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CAN AN ARBITRAL TRIBUNAL DISREGARD THE CHOICE OF LAW MADE BY THE PARTIES?

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Introduction

This article analyses whether disregard by the arbitral tribunal of the choice of law made by the parties may be considered an excess of power or a procedural irregularity, thus leading to the invalidity or unenforceability of an award.

Arbitration is, as known, an out-of-court method of dispute resolution that is mostly based on the will of the parties. The arbitral tribunal is bound to follow the parties’ instructions because it does not have any powers outside the scope of the parties’ agreement. Tribunals are therefore, and correctly, very reluctant to deviate from the instructions of the parties.

Nevertheless, there might be situations where a tribunal is faced with the necessity or the opportunity to disregard the parties’ instructions in respect of the applicable law. As an example, following the parties’ choice might result in a violation of applicable fundamental principles (ordre public) if the parties have made a conscious choice of law in order to avoid the application of certain rules of the otherwise applicable law; for instance, the rules on export, taxes, and competition regulation. Or, following the parties’ choice might result in a contradiction with the contractual regulation made by the parties themselves—if they have made a not so conscious choice of law (or no choice at all) and have not noticed that the contractual regulation contradicts the governing law.

In both scenarios, the parties (or, rather than both of them, the party that would have an advantage therefrom) will expect that their will is respected by the arbitral tribunal; however, in order to do so, the tribunal may run the risk of rendering an award that violates public policy, or of applying the

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governing law inaccurately. To avoid these undesirable results, the arbitral tribunal may be tempted to disregard the choice of law made by the parties.

The sections below will analyse whether an arbitral award may be deemed invalid or unenforceable if it disregarded the parties' choice of law. There are, mainly, two grounds for the invalidity or unenforceability of an award that are relevant to this question: (i) excess of power, and (ii) procedural irregularity. It will be necessary to distinguish two different scenarios, according to: (i) whether the arbitral tribunal has disregarded the choice made by the parties for applying the law of another country, or (ii) whether the choice made by the parties was disregarded for applying general principles of trade or other transnational sources (locus mercatorum).

1. Criteria to Evaluate the Award's Effectiveness

As long as the losing party complies with arbitral awards voluntarily, there is no point of contact between the national courts and the arbitration. Consequently, there will be no national judge to override the parties' contract or expectations by considering an agreement invalid because it violates EU competition law,¹ or a firm offer not binding because it fails to comply with some formal requirements set by the chosen law.² The arbitrators may or may not decide to apply these rules; however, as long as the losing party accepts the result of the arbitration, there will be no opportunity for a judge to verify the arbitrator's acts.

If the losing party does not voluntarily accept the award, there are two possibilities of obtaining judicial control over an award: (i) the losing party may challenge the validity of an arbitral award before the courts of the place where the award was rendered, and (ii) the losing party may abstain from carrying out the award, so inducing the winning party to seek enforcement of an arbitral award by the courts of the country (or countries) where the losing party has assets.

1.1. Challenge of the Validity

The validity of an award may be challenged before the courts of the place where the award was rendered. Because the challenge is regulated by

¹ Violation of EU competition law is, according to a controversial European Court of Justice decision, to be deemed as a violation of ordre public (Ecco Swiss China Time Ltd v. Benetton International NV., No. C-126/97). For further information, see STOCKHOLM ARB. REP. 2000:1, p. 23.

² Under certain circumstances acceptance by the offeree would be a prerequisite for the offer to be binding, in case the governing law was English. For more references, see BEATSON, ANSON'S LAW OF CONTRACT, Oxford 2002, pp. 88ff. 118f.
national arbitration law, and may differ from country to country, it is impossible to make an analysis with a general validity. Therefore, we will look here at the discipline contained in the 1985 UNCITRAL Model Law on International Commercial Arbitration, which is acknowledged as embodying a general consensus in the matter of arbitration, is adopted more or less literally in circa 40 countries, and is used as a term of reference even in many countries that have not formally adopted it.

The grounds that may be invoked under article 34 of the UNCITRAL Model Law to invalidate an award are the same grounds that may be invoked under article 36 of the Model Law as defences against the enforcement of an award. These are, in turn, the same grounds that are listed in the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards as the only possible defences against the enforcement of an award. In the interest of harmonisation, that in a field like international arbitration is extremely important and fully complies with the purposes of both the UNCITRAL Model Law and the New York Convention, both instruments shall be interpreted autonomously. An autonomous interpretation aims at construing and applying a rule in a uniform way, common to all countries that have adopted or ratified the instrument. It assumes that a court avoids special interpretations due to peculiarities of its specific national system, as well as that it takes into consideration construction and application of the instrument in other countries, as a parameter for its own interpretation. Because the criteria for challenging the validity and resisting the enforcement of an award, interpretation or application of articles 34 and 36 of the UNCITRAL Model, as well as of article V of the New York Convention, are relevant to each other, we will deal with the grounds for invalidity and the grounds for unenforceability jointly, and the comments made regarding the Model Law will be applicable also to the New York Convention, and vice versa.

It is, however, important to bear in mind that, as mentioned above, invalidity of an arbitral award is regulated by the various national laws, and that there may be further grounds for invalidity in the countries that have not adopted the UNCITRAL Model Law.

