arbitration', above n 2, 280.

<sup>143</sup> Derains, above n 3, 242-3.

## 2 *Rendering an Enforceable Award*

Arbitrators have a duty to render an enforceable award and so should take steps to do so where possible. As explained in Part III(F), while it will sometimes be difficult to predict where enforcement might take place, where this is not the case, those countries' mandatory rules have a strong claim to being applied.<sup>144</sup>

## 3 *Closeness of the Connection between the Dispute and the Law*

There should be a threshold requirement of a close connection between the dispute at hand and the law that purports to apply. After that, the closer the connection, the more arbitrators should be willing to apply the law. The advantages and nature of a close connection requirement were discussed in Part VI(A)(1). It makes proceedings less complex, reduces the potential for dilatory tactics, increases efficiency, deters state legal expansionism, and puts all states on a more even footing. It follows logically that these advantages would become greater if mandatory rules' applicability increased according to the closeness of the connection.

## 4 *Degree of Universal Protection the Subject Matter of a Law Receives*

If arbitrators must apply all mandatory rules that reflect values very widely accepted by the international community, that is transnational public policy,<sup>145</sup> it makes sense to say that the more widely held the value, the more willing arbitrators should be to apply any mandatory rule that reflects it. So, the closer a mandatory rule is to becoming part of transnational public policy, the less arbitrators need rely on the other principles here listed before overriding party autonomy.

## 5 *Importance of the Mandatory Rule to the Enacting State*

The more important a rule of law is to the enacting state, the more willing that state will be to deny arbitrability of that rule if it is not applied by the arbitrators. Ergo, the more important a rule is, the more willing arbitrators should be to apply it. The obvious difficulty lies in discerning shades of legislative intent. How can arbitrators tell how important the rule is to the country concerned? There are both subjective and objective sources of evidence. Since sovereign states' right to self-determination obviously includes the right to determine which rules of law are their most important, evidence that indicates their subjective attitude towards the rule is the most persuasive. However, such evidence is difficult to obtain. The fact that the rule is mandatory shows that the enacting state considers it important enough to apply. For internal political reasons, as well as tactical ones in the arbitration arena, most would be reluctant to list laws in order of importance. Therefore objective evidence, while *prima facie* undesirable, may be appropriate to examine.

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<sup>144</sup> See above Part II for further discussion.

<sup>145</sup> See above Part IV(B).

(a) *Subjective Indicators of the Importance of Mandatory Rules to States*

(i) *Parliamentary Debates*

Depending on the country concerned, it may be possible to determine the importance of a particular law by looking at parliamentary discussion that preceded its enactment.

(ii) *Court Decisions*

National courts are likely to be more in tune with the importance their legislatures confer upon certain laws than arbitral tribunals could ever be. So, if national court decisions happen to comment on such matters — whether explicitly or not — this could be useful evidence for arbitrators. For example, prior to *Mitsubishi*,<sup>146</sup> there was a long line of US cases that recognised antitrust law as fundamental to the ideological and economic integrity of the US.<sup>147</sup>

(iii) *The Severity of the Penalty for Breaching the Law*

Looking at the penalty for breaching a particular law may be indicative of its importance. Is there a criminal or civil penalty? Is a breach punishable by imprisonment? Are treble damages payable? Or does a breach merely make the transaction voidable? If arbitrators look at the penalty of the mandatory rule concerned, and compare this to the most severe penalties that country imposes for breach of any mandatory rule, this may assist the determination.

(iv) *Reluctance to Allow Arbitrability*

It has already been said that, traditionally, the US refused to allow arbitration of securities transactions due to fear that arbitration would not adequately provide for US consumer protection.<sup>148</sup> The same can be said of antitrust law.<sup>149</sup> This suggests that mandatory rules relating to securities transactions and antitrust are more important to the US than those whose arbitrability has never been questioned. Thus, the more historically cautious a country has been in allowing arbitrability of a particular subject matter, the more willing arbitrators should be to apply related mandatory rules in order to assuage states' confidence in arbitration as a dispute resolution mechanism. Care would be needed not to confuse this subject-specific reluctance with a generally cautious position towards arbitration.

