LECTURES ON
INTERNATIONAL COMMERCIAL LAW*

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PREFACE

This compendium is a temporary publication, recording and elaborating the lectures that I have been holding in the past three years in the course “International Commercial Law” at the Law Faculty of the Oslo University, as well as in the course “Regulation of International Business” at the Centre for Energy, Petroleum and Mineral Law and Policy at the University of Dundee. I have also incorporated some of the material used in the seminars that I held at The Hague Academy of International law, where I have been Director of Studies in the 2002 course on private international law.

This temporary version is meant to be a complement, not a substitution, of the reading materials recommended for the respective courses. This is because, in the present version, the compendium contains a series of examples and illustrations of the main thesis on the scope and function of international commercial law, but it does not give a systematic overview of the content of international commercial law. In due course the compendium will be integrated. I am planning, i.a., a systematic comparison of Common Law and Civil Law in the parts of contract law that are relevant to the subject-matter. Also, the final version will contain a presentation of the most important conventions regulating international commerce, a systematic presentation of jurisdiction and arbitration, as well as a systematic analysis of the content and function of the most important types of contracts. There will also be more extensive references to literature and cases, so that the statements made in the text can be verified and researched further.

The material analysed in this compendium is largely based on my professional experience as an in-house lawyer in multinational companies and later on as practising international lawyer. I have tried to systemise the questions that I have encountered in my practice, and to serve the answers and the guidelines that I had wished somebody had served me when I started practising back in 1985. Therefore, the outline followed in my lectures does not always correspond to the traditional organisation of the subject for teaching purposes; the outline is based rather on the desire to address the questions and problems that arise in connection with the drafting and implementing of international contracts. I will not, for example, introduce the legal framework that binds the States in their own regulation of international trade (such as the WTO and similar agreements). I will go straight to the contracts that the parties to a transaction enter into, analyse how they are written and how they are affected by the governing law (including also international conventions), by international trade practice and other non-legislative sources (often called trans-national law, soft law or lex

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mercatoria). Since a contract is not useful to a party if it cannot be enforced, I will also analyse the enforceability of the rights and obligations regulated in the contract, particularly from the point of view of international commercial arbitration.

I would like to acknowledge the support that I received from those who read up to numerous versions of my manuscript, making relevant comments and constructive recommendations: professors Erik Røsæg, Helge Thue and Magnus Aarbakke from the University of Oslo, and professor Kurt Siehr from the University of Zürich and the Max-Planck-Institute of Hamburg. A special thanks goes to professor Magnus Aarbakke, for his constant and constructive support in the last months prior to the printing of this compendium.

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INTRODUCTION - IS THERE AN INTERNATIONAL COMMERCIAL LAW?

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1. INTRODUCTION

International commercial contracts are often deemed to be the object of international commercial law; in many universities International Commercial Law is a subject that is studied, along with national commercial law, criminal law and the other subjects. It may be difficult to understand, at first sight, what the subject “International Commercial Law” covers. There are two elements that need explanation, in this definition: the term “commercial”, and the term “international”. After having explained these two terms, it will be necessary to ask ourselves whether there is an identifiable body of legal rules that regulates such relationships, or, in case of negative answer, how these relationships are regulated.

1.1 Explanation of the Term “Commercial”

To explain the term “commercial”, it will be sufficient here to specify that it refers to transactions entered into between parties in the course of their business activity. This leaves outside of the scope of the subject consumer contracts, as well as other aspects of private law, such as family or inheritance law. It is not the intention here to contribute to the old and extensive debate, characteristic particularly of some civil law legal doctrines, about the difference between private law and commercial law; the difficulty to define precisely the term “commercial” appears clearly in the explanation of the term provided by the Model Law on International Commercial Arbitration made by the United Nations Commission on International Trade Law (UNCITRAL), that in endnote 2 serves a tautology, i.e. it explains the term “commercial” by referring to the same concept, without imparting any additional explanation other than a long, non-exclusive list of transactions that are deemed to be of a commercial nature:

"The term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business co-operation; carriage of goods or passengers by air, sea, rail or road.”
As unsatisfactory as it may be to operate with a non-exhaustive list rather
with a clear definition of the scope of the content, we will follow the guidelines
laid down by the UNCITRAL, and consider as the object of our lectures the
kinds of transactions listed above.

1.2 **Explanation of the Term “International”**

As far as the term “international” in the name “international commercial law” is
concerned, there are two possible interpretations: (i) the law is international,
because it stems from international sources, or (ii) it is not the law that is
international, but the object that it regulates is. It is this latter construction that
correctly describes the subject that we are going to study. We will focus on the
law that governs international commercial relationships; however, the definition
of “international” varies, according to the criteria used by the interpreter.
Different state laws and different international conventions have different
definitions of what is international.

For example, the Vienna Convention on International Sale of Goods of 1980
(also known as CISG) specifies, in article 1.1, that a sale falls within the scope
of the convention (and therefore is to be deemed international) if the parties
have their place of business in different states:

"This Convention applies to contracts of sale of goods between parties
whose places of business are in different States."

Therefore, under the CISG a contract between, for example, a French seller and
a Norwegian buyer is considered international. A contract between two French
companies, however, would not be considered as international under the CISG,
even if the contract requires one party to import certain goods from a foreign
state for selling them to the other party.

The Hague convention on the Law Applicable to International Sale of Goods of
1955\(^1\) does not define the term international, and simply states in article 1 that
the mere determination of the parties is not sufficient to give a sale the
international character (indirectly accepting that a sale may be international if

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\(^1\) This convention has been ratified by 11 European states, including Norway, and is the basis
of a Norwegian piece of legislation that has long been the only general legislation within
private international law in Norway, the Act on the Law Applicable to International Sale of
Goods of 1964. The Hague Conference has in 1986 drafted a more modern convention on the
same subject; this convention, however, has not yet entered into force.

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there are some foreign elements to the transaction, this not necessarily being the place of business of the parties):

“The mere declaration of the parties, relative to the application of a law or the competence of a judge or arbitrator, shall not be sufficient to confer upon a sale the international character provided for in the first paragraph of this Article.”