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3 The text can be found on UNCITRAL’s homepage, http://www.unictral.org/en-index.htm.

4 Among the most recent arbitration laws that are based on the UNCITRAL Model Law is the Norwegian Arbitration Act. A list of the countries that have adopted the Model Law may be found on UNCITRAL’s homepage, supra note 3.

5 For example, Sweden and England have arbitration acts that follow their respective legislative tradition and cannot be considered as having adopted the Model Law. However, the Model Law has consistently been taken into consideration in the drafting work.
1.2. The Enforcement

Enforcement of an arbitral award is regulated, in over 130 countries that have ratified it, by the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.6

Article V of the New York Convention contains an exhaustive list of the grounds that may be invoked to prevent enforcement of an award. There is a large consensus regarding the opportunity to interpret these grounds restrictively, i.e., to restrict the scope of judicial control.7

2. No Review of the Application of Law

The list of grounds for invalidity or unenforceability is, as mentioned, exhaustive and must be interpreted restrictively. Nothing in the wording of this list suggests that the courts have the authority to review the merits of the arbitral decision, either regarding the evaluation of the facts, or regarding the application of the law. Judicial control under the UNCITRAL Model Law and under the New York Convention, in other words, may not be used as a vehicle for the court to act upon an error in law incurred by the arbitral tribunal, no matter how evident the error is. The inability to control the arbitral award on the merits, including also the application of the law, is generally acknowledged both in theory and in judicial practice.8

As seen below, this restriction to the scope of judicial control is of the utmost significance for the question that we are analysing here, i.e., to what extent the arbitral tribunal may disregard the choice of law made by the parties.

3. Excess of Power

The arbitral tribunal owes its very existence to the will of the parties. Consequently, it must follow the parties’ instructions as to its composition,

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6 The text of the convention and a list of the countries that have ratified it set forth in the homepage of UNCITRAL, supra note 3.

7 See the most authoritative commentary on the New York Convention, BERG, VAN DEN, Consolidated Commentary on the New York Convention, ICCA YEARBOOK COMMERCIAL ARBITRATION, 2003, 501 A, with extensive reference to judicial practice.

8 See BERG, supra note 7, Commentary, cit., 2003, 501 B and C. In common law there is a tradition for permitting a certain control of error in law in the phase of challenge of the validity of an award, although it has been considerably restricted in modern legislation (see, for example, section 69 of the English Arbitration Act). This, however, does not affect the enforceability of a foreign award that is governed by the New York Convention. See BORN, INTERNATIONAL COMMERCIAL ARBITRATION: COMMENTARY AND MATERIALS, 2d ed., 2001, p. 181, with references to the U.S. doctrine of manifest disregard of the law, which may be used as a defence against enforcement of a U.S. award, but not of a foreign award.
the procedure that it will follow, its jurisdiction, the scope of the dispute that it is called upon to solve, and the kind of remedies that it may grant. An award that does not follow the parties’ instructions is an award that exceeds the powers that the parties have conferred upon the arbitral tribunal. The parties’ instructions are the ultimate source of the tribunal’s power; therefore, an award that is affected by an excess of arbitral power does not have a legal basis, and is ineffective.

This is the rationale behind the exception of “excess of power,” that is listed both in the UNCITRAL Model Law, articles 34.2(a)(iii) and 36.1(a)(iii) and in the New York Convention, article V.I(c), as a ground to set aside the award and, respectively, refuse enforcement thereof. The question then becomes whether the exception of excess of power can be invoked to sanction the tribunal’s choice of applicable law.

3.1. The Scope of the Excess-of-power Defence

The normal scope of application of the exception of excess of power relates not to the choice of the applicable law, but to the object of the dispute.

It can be assumed, for example, that the parties have decided to submit to arbitration the disputes arising out of a contract for the sale of certain production equipment. At a certain point in time a dispute arises between the parties, and the arbitral tribunal is requested to decide whether the buyer has to pay the full price for the delivered equipment, or a reduced price because of certain alleged defects in the equipment. The arbitral tribunal comes to the conclusion that the price has to be paid in full, but resolves to set-off part of that price against a claim that the buyer has against the seller under a different contract; for example, for the lease of the production premises. According to the UNCITRAL Model Law and the New York Convention, the arbitral award is ineffective (at least for the part determining the set-off) because the arbitrators have exceeded their power. The mandate that the tribunal had received was to decide whether the price...

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9 The wording is, in the UNCITRAL Model Law: “the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside;” and in the New York Convention: “The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced.”
was to be paid in full or in part because of defects in the delivery. Any
decision regarding counterclaims deriving out of other contracts was not a
part of the dispute that was submitted to the arbitral tribunal and, therefore,
could not be decided upon by that award.

3.2. The Difficult Borderline Between Review of the
Applicability of the Law and Review of the Merits

Whether an arbitral tribunal has exceeded their power is relatively easy to
ascertain, as long as it is confined to the object of the dispute. More
difficult, however, is the question regarding the applicable law: the award is
on an object within the scope of the tribunal’s power, but the tribunal
applies a law different from the law requested by the parties. As we have
seen above, neither the challenge nor the enforcement of an arbitral award
may be used as a basis for the courts to review the arbitral tribunal’s
decision, including also its application of the law. It may not always be easy
to determine the border or fine line between the review of the tribunal’s
application of law, and the decision on whether the tribunal had the
authority to apply that law. The former is not within the scope of the
jurisdiction of the court, and the latter might be considered as an excess—
by the arbitral tribunal—of the power that it was given by the parties and,
therefore, be within the scope of the jurisdiction of the court.