(b) *Objective Indicators of the Importance of Mandatory Rules to States*

(i) *Consistency with International Obligations*

The more serious a state is about protecting the subject matter of a law, the more it will ensure that compliance with its international obligations could not lead to the subject-matter being harmed. For example, if a country passes a

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<sup>146</sup> 473 US 614 (1985).

<sup>147</sup> See, eg, *United States v Aluminium Co of America*, 148 F 2d 416 (2<sup>nd</sup> Cir, 1945).

<sup>148</sup> See above Part III(E).

<sup>149</sup> See *Mitsubishi*, 473 US 614, 628–9 (1985). See also *American Safety Equipment Co v JP Maguire & Co*, 391 F 2d 821 (2<sup>nd</sup> Cir, 1968).

mandatory rule for the protection of a particular marine environment, it would be inconsistent to then agree to a free trade agreement with another country that would inevitably damage that marine environment via the shipping of goods.

With this, and all the other principles, a degree of pragmatism and common sense is required. Should it be treated as an inflexible rule, undesirable outcomes would follow. For example, the damage caused by the free trade agreement may be near negligible. Alternatively, it may be of fundamental importance to the peaceful relations of the countries concerned. In either case, to use the agreement as evidence of the unimportance of the marine environment would be misleading.

(ii) *Commitment to Protecting the Subject Matter*

Another indicator of a law's importance may be the additional measures taken to protect its subject matter. For example, if the export of certain animal goods is prohibited, with the aim of ensuring the survival of the species, the arbitral tribunal could look to what other measures are being taken in this regard. Such measures might include research, financial assistance, or the creation of wildlife reserves. With the help of expert witnesses this could be compared to measures taken by other countries, or by this country in regard to a different subject matter.

One significant problem with undertaking such an analysis is that the arbitrators would appear to be passing judgment on the state that provides the mandatory rule. The arbitrators must not only second-guess the state about the importance of the law, but implicitly criticise the lengths to which it has gone to protect the law's subject matter. The aftermath of World Trade Organization hearings have demonstrated how unsympathetic countries can be to criticism by adjudicative panels.<sup>150</sup> Further, in arbitration, countries are not parties to the dispute so they cannot defend themselves. While the degree of their discontent is likely to vary according to the importance of the arbitration, it is unlikely that they would ever take kindly to their reputation being dependent on arguments raised by private parties.

The worst-case scenario is that states could be more angered by this implicit criticism than by the failure to apply the mandatory rule, and deny arbitrability. However the potential for this to occur could be minimised by making confidential any arbitration where such an assessment is to be made. To mitigate the problem further it may be possible for states to provide evidence of the systems in place to protect the subject matter of the law. Participating as a factual witness in this way may help placate any concerns, and have the added advantage of putting arbitrators in a more fully informed position. A refusal to appear may also indicate how important a state considers the law's enforcement to be.

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<sup>150</sup> In addition, non-governmental organisations such as Greenpeace are active critics of the WTO and regularly campaign against it: see, eg, Greenpeace, *WTO Meeting Fails the World* (2001) <<http://www.greenpeace.org/international/news/wto-meeting-fails-the-world>> at 1 October 2005; Greenpeace, *Earth Wins: First Setback for WTO since Seattle* (2002) <<http://www.greenpeace.org/international/news/earth-scores-against-wto>> at 1 October 2005; Greenpeace, *Why Is the WTO a Problem?* (2003) <<http://www.greenpeace.org/international/press/reports/why-is-the-wto-a-problem.pdf>> at 1 October 2005.

Knowing that arbitrators are likely to undertake such an assessment may even discourage states from enacting mandatory rules when there is no legitimate chance of it being applied, and thus limit legal expansionism. Ideally, it would also encourage states to demonstrate sufficient commitment to protecting the subject matter for the law to be applied, thus furthering public justice (or protection of the environment). A corollary of this would be more clear-cut resolutions to mandatory rules issues.

(iii) *History of Concern for the Subject Matter*

The degree of concern a state has traditionally shown for the protection of a subject matter may be indicative of its importance. For example, EU nations have historically gone to great lengths to protect the environment.<sup>151</sup> This is not to suggest that other countries that have not shown such a historical interest (for example, developing countries) do not and would not consider environmental protection important, but merely that they may be required to produce more evidence to establish this.