Therefore, a contract between two Italian parties for the sale of a product manufactured in Italy and contemplating delivery and payment in Italy, will not qualify as international under the Hague Convention, even if the contract has a clause choosing German law as the law governing the transaction. However, the above mentioned contract between two French companies for the import and successive domestic sale of certain goods might be considered as international for the purpose of the Hague Convention, because there is a foreign element in the import of the goods.

The Rome Convention on the Law Applicable to Contractual Obligations of 1980, which is the European Community’s instrument regulating the choice of law in case of international contracts, speaks in article 1.1 of any situation involving a choice between the laws of different states, thus indirectly opening even for the eventuality that the only foreign element to a transaction is the choice made by the parties of a foreign law (although, in such a situation, the applicability of the conflict rules contained in the convention is limited by article 3.3 thereof):

”3.1 The rules of this Convention shall apply to contractual obligations in any situation involving a choice between the laws of different states.

3.2 [...] 

3.3 The fact that the parties have chosen a foreign law, whether or not accompanied by the choice of a foreign tribunal, shall not, where all the other elements relevant to the situation at the time of the choice are connected with one state only, prejudice the application of rules of the law of that state which cannot be derogated from by contract, hereinafter called ’mandatory rules’.”

Therefore, the above mentioned import and subsequent domestic sale between two French companies would fall within the scope of article 3.1 of the Rome Convention and allow a wide choice of law, because the import of the goods is an element that connects the situation with more than one state. The domestic
contract between the two Italian companies mentioned above, however, would fall within article 3.3 of the Rome Convention and allow a more restricted party autonomy.

The UNCITRAL Model Law on International Arbitration defines in article 1.3 an arbitration as international if one of more conditions are met, including also the mere determination by the parties that the subject-matter of the dispute relates to more than one state:

"An arbitration is international if:

(a) the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of business in different States; or

(b) one of the following places is situated outside the State in which the parties have their places of business:

(i) the place of arbitration if determined in, or pursuant to, the arbitration agreement;

(ii) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected; or

(c) the parties have expressly agreed that the subject-matter of the arbitration agreement relates to more than one state."

Therefore, a dispute arising out of the above mentioned domestic agreement between two Italian companies would qualify as international for the purpose of the UNCITRAL Model Law, if the parties have chosen a foreign governing law or a foreign state as venue for the arbitration. Having in mind these discrepancies, and that therefore it is necessary to verify in each specific case on the basis of the applicable law whether the transaction is international or not, it will suffice for the purpose of this course to define a transaction as international whenever there is a foreign element to it, that connects it with at least two different states.

The most evident example would be a contract entered into by two parties resident in different states: For example, an Italian clothes producer entering into an agency contract with a Norwegian agent for the promotion and sale of the products on the Norwegian territory, or a Russian aluminium producer entering into a contract for the export of its products to Norway.

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There might be, however, less evident cases, where inquiry is necessary before
the transaction may be defined as international or domestic. Where a contract is
entered into between a local company and the wholly owned subsidiary of a
foreign company, for example, some state laws permit to define disputes
connected therewith as international,\textsuperscript{2} whereas others focus on the formal aspect
of the common nationality of the parties, and consider the disputes as domestic.\textsuperscript{3}

\textbf{1.3 Explanation of the Concept “International Commercial Law”}

Once explained the object of our lectures, it may seem easy to come to the
conclusion that the name of the subject “international commercial law” is self-
explanatory, i.e. it refers to the law that regulates international commercial
transactions. This understanding of the scope is correct; what is quite
misleading, however, is the name “law”, in the singular; it might lead to think
that there is a unitary body of legal rules that regulates international commercial
transactions, issued by some international body with the appropriate authority.
As desirable as it may be to see that all kinds of questions arising out of any
international contract are regulated, for example, by a series of conventions
issued by the UNCITRAL, or by harmonised laws that are uniformly applied all
over the world, the real picture looks quite different.

\textbullet \textbf{a) International Commercial Law Is not a Collection of Substantive Rules}

The question about the law governing an international transaction becomes
relevant when there is a dispute between the parties: either a dispute that has
already arisen, or a potential dispute, that the parties may envisage and want to
regulate as early as during the contract negotiations. In order to find out what
rules apply to the disputed matter, the first source to look at is the text of the
contract. If the text of the contract solves the dispute in an uncontroversial way,
it is not necessary to search any further. However, the parties may not agree
(during the phase of negotiations) on a certain contractual regulation of that
matter, or they may disagree (during the performance of the contract) on the
interpretation of the contractual regulation. In this event, it will be necessary to
find rules of law that can fill the gaps of the contract or guide in the

\textsuperscript{2} For example, the Russian Law on International Commercial Arbitration of 1993 provides, in
article 1.2, that disputes arising out of contracts between to Russian companies may be
submitted to international arbitration, if one of the Russian companies is (wholly or even
partially) owned by a foreign entity.

\textsuperscript{3} For example, the Swiss Private International Law Act, article 176.1

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interpretation thereof, perhaps even replacing some terms of the contract that might be invalid or illegal.

This is when international commercial law becomes relevant: it points at international conventions and other international or trans-national sources that might be applicable to the particular case. International commercial law, however, does not always contain a substantive regulation that may solve the disputed matter; more often than not there is no international convention applicable to the disputed matter, and the other sources might not contain sufficient answer or might be in contradiction with other applicable rules. In such cases international commercial law should be a tool to permit identifying the substantive rule that will solve the disputed matter. International commercial law is, rather than (or in addition to) a collection of rules regulating rights and obligations of the parties, a map that helps determining where the rules regulating rights and obligations can be found.