An analysis of the reported cases concerning the UNCITRAL Model
Law and the New York Convention shows that the defence of excess of
power is seldom given effect to, for the purpose of sanctioning the arbitral
tribunals’ application of the law.\footnote{See BERG, Commentary, cit., 2003, 512 C.}
When the question has arisen, it seems that it has mainly been answered negatively, both in practice and in theory.\footnote{In theory, see, e.g., P. FOUCHARD; FOUGHARD, GAILLARD, GOLDMAN ON
INTERNATIONAL COMMERCIAL ARBITRATION, 2004, available at http://www.kluwer-
excluding that a decision rendered \textit{ex bono et a quo} exceeded the arbitral tribunal’s power.
From the reasons of the decision, however, it appears that the court based its reasoning on
the conclusion that the parties had actually empowered the tribunal to decide \textit{ex bono et a quo}
therefore, it is not surprising that the court did not see any excess of power). \textit{See also} a
German decision decided similarly, even mentioning, in an \textit{obiter dictum}, that the arbitral
tribunal’s choice of law may not be reviewed by the court. However, also in this case the
court based its conclusion on the fact that the parties had empowered the tribunal to decide
\textit{ex bono et a quo} (Landesgericht Hamburg, 18.9.1997, available at ICCA YEARBOOK
COMMERCIAL ARBITRATION, vol. XXXV, 512).} However, even if it is not very practical, it is theoretically possible to
request annulment of an award or to resist its enforcement on the basis of the allegation that the arbitral tribunal has gone beyond its powers in connection with the application of the law. The matters submitted to arbitration depend closely on the criteria that they have to be measured against. The dispute is to be solved on the basis of certain rules that have been agreed upon by the parties (or, failing such agreement, are designated by the applicable private international law); if the tribunal applies a different law, and assuming that the two laws regulate the question in different ways, it could be considered as if the tribunal had applied a different contract. The assumptions for resolving the dispute would not be the same as those agreed upon by the parties; therefore, the decision would be on matters different from those submitted by the parties.

This judicial control, however, has to be based on a careful analysis of the reasons of the award, to verify that the proper criteria for the exercise of the defence are met. As we will see below, under certain circumstances the arbitral tribunal’s application of a law different from the law that was chosen by the parties cannot be seen as a disregard of the parties’ choice. For instance, when the choice made by the parties does not cover the relevant area of law, or because the law chosen by the parties gives effect to rules of other laws (for example, through the force majeure principle, rules on immorality, or rules on illegality that are extended in violation of foreign laws). Under other circumstances, however, the disregard by the arbitral tribunal of the parties’ choice may qualify as a disregard of the parties’ instructions.

3.3. The Tribunal Disregards the Choice of the Parties and Applies National Law

In the first scenario that we will examine, the tribunal disregards the choice of law made by the parties because it applies rules of another law. In the second scenario, the arbitral tribunal applies sources that are not national or international in the strict sense (i.e., deriving from treaties or conventions), but transnational and non-authoritative, such as general principles of international trade. The first scenario may be divided into two further categories, according to whether the tribunal applies some rules of the law that would have been applicable to the dispute if the parties had not made a choice, or applies a law that would not have been applicable even in the absence of the parties’ choice.

3.3.1. Disregard of Parties’ Choice in Favour of the Otherwise Applicable Law

To illustrate the matter, we can assume that two competing manufacturers, for the licensing of certain technology, entered into a
contract. Moreover, the transfer of technology is accompanied by a system for sharing the market between the two competitors, which violates European competition law. The contract contains a choice-of-law clause, according to which the governing law is Swiss law, and an arbitration clause. We can further assume that a dispute arises between the two parties and that one of the two parties alleges that the contract is null and void because it violates European competition law. The other party alleges that EC competition law is not applicable to the contract, and that the choice of Swiss governing law was meant specifically to avoid the applicability of EC law. Hence, it is outside of the tribunal's power to take into consideration EC competition law.

What can the arbitral tribunal do? If it follows the arbitration agreement and applies Swiss law, as chosen by the parties, it runs the risk of rendering an award that violates EC *ordre public* (EC competition law having been qualified by the European Court of Justice as *ordre public* in a case similar to the one illustrated here).12 An award that violates the *ordre public* of the court may be set aside as invalid13 and is unenforceable.14 If the arbitral tribunal has its seat within the European Community, therefore, the award runs the risk of being annulled; and if the award has to be enforced in an EC country, it runs the risk of not being enforced.

Consequently, the tribunal might be inclined to take into consideration EC competition law; thus, avoiding rendering an invalid or unenforceable award. Does the arbitral tribunal run the risk of exceeding its power or incurring a procedural irregularity if it takes into consideration EC competition law? In other words: is the arbitral tribunal forced to choose between two grounds for invalidity or unenforceability of the award, i.e., excess of power or procedural irregularity on the one hand, and a potential conflict with *ordre public* on the other hand?