(iv) *Other States' Concern for the Subject Matter*

It may also be possible, in certain circumstances, to use other states' regard for a particular subject matter to infer its importance for the enacting country. For example, if a law safeguards a religious belief, the arbitral tribunal could look to other countries with similar religious attitudes to see if they too consider the protection of this belief important. While a workable definition of 'similar' would be difficult to establish, this could perhaps be avoided by prescribing a proportional relationship between the weight of the evidence and the similarity of the countries' beliefs. The weight of the evidence would also increase according to the percentage of those countries that consider the belief important, and the degree of importance they afford it.

Obviously, such an analysis would have to be flexible. For example, the more progressive the law, the less this evidence should be used. This is because any approach to mandatory rules should not be used to penalise states for altering their beliefs and political attitudes. The converse would also hold true — the less progressive the law, the more reliable the above evidence becomes. Other countries' attitudes increase in relevance the more they have considered, debated and reflected upon a particular law.

6 *Appropriateness and Applicability of the Law to Protecting Its Subject Matter*

This article has consistently acknowledged, based on a balancing of the considerations in Part III, that in certain circumstances it is necessary to apply mandatory rules contrary to party autonomy. However, it best accords with party autonomy, the need to minimise state legal expansionism, and justice (both private and public), to do so only when the particular mandatory rule is appropriate and adapted to protecting its subject matter. It follows that the more a law is appropriate and adapted to protecting its subject matter, the more

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<sup>151</sup> See Cynthia Shea, 'European Environmental Policy: Effects of the Single Market' (1993) 16(1) *International Environment Reporter* 30, 30-4.

arbitrators should be willing to apply it. Certainly the principle of state sovereignty suggests that individual states should be able to determine the appropriateness of a law. And doubtless, 'political' difficulties might arise if arbitrators are seen to second-guess legislatures in this regard. However, by virtue of the simple fact that complex mandatory rules questions have no easy solutions, such second-guessing may be justified. If so, the following considerations might help.

First, it seems intuitively wrong to allow a law that is unnecessary to override party autonomy. It is therefore appropriate to say that, in principle, the less necessary the law, the less inclined arbitrators should be to apply it. One method of seeing whether a law is unnecessary would be to consider possible alternative measures that could be taken to protect its subject matter.

The application of this principle may, however, be problematic in many situations. For example, it may be difficult to obtain evidence of the alternate measures that the responsible government originally contemplated, and why they were rejected. Such alternate approaches may appear feasible in theory, but in practice may be politically sensitive, in which case arbitrators would be unjustified in criticising the approach taken. Similarly, other approaches may be impractical from a cost/benefit perspective. However, if such evidence were available, and it were considered with common sense, there may be situations in which it is clear that due to carelessness or negligence the government concerned did not choose a better method of protection.

Second, it is logical for arbitrators to be reluctant to apply a law whose scope is so broad that it regulates activities incapable of harming the law's intended subject matter. In such cases arbitrators should be more reluctant to override party autonomy. Finally, the same reasoning that applied to these proportionality considerations also applies to ineffective laws.

## 7 *Volume of Mandatory Rules*

If legislatures were aware of a general interpretive principle whereby arbitrators' hostility to mandatory rules increased according to the number of mandatory rules each country enacted, this would hopefully discourage a proliferation of mandatory rules. But since the reason for its existence is to quell fears of state legal expansionism, which are often unnecessary,<sup>152</sup> this principle should not assume a dominant position in arbitrators' hierarchy of concerns.

## 8 *Bona Fide Enactment*

Only mandatory rules enacted bona fide should be capable of application by an arbitral tribunal. It is difficult to envisage many situations when a state would enact a mandatory rule as a cloak for achieving an ulterior purpose. One possible motive would be to absolve a company originating in the country that enacted the law from meeting its contractual obligations. In such a situation, it would be contrary to principles of good faith and patently undesirable to allow the law to interfere with the parties' contract.<sup>153</sup>

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<sup>152</sup> See above Part III(B).