To have a first understanding of how this tool works, it might be worthwhile to develop backwards the reasoning that should be made in the determination of the applicable rules, starting from the desired result and back to what is needed to obtain that result.

b) The Desired Ultimate Result Is an Enforceable Decision

When looking for the solution to a (potential or existing) dispute there is one aspect that is determinant: the enforceability of the solution. If the solution to a dispute cannot be carried out without the cooperation of the other party, then the solution is not worth much. In some cases both parties may have each its own interest to implement the solution, for example if they have renegotiated the contract in a way that ensures a balance of interests acceptable to both. In these cases it is not decisive to have an enforceable solution, as both parties may be expected to have an interest in implementing it. In other cases, however, the solution to the dispute may be advantageous to one party, but not to the other, for example if an arbitral tribunal or a court has accepted the claim of one party and dismissed the defence of the other party; why should the losing party volunteer to implement a solution that it does not agree with? If the implementation of the solution is not enforceable, but depends on the will of the losing party, it runs the risk of being stopped; the aim should always be to obtain a solution that can be carried out even if the losing party decides not to cooperate. This is possible when the decision is enforceable.
c) A Court Judgement or an Arbitral Award is Enforceable

In order to achieve enforcement, it is necessary to obtain the assistance by the competent courts of law, which can implement the solution even without the agreement of the losing party (for example, they can attach some assets of the losing party, sell them at an auction and use the proceeds to cover the claim of the winning party).

But when is it possible to obtain such assistance by the courts? Apart from special legal instruments, such as for example the bills of exchange, that are directly enforceable by the courts, the legal instruments that the parties to a commercial transaction need, in order to obtain enforcement, are a final judgement or a final arbitral award.

d) In an International Dispute, Enforceability of a Judgement or an Award Depends Primarily on International Conventions

A final judgement by a court of law is unquestionably enforceable in the same state where the judgement was rendered: if a court in state A orders that the losing party effects a certain payment to the winning party, and the losing party does not comply therewith, the winning party can take the judgement to an enforcement court in state A to receive assistance (for example, attaching assets that the losing party has in state A), in accordance with the procedural rules of state A.

In an international transaction, however, the parties may be resident each in a different state, and the losing party might not have assets in the state of the court that rendered the judgement. If a court in state A has ordered the losing party to effect a payment to the winning party, but the losing party has only assets in state B, how can the judgement of the court of A be enforced in state B? The winning party will have to seek assistance of the courts in state B; the enforcement court of state B will apply the procedural rules of its own state to enforce the judgement rendered in state A; the procedural rules of some states regulate the recognition and enforcement of foreign court decisions, whereas the procedural rules of other states do not regulate them. There are also multilateral and bilateral conventions that extensively regulate the mutual recognition and enforcement of court decisions by the states signatories to the convention.

The most significant convention from the point of view of Norway is the Lugano Convention of 1988, ratified by the member states of the European
Community and the member states of the European Free Trade Area, as well as by Poland.\footnote{For a Norwegian commentary to the Lugano Convention, see ROGNLIEN, S., \textit{Luganokonvensjonen – kommentarutgave}, Oslo 1993. See also PÅLSSON, L., \textit{Bryssel- och Luganokonventionerna}, Stockholm 1995.}

The Lugano Convention is largely based on the Brussels convention of 1968, ratified by the member states of the European Community; the Brussels convention has now been transformed into a Council Regulation (44/2001), and is directly applicable in all member states of the European Community, except Denmark.

Therefore, judgements rendered in any EU or EFTA state, as well as Poland, may be recognised and enforced in any other EU or EFTA state, as well as Poland, following the simple procedure contained in the Lugano Convention and the Brussels Regulations, as the case may be.

A similar convention is being drafted in the framework of the Hague Conference, and is meant to have a world-wide application; until this convention is finally drafted and ratified, however, judgements that do not fall within the scope of the Lugano Convention or of the Brussels Regulation will have to be recognised and enforced on the basis of other conventions (with regional or bilateral character) entered into between the state of origin of the judgement and the state of enforcement. In the event that there are no such conventions between the two relevant states, enforcement will have to be subject to the domestic rules of procedure of the state of enforcement. These rules vary from state to state, and they may range from the requirement to review the foreign decision with a simple procedure in order to verify that fundamental principles of process have been respected in the foreign proceeding, to the requirement to carry out a full process, whereby the foreign decision does not have any formal effect.

The enforceability of a foreign arbitral award is easier to ascertain than the enforceability of a court decision, as it is uniformly regulated in the 133 states (including Norway) which have ratified the New York Convention of 1958 on Recognition and Enforcement of Arbitral Awards. The New York Convention provides that any court in a state signatory to the convention shall recognise and enforce, on the basis of a simple procedure, arbitral awards rendered by arbitral tribunals having their seat in any other state signatory to the convention. Arbitral awards, therefore, enjoy an effective regime of enforceability that has a much wider geographical scope than the regime provided for court decisions.
e) To Render an Enforceable Decision, the Court or the Arbitral Tribunal Must Have Had Jurisdiction

One of the assumptions of enforceability of a foreign judgement or award is, as a rule, that the court or the arbitral tribunal that rendered the decision had jurisdiction to decide on the case.

In the case of enforcement of foreign judgements under the Lugano Convention or the Brussels Regulation, the jurisdiction is regulated in the convention and the regulation themselves. It is not necessary to explain the jurisdiction rules in detail here, it might suffice to mention that the general rule is that the courts in the state of the defendant have jurisdiction, therefore, if a party to an international contract has a claim against its counterparty, it can file a suit with the courts of the place where the counterparty is resident. There are also certain alternative fora, such as, if the dispute regards a contract, the courts of the state where the disputed obligation is to be performed; or, if the dispute regards a tort, the courts of the state where the tort occurred. There are also certain exclusive fora, such as, if the dispute regards real estate, the courts of the state where the real estate is located. In the case of international contracts, however, it is rather customary - and certainly very advisable, in order to avoid uncertainty- that the parties choose themselves, in a clause of their contract, the courts to which disputes arising between them out of the contract shall be submitted. Both the Lugano Convention and the Brussels Regulation recognise the validity of these choice-of-forum clauses, which play therefore a significant role in international commercial law.