In my opinion there is room for arguing that an arbitral tribunal is, under certain circumstances, not affected by the choice of the parties. The fact that the parties have chosen a certain governing law does not exclude the relevance of all rules of any other laws. This will depend both on the substantive rules of the chosen law (such as the rules on illegality or on *fora majorum*, that may make reference to the effects of foreign laws), and on the conflict rules of the private international law applicable by the tribunal (such as the scope of party autonomy, the applicability of overriding

12 The already mentioned Eco-Swiss case, *supra* note 1.
13 UNCITRAL Model Law, art. 34.2(b)(ii).
14 UNCITRAL Model Law, art. 36.1(b)(ii), and New York Convention, art. V.2(b).
mandatory rules). A variety of approaches are thinkable, as we will see below.

a) Violation of the ordre public of the lex arbitri?

If the tribunal is located in a European Union state, it cannot be expected to disregard its own ordre public; otherwise, the courts of the state where it was rendered would annul the award. Therefore, EC competition law would have to be taken into consideration, and the parties' choice of the Swiss governing law would have to be restricted accordingly. The arbitral tribunal would find the authority to do so based on the applicable private international law, if it contains a rule that renders a choice of law made by the parties invalid, to the extent the parties' choice violates the applicable ordre public.15

b) Application of the chosen law refers to the excluded law

If the tribunal is located in a state outside the European Union, it might apply the law chosen by the parties in full—including also any illegality rule contained therein permitting the disregard of an agreement (or a choice of law) made by the parties that leads to the violation of mandatory rules of foreign law. Under these circumstances, the tribunal would not have exceeded its power; on the contrary, it would have given full application to the law chosen by the parties, and the instruments to restrict the effects of the choice of law would be given precisely by the chosen law.

Application in full of the law chosen by the parties may, in several situations, lead to taking into consideration the very rules of the law that the parties had intended to exclude. For example, a rule on force majeure of the chosen law may lead to the consideration of foreign rules restricting export or import,16 and rules on immorality or illegality in the chosen law may lead

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15 Most private international laws contain such a rule. Within European law, it is provided for in article 16 of the 1980 Rome Convention on the Law Applicable to Contractual Obligations.

to the invalidity of a contract entered into to avoid the application of a foreign law.\textsuperscript{17}

c) Application of the private international law

The tribunal might examine the applicable private international law to determine the borders of party autonomy. In this way, the tribunal might ascertain to what extent the choice of Swiss law made by the parties is valid under the applicable private international law, or to what extent it may be restricted by applying other conflict rules or by taking into consideration overriding mandatory rules of other laws. The EC competition law would be an example of the latter: rules that the judge (or the arbitral tribunal) is entitled to apply irrespective of the choice of law made by the parties.\textsuperscript{18}

The applicable private international law may result in further restrictions of the chosen law. By choosing the applicable law, the parties have exercised a choice-of-law rule (the rule of party autonomy), and the scope of such rule is determined by the applicable private international law. Generally, the parties' choice will not extend to areas such as legal capacity, incorporation or organisation of a company, encumbrances, or securities exchange, etc. In these areas, the applicable law will have to be determined by the arbitral tribunal irrespective of the choice made by the parties.

There is no uniform answer to the question of which private international law is applicable to an arbitral dispute. The various arbitration laws and rules of institutional arbitrations present a series of solutions, ranging from the application of the private international law of the place of arbitration,\textsuperscript{19} to the application of the private international law that the arbitral tribunal deems most appropriate,\textsuperscript{20} the application of conflict rules

\textsuperscript{17} For example, article 20 of the Swiss Obligation Code.

\textsuperscript{18} In the European private international law, the authority to apply overriding mandatory rules is regulated in article 7 of the already mentioned 1980 Rome Convention.

\textsuperscript{19} This is the traditional approach that is still followed in some modern arbitration legislation; for example, art. 31 of the 2004 Norwegian Arbitration Act.

\textsuperscript{20} This approach is followed, among others, by the UNCITRAL Model Law and the English Arbitration Act, and it can result in the application of the private international law of the country where the arbitral tribunal has its venue, of another law that seems to be more appropriate, or even, of no specific law (often arbitrators compare the choice of law rules of all laws that might be relevant, and apply a minimum common denominator).
specifically designed for arbitration, or the direct application of a substantive law without considering choice-of-law rules.

d) Conclusion

Based on the foregoing it seems unlikely that, in the example made here, the award will be deemed invalid or unenforceable for excess of power, even if the tribunal has given effect to EC competition law, whereas the parties had intended to exclude the applicability of that law. It seems more likely that an arbitral tribunal will fear the invalidity and lack of enforceability of an award if it disregards EC competition law. Taking into consideration that a tribunal should aim at rendering awards that are effective, it seems that the expectations of the parties to receive aid by arbitral tribunals in avoiding mandatory rules of closely connected laws should be disappointed more often than not, at least in those situations where the mandatory rules are of such a nature that an award disregarding them might be deemed against *ordre public* in the state of origin of the award or in a state of enforcement. As seen above, the arbitral tribunal does not need to fear any excess of power challenge, as there are many routes allowed under the applicable private international law to restrict the scope of the choice of law made by the parties.