<sup>153</sup> This view is consistent with current arbitral practice: see Craig, Park and Paulsson, above n 68, 44–5 and the cases there cited.

## VIII CONCLUSION

Arbitrators confronted with mandatory rules questions find few easy answers. There is now a significant body of literature to guide them, but generally speaking opinions tend to be cursory and contradictory. Arbitral case law is even more unhelpful. Despite the increasing number of arbitral tribunals confronted with mandatory rules issues, explicit analyses of principle are few and far between. Perhaps this is because, as Mayer suggests, ‘arbitrators are not particularly motivated by any desire to contribute to jurisprudence and accordingly tend to proceed by affirmation rather than persuasion’.<sup>154</sup> Regardless, the situation needs to improve if a consistent and principled approach is to be achieved.

The reason for the complexity of this issue is that mandatory rules leave arbitrators tangled up in arbitration’s identity crisis. This crisis is not new — it has beset many areas of arbitration, and is well known to arbitrators and academics alike. While recognising arbitration as hybrid often keeps the crisis at bay, the fact that party autonomy and state interests are in direct competition when mandatory rules are involved means that more is required than the pragmatic compromise the hybrid conception has thus far provided. Until there is a precise identification of the weight different interests should be prescribed, a principled resolution of the tension between party autonomy and state interests will remain elusive.

On the other hand, mandatory rules have been equally unhelpful in establishing arbitration’s identity. It can perhaps be said that the principles explored in Part VII inched arbitration closer into focus, but for the most part, any unhelpfulness has been reciprocal. Perhaps this was to be expected — it is unlikely that the picture any one case study could paint would be an accurate representation of arbitration in its entirety.

For arbitrators who want a present, workable solution for their daily practice, there do appear to be two feasible alternatives. There is a restrictive approach that applies mandatory rules only in the accepted categories listed in Part IV — when they create a *force majeure*, reflect transnational public policy, or accord with the parties’ expectations, or alternatively an approach that gives arbitrators a broader discretion. As has already been noted, arbitration’s unresolved nature makes it difficult to undertake a persuasive, principled analysis of which is preferable.

In favour of the more restrictive approach is its provision for party autonomy and consistency. Its disadvantage is that many considerations relevant to the debate have no link to the accepted categories’ *raison d’être*, and therefore receive scant attention. In this regard, a broader discretion does better. It allows arbitrators to determine mandatory rules’ applicability by balancing all relevant considerations, and therefore has a greater chance of catering for all interests involved. The disadvantage, of course, is the potential for arbitrators to balance interests differently and thus reach inconsistent outcomes.

However, after analysing different methods of exercising discretion and discerning interpretive principles, situations can be identified in which it would

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<sup>154</sup> Mayer, ‘Mandatory Rules of Law in International Arbitration’, above n 2, 276.

be difficult for party autonomy to override mandatory rules. While application of these laws should not be automatic, recognising the strength of considerations in their support should help mitigate fears of inconsistency. The first is mandatory rules of the arbitration's seat. These have special significance for arbitrators of jurisdictional predisposition, and should have at least some theoretical importance for any arbitrator under a hybrid system. When this is coupled with concern for the award's enforcement, it becomes difficult for such laws to be ignored. Another consideration is the mandatory rules of the probable place or places of enforcement. When the place of enforcement can be predicted, it is likely that arbitrators' theoretical duty to render an enforceable award is by itself sufficient to justify these laws' application. Finally there are mandatory rules of the place of performance. The closeness of such laws' connection to the dispute mitigates strongly in favour of their application, as does fear of states denying arbitrability, which has formed much of the rationale for applying mandatory rules generally, and becomes particularly acute when states are trying to control activities within their territory.

In addition, consistency may be enhanced by the theoretical guidance given by the principles listed in Part VII, even if their practical utility is limited. While neither this nor the situations discussed above manage to overwhelm fears of inconsistency entirely, together they do begin to allay fears sufficiently for the advantages of arbitrators' discretion to seem comparatively greater than those of the more restrictive approach. This suggests that at present, giving arbitrators a broader discretion seems, on balance, to be the most attractive method of determining mandatory rules' applicability.