In the case of enforcement of arbitral awards, the requirement of the jurisdiction is met if the parties have included an arbitration clause in their contract or have entered into an arbitration agreement, which satisfy the few criteria set forth in the New York Convention.

f) The Rules Applicable to the Dispute Are those Chosen by the Parties or Determined by the Conflict Rules of the Forum

5 Article 2 of the Lugano convention and of the Brussels Regulation.
6 Article 5.1 of the Lugano convention and of the Brussels Regulation.
7 Article 5.3 of the Lugano convention and of the Brussels Regulation.
8 Article 16 of the Lugano convention and article 22.1 of the Brussels Regulation.
9 Article 17 of the Lugano convention.
10 Article 23 of the Brussels Regulation.
Identification of the state having jurisdiction is important not only to ensure enforceable decisions in case of dispute, but also as a basis to find out what rules govern the dispute and the contract. Even if there is no dispute between the parties, and the parties are simply trying to interpret the contract or to fill gaps in the contractual regulation, it will be necessary to find out what court would have jurisdiction in the case of dispute, for so to apply the private international law of that court’s state to identify the law governing the contract. Private international law is the branch of the law that contains the so-called conflict rules, or choice-of-law rules, permitting to identify what state law governs a situation that has connections with more than one state. Each state has its own private international law, therefore it is necessary to identify which state’s conflict rules are applicable, and this is done by finding out in which state the forum would be in case of disputes.

In the case of contracts having their scope within the European Community, the private international law is harmonised, as all the member states have ratified the Rome Convention of 1980 on the Law Applicable to Contractual Obligations; therefore, the conflict rules should identify the same governing law, irrespective of where in the EC the forum is.

It is not necessary here to analyse in details the various conflict rules applicable in the case of contracts; it must, however, be mentioned that the most important conflict rule in the case of contract (recognised not only by the Rome Convention but also by the vast majority of national private international laws) is the so-called party autonomy, according to which the parties may choose the law governing their contract. This conflict rule is often given effect to in choice-of-law clauses contained in the contract.

**g) The Parties’ Possibility to Choose the Applicable Rules is Limited by the Conflict Rules of the Forum**

It must be noticed that the parties are not completely free to choose the governing law: their choice has to be made within the framework of the applicable private international law. This framework is, as a rule, rather generous, and the parties enjoy therefore a wide freedom in their choice of law; however, there may be both limitations of a formal nature (for example, some private international laws require that the choice of law is made in writing), as well as limitations to the scope of the choice (for example, the parties may as a general rule not choose the law governing their legal capacity, or governing relationships connected with real estate, or pledge). In addition, the private international law of the forum may restrict the applicability of the law chosen by

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the parties by applying mandatory rules of other laws (for example, rules protecting the agent, or rules of labour law).

Therefore, even if the contract contains a clear choice of the governing law, the private international law of the *forum* plays still an important role in determining the scope of that choice.

**h) International Conventions and Trans-national law Are Applicable within the Framework of the Governing Law**

International conventions, if ratified by the state whose law is governing the transaction, are part of the governing law, and therefore fully applicable to the transaction. Trans-national law, which comprehends a series of non-legislative sources regulating international contracts (see more in detail below, section 2.3), is applicable within the framework of the governing law, as chapter 3 below will illustrate.

The state law, in other words, constitutes always the framework in which the regulation of international contracts must fit, and it must therefore be kept in mind while drafting or interpreting international contracts or applying transnational sources.

**1.4 Aim of the Course**

As the explanation made under 1.3 above showed, the answer to the question of what rules are applicable to an international contract assumes in turn that various other questions are answered: Have the parties made a choice of law in the contract? Is this choice of law admissible in full under the private international law of the *forum*? Where would the *forum* be? In case the parties have chosen the *forum* in the contract, is this choice admissible? Would a decision be enforceable in the state where the losing party has assets? If the parties have not made a choice of *forum*, were would the *forum* be? If the parties have not made a choice of law, which law would be applicable according to the conflict rules of the *forum*? If the parties have chosen to exclude the jurisdiction of national courts of law and to submit disputes to arbitration, what rules have to be applied?

These questions should be answered on the basis of the private international law of the *forum*, as there is no uniform body of rules regulating these matters on an international level.

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We will assume, in Part I of these lectures, the point of view of a Norwegian court, as a representative of Civil Law systems. Whenever it is relevant, we will highlight the main differences in respect of the point of view of a court within the European Community, primarily in respect of Common Law Systems, but also in respect of other Civil Law systems.

In Part II, we will assume that the questions have to be answered not by a national court of law, but by an arbitral tribunal. We will verify to what extent an arbitral tribunal has to apply the same reasoning as a court of law, or enjoys a freer position in respect of the application of the sources of law to the dispute.

The parties may, as shown above, exercise a considerable influence on the interpretation and regulation of the contract, by choosing the forum and the governing law; even in the lack of these choices, however, the parties should nevertheless be aware of the competent forum and the governing law, as these are going to influence the interpretation and may be even the validity of the contract.

It is my experience, however, that the choice of forum and of the governing law are not considered as particularly important during the phase of drafting the contract, and that seldom the parties are aware of what the forum and governing law are, while they are drafting the contract. It is first when a dispute arises, that the parties become concerned with the forum and the governing law. It is a widespread practice among international business lawyers to structure a transaction and draft the text of the contract without having first discussed the choice of forum or the choice of law. This practice is based on the assumption that what counts in an international transaction, particularly (but not only) if disputes are to be submitted to arbitration, is the regulation that the parties agreed upon in the contract, as well as a not better identified international commercial practice; and that rules of law, particularly national rules of law, cannot interfere in a significant manner with the contractual regulation.