3.3.2. Disregard of Parties' Choice in Favour of a Law not Otherwise Applicable

Private international law does not always provide a means for restricting the scope of party autonomy; as a matter of fact, the restrictions that we have seen above are more the exception than the rule, and in the majority of the cases the choice of law made by the parties cannot be restricted by other choice of law rules, by overriding mandatory rules, or by principles of *ordre public*.

It can be assumed that the parties, after having entered into a contract, renegotiate the price and enter into a new contract with the sole purpose of increasing the price. If the amending contract is governed by English law, the party that agreed to pay a higher price might claim, under certain circumstances, that the price increasing contract is not binding because it

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21 For example, the Swiss and the Italian arbitration laws contain a choice of law rule that designates as applicable the law of the country with which the subject matter of the dispute has the closest connection.

22 French arbitration law, as well as the rules of the International Chamber of Commerce of the London Court of International Arbitration and of the Arbitration Institute of the Stockholm Chamber of Commerce, give the arbitral tribunal the authority to apply directly the substantive law that it seems more appropriate, without going through the mediation of a choice of law rule.
did not contemplate any consideration in exchange for the promise to pay a higher price (the expectation of obtaining a performance that the other party was already obliged to perform, according to the first contract, does not normally qualify as consideration).\textsuperscript{23} The arbitral tribunal may find this result unsatisfactory, since the expectation of the parties at the moment of entering into the second contract was clearly that the term of the higher price should be binding. In order to avoid this result, the tribunal may decide not to apply English law, but, for example, the law of the country where the contract is to be performed, because under such law the increase of price would be deemed binding upon the parties.

In a scenario like this one, the private international law does not provide a tool to override the choice of law made by the parties—there is no violation of \textit{ordre public}, there are no overriding mandatory rules, and the subject-matter is clearly within the scope of the party autonomy. Therefore, it is not possible to argue—as we did in the previous section—that the arbitral tribunal has not disregarded the parties' choice, but simply has filled its gaps in accordance with the applicable private international law. Moreover, in our example, the law applied by the arbitral tribunal is not the law that would be applicable if the parties had not made a choice (this law being, at least in the European private international law, not the law of the place of performance, but the law of the country where the party making the characteristic performance has the place of business).\textsuperscript{24} The tribunal has, in other words, not used the applicable private international law to integrate or correct the parties' choice. It has simply decided that it was more appropriate to choose a different law.

Has the tribunal exceeded its power?

Once again, it is necessary to draw a line between the tribunal's application of the law and the tribunal's disregard of the parties' instructions.

If, from the award's reasons, it is possible to infer that the arbitral tribunal has applied some choice of law rules, and that this application has led to the misapplication of the law chosen by the parties, we are in the field of application of the law; more specifically, in the field of application of private international law. If the arbitral tribunal has applied private international law wrongly, for example, because it wrongly assumed that the

\textsuperscript{23} See Blatson, \textit{supra} note 2, at pp. 107 ff., with extensive references to doctrines and equitable remedies that have been developed to mitigate the undesirable results of this approach.

\textsuperscript{24} See article 4.2 of the 1980 Rome Convention.
English rule on consideration would be contrary to *ordre public*, it has incurred an error in law. As known, errors in law are not subject to judicial control under the UNCITRAL Model Law or under the New York Convention. Therefore, an award that disregards the parties' choice of law on the basis of a wrong application of private international law may not be considered invalid or unenforceable because of excess of power.

If, however, the award does not take into consideration private international law, and there is no basis for assuming that the disregard of the parties' choice is due to an error in the application of choice of law rules or in the interpretation of the contract, then it is possible to argue that the arbitral tribunal has ignored the parties' instructions. This qualifies as an excess of power. There are, admittedly, only a few cases where this line of thought was applied; however, this is fully compatible with the judicial control that may be exercised on arbitral awards under the UNCITRAL Model Law and under the New York Convention.²⁵

3.4. Disregard of Parties' Choice in Favour of Transactional Sources (Lax Mercatoria)

Application of transnational principles is not a new phenomenon in international arbitration,²⁶ and many authors consider the *lex mercatoria* as the most appropriate source to be applied in this context.²⁷

²⁵ There are at least two cases where this reasoning was applied to set aside arbitral awards rendered under the Washington Convention of 1965, establishing an arbitration mechanism for disputes between private parties and foreign states (ICSID), and providing for an independent, non-national system for reviewing the validity of awards, which includes, among others, the possibility to annul an award if the tribunal has manifestly exceeded its powers (article 52.1(c) of the Convention). In Klöckner GmbH v. The United Republic of Cameroon and Socame (ICSID Case No Arb/81/2), the *ad hoc* Committee acting as controlling instance affirmed that failure by the tribunal to apply the governing law is to be deemed as an excess of power, and so did the *ad hoc* Committee controlling the award rendered in Amcu Asia v. The republic of Indonesia (ARB/81/1). For further references, particularly to the debate that arose in connection with the Klöckner decision, see G.C. Moss, *supra* note 16, at pp. 276ff.

²⁶ Two famous and controversial cases that adopted transnational principles are the 1951 Petroleum Dev (Trucial Coast) Ltd. v. the Sheik of Abu Dhabi, 1 INT'L & COMPARATIVE L. QUARTERLY 154 & 247 (1952), and Saudi Arabia v. Arabian American Oil Company (ARAMCO), 27 INT'L L. REP. 117 (1963). For references and a criticism of this approach, see Fouchard, *supra* note 11, at 1512.

In the case presented in the previous section, for example, where the application of English law would make the amended contract nonbinding, the arbitral tribunal may decide that the English doctrine of consideration is peculiar to English law, and that in an international setting it is not appropriate to apply a rule of a municipal law, particularly when it conflicts with the expectations of international trade. The tribunal may thus resolve to apply a principle that is often referred to as a generally acknowledged principle within international trade: *pacta sunt servanda*, according to which an agreement has to be complied with irrespective of the presence of consideration. The tribunal, in this case, would have disregarded the parties' choice for applying not the law of another country, but generally acknowledged principles or other non-authoritative transnational sources, also known as the *lex mercatoria*.

Would this be considered as an excess of power?

In the context of the defence of excess of power, it is not very significant to distinguish between disregard of the choice of the law made by the parties for applying the law of another country, and disregard for applying the *lex mercatoria*. This distinction becomes more relevant when the exercise of the tribunal's powers is measured not against the arbitration agreement (as is the case in the defence of excess of power), but when it is measured against the applicable arbitration law (as is the case in the defence of procedural irregularity, that we will see immediately below).

From the point of view of the excess of the parties' instructions, the same reasoning explained above will apply here: if the tribunal's disregard of the parties' choice is due to the wrong application of private international law or the wrong interpretation of the contract, judicial intervention would not be appropriate. If, however, the application of the *lex mercatoria* is due to a blunt disregard of the parties' instructions, then the tribunal has exceeded its powers and this can result in the invalidity or unenforceability of the award.

4. Irregularity of Procedure

The defence of procedural irregularity adds one parameter to the evaluation of the arbitral award: not only does it permit the measurement of the arbitral procedure against the parties' instructions contained in the arbitral agreement, but it also makes reference to the arbitration law of the place of arbitration.28

28 The wording is, in the UNCITRAL Model Law: “the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless
4.1. The Scope of the Defence of Procedural Irregularity

The defence of procedural irregularity is seldom applied in the context of choice of law. Generally, this defence pertains to the composition of the arbitral tribunal, the production of evidence, the setting or respect of time schedules, etc.²⁹

With respect to the disregard of the parties’ choice of law, it is first necessary to point out that the tribunal’s interpretation of the contract and application of the law (including also the private international law) may not be reviewed by the court, irrespective of how evidently wrong they are, as already mentioned in connection with the defence of excess of power. Therefore, a tribunal’s disregard of the parties’ instructions pertaining to the governing law may not, as a rule, fall within the scope of procedural irregularity if it does not fall within the scope of the excess of power defence. There is, however, one context in which it is possible to differentiate: when the arbitral tribunal disregards the choice of the parties and applies general principles or other transnational sources. In this case the arbitral tribunal may, in addition to exceeding the instructions of the parties, have exercised powers that it might not have had according to the applicable arbitration law.

As seen below, the arbitral tribunal does not necessarily have the power to apply the *lex mercatoria* on its own initiative; in the majority of the arbitration laws, the arbitral tribunal has to apply a national law, unless the parties have requested otherwise. Therefore, application on the tribunal’s own initiative of transnational sources may result in something more than a simple wrong application of the private international law. It may result in a violation of the rules that govern the arbitration, which in turn is the basis for the defence of irregularity of procedure. This matter, however, requires an accurate analysis, that we will carry out below.

4.2. Decision at Law or in Equity (ex bono et aequo)

Most arbitration laws, as we will see below, permit the parties to request that the arbitral tribunal render its decision without taking into strict consideration the applicable law. This kind of decision, called a decision *ex bono et aequo*, assumes that the tribunal is not applying the provisions of a

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²⁹ *See Berg, supra note 7, Commentary, cit., 2003, 513 D.*
specific law, but is acting as an *amicable compositur*, i.e., taking into consideration the circumstances of the case, the interests of the parties, as well as the common sense of justice and any other sources or circumstances that it might consider appropriate. Among these sources and circumstances, it is possible to also apply the *lex mercatoria*. An award rendered in equity will be subject to the same regime as an award rendered at law, when it comes to validity and enforceability. The same circumstances that might affect the validity of an award at law, therefore, will affect also the validity and enforceability of an award rendered *ex bono et aequo*.

4.3. *Is Transactional Law the Basis for a Decision at Law or ex bono et aequo?*

We have mentioned a situation wherein the parties have directed the arbitral tribunal to act as an *amicable compositur*, and that the tribunal has applied transnational sources on the basis thereof. But what if the parties have not expressly directed the tribunal to decide *ex bono et aequo*? may the tribunal nevertheless apply the *lex mercatoria*? The answer to this question assumes the answer to another question: would a decision taken on the basis of transnational law be deemed to be a decision at law, or would it be deemed to be a decision taken *ex bono et aequo*? This definition is important because, as we will see immediately below, under some arbitration laws the arbitral tribunal may render an award in equity only if the parties have expressly instructed it to do so. Otherwise, the arbitral tribunal has no authority, under the applicable arbitration law, to render an award other than at law.