To meet this rather wide-spread mentality, these lectures will not follow the logical outline that would be expected in the explanation of the subject, and will start from the result rather than from the beginning. It would be logical to expect that the explanation of the subject starts from the first step that has to be clarified in the legal reasoning, i.e. the establishment of the forum and of the applicable conflict rules. We have seen under section 1.3 above that the establishment of the forum is necessary to identify the applicable private international law; the identification of the applicable private international law is necessary to verify whether the choice of law made by the parties is admissible in full; the applicability of the chosen law is an assumption to the solution of the
dispute. Therefore, a logical presentation of the material should start from the forum, continue with the conflict rules and end up with the governing law. However, this explanation would not be considered relevant by the large number of practicing lawyers and writers who consider questions of forum, of private international and of national governing law as immaterial in international contracts, on the assumption that national regulations do not count in international contracts. Therefore, we will start our presentation with two chapters, chapter 3 and chapter 4, that will have the sole purpose of showing that state law counts also for international contracts. After having established that international contracts are subject to state laws, it will be evident that the questions of forum and of private international law are relevant, otherwise it would be impossible to identify the applicable state law. Only then we will make the presentation of these matters, in chapter 5.

These lectures do not have the ambition to describe the national rules of law regulating commercial contracts all over the world, nor to analyse in detail all the international conventions that regulate various commercial transactions. The aim of these lectures is to create an understanding of the context in which international commercial contracts are placed, in terms of sources of law: which role is played by the contractual regulation, which one by state law, which one by trans-national sources, what is the interaction among these factors, and how does this all apply to international arbitration? The question of jurisdiction does not fall directly within the scope of this course, and will therefore be touched upon only to the extent it is instrumental to the explanation made from time to time.
2. WHAT ARE THE SOURCES OF INTERNATIONAL COMMERCIAL LAW?

Contrary to most of the other law subjects that are studied at universities, and notwithstanding the diffuse feeling to the contrary that can often be met in international practice, there are only few authoritative sources of law within international commercial law; and those few that exist cannot be considered to give an exhaustive regulation of the subject-matter.

2.1 International Contracts

a) Introduction

An international transaction will in most cases be formalised in an international contract, entered into by the parties. An international contract is not a source of international commercial law, but in the event of differences between the parties to a transaction, the contract is the first source that should be verified. The parties may have regulated in the agreement the consequences of the particular situation that arose, they may have allocated the risk connected therewith between themselves, they may have agreed on guidelines that can be followed to solve the differences. It is only in case the contract is silent on the consequences of a certain situation, or when the regulation contained in the contract conflicts with mandatory rules of applicable laws, that it becomes necessary to ascertain the content of the governing law.

The relationship between an international contract and the sources of international commercial law, however, is not always completely clear. This depends in large part on the style in which international contracts are written.

b) Is the style of international contracts affecting the applicability of the governing law?

International contracts are usually written in the English language, even if the parties to the contract are not from English speaking states. The lawyers who draft the contracts do not always, therefore, have a common law background (common law being the legal system that underlies the Anglo-American legal terms and drafting style); they may have, for example, a civil law (romanistic or germanic) or an Islamic law background. Many of the non-common lawyers who draft contracts in English do not have a specific knowledge of a common
law system, like, for example, of English law. They may have a proficient knowledge of the English language, but their understanding of the meaning of English legal terms may have been developed on the basis of their experience within the field of international contracts, rather than on the basis of their analysis of the English law.

International contracts have, as a matter of fact, become during the past couple of decades more and more standardised, primarily on the basis of English or USA contract models. An international lawyer will therefore, in the course of his or her practice, encounter contract drafts that are similarly structured, that contain similar terminology, and that have similar general clauses, irrespective of the type of transaction that the contracts regulate. The aspects that are specific to each transaction type will be regulated in the appropriate, specific manner, but the structure of the contract and the regulation of aspects that are not specific of one single type of transaction (so called “boilerplate clauses”, such as clauses regulating force majeure circumstances, confidentiality, assignment of the contract, representations and warranties by the parties, termination, etc.) will be regulated in a relatively common way. The degree of detail in the contractual regulation, the regulation of specific aspects of the parties’ liability, the terminology, the boilerplate clauses are all aspects that many international contracts have in common, and they are all based on common law models.

This standardisation on the basis of common law models has at least two implications: on the one hand, it induces an overlapping between common law legal institutes and governing laws that not necessarily belong to the common law systems, creating sometimes unexpected (and undesired) consequences;\(^\text{11}\) on the other hand, it may give parties the impression that the contract is a self-sufficient, exhaustive regulation of their relationship, as if the contractual terms and legal institutes upon which they are based found their legitimacy and legal implications not in a specific national legal system, but in a trans-national system of terminology and regulations handed down from international contract to international contract.

These implications of the contractual style will be illustrated by analysing several examples, see below, chapter 3. The examples will show that, while in most situations the regulation contained in the contract is a sufficient and satisfactory regulation (if properly drafted), in some situations the interaction between common law and civil law backgrounds can create difficulties. This

again shows that, ultimately, international contracts are subject to a national system of law, and that the contractual terms should take this into account.

2.2 International Conventions

The closest to a source of international commercial law in the proper sense are international conventions regulating matters related to international commercial transactions, such as the Vienna Convention on the International Sale of Goods of 1980 (CISG), or the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958.

These conventions, however, cover only specific aspects of commercial law. Other aspects, even if they may be closely connected with the object of these conventions’ regulation, are not covered, and (unless regulated by other conventions or regional regulations) are left to the regulation of each state. Questions related to, for instance, the retention of title or other securities related to the sold goods, are not within the scope of the CISG, nor are questions on the arbitral procedure covered by the New York Convention.

Furthermore, an international convention is a source of law in the states that have ratified it; however, in respect of all other states, the regulation is given by national sources or other regional or international sources. Therefore, it is not possible to speak about a unitary “international commercial law”, even for the areas that are specifically regulated by an international convention. Some conventions may enjoy a large recognition, such as, for example, the New York Convention, which is ratified by 133 states; many others, however, have a more restricted number of signatories (the CISG has been ratified by 61 states). Even 133 signatories, as a matter of fact, is not a sufficient number of states to justify speaking unconditionally of an “international commercial law”, if it is compared with the number of states who are members of the United Nations (191).

2.3 Trans-National Sources

There are various non-authoritative compilations, codes, standard agreements, model laws, and similar instruments that are produced with the aim of regulating specific international transactions or international contracts in general. These instruments can be defined in various, broadly equivalent ways: trans-, a- or non-national sources, sources of soft law (adopting a terminology that is typical for public international law), lex mercatoria.
These instruments are generally produced by private associations, such as the International Chamber of Commerce (ICC), which has produced a number of instruments such as the INCOTERMS (regulating the terms and conditions of international sale contracts) or the UCP 500 (regulating the documentary credits), or branch associations, such as the ISDA, International Swap and Derivatives Association, that produces instruments for the standardisation and regulation of Swap Agreements. Other trans-national instruments may be produced, without, however, having any binding character, by international organisations, such as the UNCITRAL, which has produced, among other things, a series of model laws, such as the Model Law on International Commercial Arbitration, or the UNIDROIT, which has produced, among other things, the Principles of International Contracts.

Some of these instruments are extremely widely acknowledged, and after years or even decades of general use in practice are in some cases deemed to have become an international trade practice, and are therefore applied even if the parties have not made reference to them (if the applicable law directs or permits the judge to apply trade usages). Others are in the process of obtaining a generalised acknowledgement, and cannot be considered as customary law yet; therefore, they are applicable only to the extent the parties have made reference to them in their agreement.

In addition to these non-authoritative codifications or compilations, the trans-national law of international commercial contracts is based on generally acknowledged principles and rules. As a source of international commercial law this might, however, be significantly more difficult to determine than the above mentioned private compilations. Based on this difficulty, large part of the legal doctrine and of case law questions the usefulness of the trans-national law, and considers it as a fragmentary and vague sum of rules and principles, that has little practical value when it comes to solving detailed legal questions.\textsuperscript{12} Trans-national law, however, has a number of active supporters, and there is a wide range of publications that present lists of rules and principles that can be considered generally acknowledged, thus facilitating their determination and attempting to meet the criticism that such rules and principles are difficult to determine.\textsuperscript{13}


\textsuperscript{13} Among the supporters of the transnational law see, for example, LANDO, O., “The New Lex Mercatoria in International Commercial Arbitration”, 34 International and Comparative Law Quarterly 1988, 86ff.
It is sometimes alleged that trans-national law is better suited to regulate international transactions than state law is; among the main reasons presented to justify this superiority of trans-national law, are: (i) state law is conceived for regulating domestic transactions, and not international; (ii) state laws differ from each other and therefore create a confusion among the business operators as to what rules actually govern their transaction; (iii) state laws are too rigid and too slow in adapting to new commercial practices or technologies.

On the basis of the above mentioned reasoning, it is sometimes proposed\(^{14}\) to consider, as source of trans-national law, also international conventions, on the basis of a reasoning that grossly goes along the following lines: (i) International conventions that regulate international transactions are not conceived for domestic transactions; (ii) moreover, they have been ratified by a plurality of states, therefore they do not represent some national peculiarities of some specific states; (iii) therefore, two of the above mentioned reasons to prefer trans-national law are satisfied, and (iv) international conventions can accordingly qualify as trans-national law. As appealing as this reasoning can be, there is a considerable objection to uncritically qualifying international conventions as trans-national law, and assuming on this basis that they represent rules and principles that should be applied to international transactions. An international convention becomes binding upon a state by the state’s signature or ratification; if a state does not agree with some aspects of a convention, it does not sign it, and it is not bound by it. If the convention nevertheless is considered to be trans-national law and is applied as binding even when the law of that state is governing, then the signature and ratification of a convention become redundant, with all the implications in terms of sovereignty and public international law that can be conceived.

A convention can, however, be deemed to express a consensus of various states on a certain rule, and this can in itself weigh as an argument in the reasoning of a judge who is ascertaining the law on a specific question.

\(^{14}\) See, for example, LANDO, O., “The New Lex Mercatoria”, op.cit., p. 747.
Irrespective of the degree of acknowledgement of all the above mentioned sources of trans-national law, however, application of these sources faces the question of the relationship with the state law that governs the transaction: is trans-national law a replacement of state law, or is it an integration thereto, and to what extent can the state law be replaced or integrated?

These questions will be dealt with by analysing some examples, see below, chapter 4. The examples will show that trans-national law is an extremely useful tool to integrate the law applicable to an international transaction, but it is not capable of replacing it completely, and it cannot prevail in case of conflict with mandatory rules of applicable national or international rules.

2.4 State Laws Regulating International Transactions

Some states have special legislation for international transactions, for example statutes on specific international contracts or on foreign investment. These are sources of international commercial law in the state that issued them; they are applicable to international transactions, but only when the state law that they belong to is governing the transaction. Their applicability is determined by the private international law of the forum, and they are treated as any other state law in the context of choice of law, even if they regulate international transactions. From the point of view of the issuing state, therefore, these sources constitute international commercial law. However, they are not applicable to international contracts just because they define their own scope as international; these instruments will be applicable to international commercial contracts whenever the state law to which they belong has been chosen by the parties or has been identified as applicable by the appropriate conflict rules.

2.5 Choice-of-law Rules and International Commercial Law

In Norwegian law the Sale of Goods Act has a chapter regulating international sale contracts (chapter XV). This chapter is actually based on the CISG, and is as such a reflection of uniform legislation. However, in the Norwegian system the text of the CISG has been modified to adjust to the system of the Act. Therefore, the version of the CISG contained in Norwegian law is peculiar to the Norwegian legal system. This circumstance has been criticised, and to my mind correctly so, because it runs against the purpose of uniformity that inspires the convention: see HAGSTRØM, V., “Kjøpsrettskonvensjon, norsk kjøpslov og internasjonal rettsenhet”, Tidsskrift for Rettsvitenskap, 1995, pp. 561 ff.

In numerous transition or emerging economies, for example, foreign investment is subject to a special regime. The states of the Former Soviet Union and of Eastern Europe have all issued Foreign Investment Acts during the 1980s and 90s.