Generally, both arbitration rules and arbitration laws make a clear distinction between a decision made at law and a decision made *ex bono et aequo*. A tribunal is empowered to take the latter decision (acting therefore as an *amicable compositur*) only if the parties have expressly instructed it to do so. This is expressly stated, for example, in the English Arbitration Act (section 46.1 (b)), in the Swiss Private International Law Act (article 187.2), in the French and the Italian Codes of Civil Procedure (respectively, articles 1497 and 834), as well as in the arbitration rules of the International Chamber of Commerce (article 17.3) and of the Arbitration Institute of the Stockholm Chamber of Commerce (article 24.3).

The above would seem sufficient to prevent an arbitral tribunal from applying transnational law on its own initiative; however, there are some who disagree. Those who disagree do not qualify a decision taken according to transnational sources as a decision taken as an *amicable compositur*; the *lex mercatoria* is, according to them, a system of law, and even a better one than state laws, when it comes to international contracts. Therefore, a decision
based on transnational sources would be a decision taken at law, not *ex h ibo et aequo.*

A confirmation of this opinion is found by its supporters (but this interpretation is not undisputed) in the terminology used by some arbitration laws and arbitration rules. These generally permit the parties to instruct the tribunal as to what "rules of law" shall be applied to the merits of the dispute. Failing a choice made by the parties, the laws and rules contain some indications as to the approach to be followed by the tribunal (which conflict rules shall be applied) that will result in the application of certain "rules of law," or in the application of a "law." The terminology "rules of law" would refer not only to a state law, but also to any system of rules, including also transnational rules; the terminology "law," on the contrary, would refer to state laws. If the applicable arbitration rules or arbitration law speak of the tribunal applying "rules of law" on its own initiative, this is interpreted as if the tribunal was empowered to apply transnational law on its own initiative; if the applicable rules or law speak of "law," this power is excluded. Also, other languages should reflect the distinction between "rules of law" and "law." For example, in French, the distinction should be between, respectively, "droit" and "loi," in German between "Rechtsvorschriften" and "Recht," in Italian between "norme" and "legge."³⁰

According to this interpretation, the tribunal would be empowered to apply the *lex mercatoria* by the French Code of Civil Procedure (article 1497), by the Swiss Private International Law Act (article 187, in the French version, but not in the German or the Italian version), as well as by the arbitration rules of the International Chamber of Commerce (article 17.1), the London Court of International Arbitration (article 22.3), and the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce (article 24.1), which all make reference to "rules of law." Other laws and rules, on the contrary, exclude this possibility, and assume that the tribunal applies a state law unless the parties have made reference to non-national sources; for example, the UNICTRAL Model Law (article 28.2), the English Arbitration Act (section 46.1), the Italian Code of Civil Procedure (article 834), as well as the UNICTRAL rules (article 33.1).

Therefore, if the above-mentioned logic is accepted, arbitration rules and legislation would provide for three kinds of decisions. Decisions in equity, which are admissible only upon the direction by the parties; decisions based on rules of law, including also transnational sources, which may, in some systems, be applied on the tribunal’s own initiative; and decisions based on state laws, which in all systems may be applied on the tribunal’s own initiative.

4.4. The Application of Lex Mercatoria and Procedural Irregularity

As seen above, it is not possible to sanction the tribunal’s disregard of the law chosen by the parties if this is made to apply the rule of another law that the tribunal might be requested to apply by the applicable private international law, or to avoid conflicts with applicable fundamental principles that fall under the *ordre public* exception. What if the tribunal’s disregard of the choice-of-law provision made by the parties is not made to apply another law, but to apply transnational principles? In our example described above, the parties to a contract realise—after the contract has