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During the course we will establish, as mentioned in section 2.1 above, that international contracts do not exist in a legal vacuum, but ultimately are subject to national systems of law. Similarly we will establish, as mentioned in section 2.3 above, that trans-national law does not replace, but supplements applicable national or international laws. The next question that comes to mind is then: given that an international contract is ultimately subject to a state law, what state’s law would govern the international transaction?

In a transaction between two parties from two different states, for example for the joint performance of some production activity in a third state, there are at least three potentially applicable laws – the laws of each of the states that are touched by the transaction. And it is easy to imagine the involvement of even more states, for example if the raw materials for the activity are imported from yet another state. As mentioned in section 1.3 (f) above, the choice between the potentially applicable laws is made by applying choice-of-law rules, and these rules are the object of the course on Private International Law. We will therefore not explain choice-of-law rules here, but there are some aspects of these rules that have an important bearing on the main aspect of our course.

If, as we have seen, one of the implications of the contractual style usually adopted for international contracts, is that the parties feel detached from any system of state law, the result of applying choice-of-law rules may contradict the expectation of the parties. In particular, certain mandatory rules of state laws that are closely connected with the transaction will be applicable even if the contract purports being international and detached from any national legal system. If, on the other hand, the parties to an international contract have used choice of law rules to escape from the application of otherwise applicable law, private international law may intervene and give the judge the instruments to apply certain mandatory rules of the law(s) that would have been applicable if the parties had not chosen a different law to govern their contract. This will be the subject of chapter 5, section 5.3.

## 2.6 International Arbitration and International Commercial Law

A great number of international contracts contain an arbitration clause, which has the effect of excluding the jurisdiction of national courts of law, for referring the dispute to an arbitral tribunal nominated by the parties (directly or through appointing authorities, but in any case following the instructions of the parties).

The impression of detachment from national systems of law, described above under section 2.1, and characteristic of some parties and writers within
international business law, may be reinforced when the international contract contains such an arbitration clause. This is primarily because international arbitration is a method for solving disputes that is based on the parties’ will: Without the arbitration clause entered into by the parties, the arbitral tribunal would not have jurisdiction on the dispute; without the appointment of the arbitrators by the parties, the arbitral tribunal would not exist in that particular composition. In short, the parties determine the jurisdiction of the arbitral tribunal, its composition, and the scope of its competence; they determine the procedural rules that the tribunal shall follow, the law that it shall apply. If the arbitral tribunal does not follow the instructions of the parties, its award may become invalid and unenforceable, because the tribunal has exceeded the power that the parties had conferred on it.

Given the strong dependence that arbitration has on the parties’ will, it is often possible to meet the opinion that arbitrators shall in any case follow the parties’ will, and that therefore state laws that the parties had intended to exclude shall be disregarded by the arbitral tribunal. Based on this opinion, it is easy to conclude that all of the considerations made above on the relevance of state laws to international contracts and to trans-national law, may apply when a dispute is submitted to national courts of law, but are not true when the international contract contains an arbitration clause. International commercial arbitration would, in other words, confirm and enhance the position according to which international contracts are not rooted in a specific system of state law, but float in a trans-national system.

Given the importance of this conclusion, it seems necessary to verify the assumption upon which it is based: To what extent can the parties actually detach their relationship from any applicable state laws, thanks to their choice of arbitration as a mechanism to solve their disputes?

As long as the decision made by an arbitral tribunal is voluntarily carried out by the losing party, the parties can achieve a total detachment: if the arbitral tribunal is nominated by the parties, decides in accordance with the will of the parties, and the tribunal’s decision is complied with by the parties, there is no contact between the contract, the dispute and the arbitral award on one side, and national courts of law on the other side. And as long as national courts of law do not have any jurisdiction on a certain matter, they also do not have any basis to question or verify the compliance with the applicable state law. Therefore, any disregard by the arbitral tribunal of the applicable state law would remain unsanctioned (unless the disregarded rules are of an administrative or criminal

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17 See below, section 6.1.4.

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law nature, which would give the courts or other competent authorities jurisdiction in spite of the existence of an arbitration clause). Consequently, the opinion that international contracts and international arbitration are floating in a non-national system is confirmed, at least as long as the contract and the dispute are confined within the borders of private law (this qualification to the detachment of arbitration is of great significance, since there has been during the past decades and still is a clear trend towards increased regulatory activity by national states or regional authorities—such as the European Commission, for example in the areas of competition, consumer protection, labour regulation).

On the other hand, if the losing party does not intend to comply voluntarily with the arbitral award, some contact points arise between the international arbitration award and national courts of law, and therefore the award becomes subject to a certain (albeit, restricted) scrutiny. There are, in particular, two phases, in which the losing party can provoke the intervention of a national court. Firstly, the phase of challenge, whereby the losing party may seize the court of the place where the award was made for the purpose of having the validity of the award verified; and, secondly, the phase of enforcement, where a court (in any state where the losing party has assets) must be seized (by the winning party) to obtain enforcement of the award, if the losing party refuses to comply with it. The former phase, of challenge, is normally regulated by the national arbitration law of the court’s state (although a considerable harmonisation is ensured by the UNCITRAL Model Law on International Arbitration of 1985); the latter phase, of enforcement, is uniformly regulated by the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards.

The grounds for declaring an award invalid under the UNCITRAL Model law are equal to the grounds for refusing enforcement of an award under the New York Convention; these grounds represent the only basis upon which a national court can evaluate an arbitral award in the phase of challenge (in states that have not adopted the Model Law, the grounds may be regulated differently). The question whether the choice of arbitration in an international contract confirms the opinion that international contracts are detached from national systems of law, therefore, has to be answered in light of these grounds. We will answer this question by analysing some examples, see chapter 6.
PART I – INTERNATIONAL COMMERCIAL LAW APPLIED BY STATE COURTS
3. CONTRACTUAL TERMS AND STATE LAW

3.1 The Impact of the Governing Law on Effectiveness of Contractual Terms

International contracts are often drafted without having in mind what law will govern the contract. The clause choosing the governing law is most of the times negotiated after the parties have agreed on all the commercial aspects of the transaction, and after the regulation of such commercial content has been drafted in the contract. Sometimes, the parties do not reach an agreement on what governing law to choose, and therefore they do not write a choice-of-law clause in their contract. Sometimes, the parties do not attach significant importance to the choice of the governing law, and agree on the proposal of one of the parties without paying attention to the implications of that choice. Sometimes, the parties do not even think of the question of the governing law.