31 In the arbitration rules of the Stockholm Chamber of Commerce the distinction between “law” and “rules of law” is clearly endorsed: Article 24.1 mentions both as an alternative (“law or rules of law”), therefore, there is no doubt that the two terms are meant to designate two different sources. In other instruments, such as the ICC rules and the UNCTRAL Model Law, there is no alternative mention of the two terms, thus rendering it more uncertain as to distinguish between “law” in the meaning of state law and “rules of law” in the meaning of *lex mercatoria*. Some court decisions seem to have followed this view: The French Supreme Court has not considered as invalid a preliminary award that decided to apply the transnational law on its own initiative (the so-called *Valentinia* case: *see* CLUNET, 1992, p. 77, with a note by Goldman, and REVUE DE L’ARBITRAGE, 1992, p. 457, with a note by Lagarde. The Austrian Supreme Court has not considered as invalid an award (rendered in the case *Paliwok v. Norman*) that applied the transnational law on its own initiative: *see* YEARBOOK COMMERCIAL ARBITRATION IX (1994), pp. 159 ff, with a note by Melis. A decision by the English Court of Appeal, *Deutsche Schifffahrts- und Tiefbohrgesellschaft mbH v. Ras Al Khaimah National Oil Co.* C.A. [1987] 2 Lloyd’s Law Rep. 246, is sometimes referred to as confirming that a decision made on the basis of the transnational law cannot be considered as an equitable decision (see, for example, BONELLI, M., *AN INTERNATIONAL RESTATEMENT OF CONTRACT LAW*, Transnational Publishers, Inc., New York, 1997, p. 201, footnote 110, and Lando, *Lex mercatoria, supra* note 27, at pp. 576 ff). In reality, this decision does not seem to qualify the transnational law, it rather seems to interpret the applicable arbitration rules (which in the case were the ICC arbitration rules) in a way that does not permit to draw conclusions on the qualification of the transnational law: *see* G.C. MOSS, *supra* note 16, at pp. 290 ff. The interpretation of the transnational law as a body of “rules of law,” however, is far from uncontroversial: *see*, criticising it, DASSEK, P., *INTERNATIONALE SCHIEDSGERICHTEN UND LEX MERCATORIA. RECHTSVERGLEICHENDER BEITRAG ZUR DISKUSSION ÜBER EIN NICHT-STÄATLICHES HANDELSBRECHT*, Scultetus Olygraphischer Verlag, Zürich 1989, p. 309, Gaja, G., *Sulle norme applicabili al mercato comune in nuova disciplina dell’arbitrato internazionale*, RIVISTA DELL’ARBITRATO, 1994, pp. 433 ff., 438 ff., and Giardina, A., *La legge n. 25 del 1994 e l’arbitrato internazionale*, RIVISTA DELL’ARBITRATO, 1994, pp. 257 ff., 269 ff.
entered into force—that the agreed price was too low. They, therefore, enter into a new contract for the sole purpose of increasing the price. At the moment of paying the increased price, the payor refuses to give effect to the increased payment and the dispute is submitted to arbitration. If the governing law is English law, and if it is not possible to find a factual benefit that would derive out of it to the payor, the amended contract may be deemed nonbinding for lack of consideration.\textsuperscript{32} What if the parties have chosen English law to govern the contract: can the tribunal on its own initiative disregard the doctrine of consideration contained in the governing English law? The tribunal might consider it inappropriate to strictly apply the doctrine of consideration. This doctrine is peculiar to common law legal systems and does not reflect the general expectation of the parties in the international business arena, and certainly not the specific expectations that the parties had when they entered into the amended contract. What happens if the arbitral tribunal decides to disregard this peculiarity of one national system of law and applies, instead, the generally recognised transnational principle \textit{pacta sunt servanda} (that provides for the binding effect of a contract)? Is the award effective, or does it run the risk of being annulled or of not being enforced?

As seen, the courts of law have no jurisdiction to review the application of the law made by the arbitral tribunal. Therefore, a wrong application of English law would not be subject to judicial control, neither would a wrong interpretation of the choice-of-law provision in the contract or a wrong application of private international law. However, an unsolicited application of the \textit{lex mercatoria} goes beyond the error in law, at least under the arbitration laws that do not distinguish between decisions \textit{ex bono et aequo} and application of the \textit{lex mercatoria}. Application of the \textit{lex mercatoria}, without having been empowered by the parties, is forbidden by these arbitration laws and may, therefore, result in a procedural irregularity.

Whether the disregard of the English doctrine of consideration is the consequence of an error in law (and therefore not subject to judicial control) or of the application of transnational principles (and therefore subject to judicial control if this is deemed to correspond to a decision \textit{ex bono et aequo}), must be established on the basis of a careful analysis of the reasons of the award.

\textbf{4.5. Concluding Remarks on Procedural Irregularity}

If the abovementioned theory about the implications for transnational law of the distinction between “rules of law” and “law” is accepted, one

\textsuperscript{32} \textit{See}, supra note 23.
may conclude that there is no uniform answer to the question of invalidity or unenforceability in the scenario made here. If the parties had adopted for their dispute the rules of arbitration of the Arbitration Institute of the Stockholm Chamber of Commerce, the tribunal would have been indirectly empowered by the parties to apply transnational sources. Therefore, the disregard of the English doctrine of consideration and the application of the principle *pacta sunt servanda* would be treated in the same way as the disregard of the law chosen by the parties for applying another state law. Whether the courts would be willing to exercise their control over the tribunal's award, or whether they would consider an intervention in this context dangerously close to a review of the tribunal's accurate application of the law (which, as known, the courts are not empowered to make), would depend on the circumstances of the case and on the reasons of the award.

If, however, the parties had adopted the UNCITRAL arbitration rules for their arbitration (and it is not unusual to subject to UNCITRAL arbitration rules an arbitral proceeding that is carried out before the Arbitration Institute of the Stockholm Chamber of Commerce), the tribunal would have been bound to apply the governing law, and an application of transnational sources would have exceeded the powers of the tribunal and could fall under the defence of procedural irregularity.

**Conclusion**

The above analysis shows that the arbitral tribunal enjoys considerable freedom in respect of the law that it applies to resolve the dispute, and that this freedom goes so far as to permit the tribunal to apply the chosen law wrongly or to disregard the instructions that the parties gave regarding what law shall be applied. However, as seen, there are certain borders or limitations to the tribunal's freedom in respect of the applicable law: the *ordre public* of the court that exercises judicial control may not be violated by the award, and the tribunal may not render a decision in equity without having been empowered to do so by the parties. Between these two borders there are a wide range of possibilities to disregard the parties' instructions, particularly by applying various rules of private international law. The interpretation of the parties' instructions, the application of the chosen law, or the choice of another law on the basis of private international law may not be reviewed by the judge—even if they are manifestly wrong. The disregard of the parties' instructions, therefore, enjoys a nearly total immunity as long as it may be qualified as error in law, because the courts have no jurisdiction thereon. If the decision to ignore the parties' instructions is not the consequence of an error in law or an error in the interpretation of the contract, but is simply the result of the tribunal's