In all these mentioned situations, the result is that a contract has been drafted, while the drafters were not aware of the legal system that the contract is subject to. In other words, the parties assume that the contract represents a sufficient regulation of their relationship, that it will be enforceable without any problems in all relevant jurisdictions, and that it will not be affected by rules or principles external to the contract, other than those that the parties may have made reference to in the contract itself (often the parties would make reference to some “private codifications”, such as, for example, the INCOTERMS in the case of international sale contracts, or the UCP 500 in the case of Letters of Credit, both issued by the International Chamber of Commerce).

This chapter will analyse the consequences of this attitude, in other words: what happens if a contract is drafted without taking into consideration the governing law?

The question may be divided into several parts: assuming that the parties have regulated their transaction in the contract with the (more or less awareness of the) intention that the contract should be the only and exhaustive regulation of their relationship, we can envisage the following scenarios: (i) the contract regulates aspects that are already regulated by the governing law, (ii) the contract regulates aspects that are not regulated by the governing law, (iii) the contract does not regulate aspects that are regulated by the governing law, and (iv) neither the contract nor the governing law regulate certain aspects. Each of these scenarios can in turn be divided into two, according to whether the
relevant rules of the governing law are mandatory or not, that is if the governing law specifies that those particular rules cannot be derogated from by contract, or if the governing law permits the contract to regulate the subject-matter in a way different from the regulation provided for by law. A third factor must also be taken into consideration, and it is the eventuality that the mandatory rules that are being challenged by the contract do not belong to the law governing the contract, but to another law that, even if not governing, has a connection with the transaction.

We will in the next paragraphs analyse what are the consequences of these various scenarios, assuming that the contractual regulation differs from the regulation made by the governing law.

3.1.1 Contractual Terms Contradicting or Supplementing Non-mandatory Rules of the Governing Law

a) Introduction

Often no difficulties arise out of contracts that contradict or supplement the governing law, as long as the derogated rules are not mandatory: in the case of dispute, it is often possible to solve the differences between the parties simply by applying the regulation contained in the contract. Often it will be possible to find a solution to the dispute without having to question the compatibility of the contract with the governing law: If the terms of the contract supplement the governing law, or if they regulate the transaction in a way different from the regulation contained in the governing law, the contractual terms will prevail, as long as the supplemented or derogated regulation is not mandatory.

b) Force Majeure

As an example, we can look at a situation where the parties have regulated in their contract the consequences of supervening external circumstances, which cannot be overcome by the parties, preventing the performance of the contract. Law usually contemplates circumstances of this kind.

In most Civil Law states, a contracting party that fails to perform its obligations is excused, if the failure to perform is due to an impediment that was unforeseen, outside of the control of the prevented party, and the consequences of which could not reasonable have been overcome. Different legal systems have different terminology, but they obtain similar effects. In Norway, for example, the principle of excuse due to force majeure circumstance is contained in various
specific acts governing different contract types, as well as in customary law;\(^\text{18}\) in Italy, it is contained in articles 1218 and 1463 of the Civil Code (Codice Civile), and in Germany in section 275 of the Civil Code (BGB). The specific regulation of the \textit{force majeure} circumstance may vary from state to state; however, in common these regulations have that the effect of excusing from liability the party that was prevented. The prevented party, therefore, is not liable for its failure to perform its obligations, if performance is prevented by an impediment that can be defined as \textit{force majeure}. This does not mean, however, that the obligation is terminated. As a general rule, it is only suspended as long as the impediment persists, and becomes enforceable again as soon as the impediment ceases.\(^\text{19}\)

In the Common Law systems, similar situations would be regulated by the doctrine of frustration, which, however, has a narrower scope of application. A contractual obligation is considered, as a starting point, absolute, and failure to perform will never be excused; however, supervening situations may change the content of the contractual obligations, so that they are not the same obligations that were assumed under the contract. In these situations, the obligor cannot be expected to perform obligations different from those that it had assumed, and the contract is frustrated. The so-called “test of a radical change in the obligation” has been confirmed by the House of Lords, and is deemed to be the prevailing doctrine even now.\(^\text{20}\) The consequences of frustration, however, are different from the consequences of an impediment under Civil Law systems. The Common Law doctrine of frustration does not contemplate any suspension of the performance, it contemplates a total discharge. The effect of a frustration, therefore, is the termination of the contract.

The parties may have agreed on a contractual regulation of the consequences of an impediment to perform the contractual obligations. For example, the contract may contain a more detailed regulation than the governing law (the contract may specify how many days the prevented party can wait before it notifies the other party of the \textit{force majeure} circumstance; it may specify how long the \textit{force majeure} circumstance may persist before the contract has to be terminated or renegotiated, etc.), or it might contain an allocation of the risk different from the one made by the governing law (for example, it may determine that the risk of some impediments, such as not obtaining the export license by the competent

\(^{18}\) See, for example, the Sale of Goods Act, sections 27, 40 and 57, and the Act on Financial Agreements, section 42.1.

\(^{19}\) See, for example, the Norwegian Sale of Goods Act, section 27.3.

authorities, has to be borne specifically by one party, for example the seller, and cannot be defined as a force majeure circumstance).

In this area, the contractual regulation will prevail over the regulation made by the law.

3.1.2  Contractual Terms Contradicting Mandatory Rules of the Governing Law

In some cases, the governing law may contain mandatory rules, that cannot be derogated from by the parties, and that are contradicted by the terms of the contract. In these cases, the regulation contained in the contract will have to be overridden by the mandatory rules of the governing law (the governing law being the law chosen by the parties in the contract, or failing which, the law determined by the conflict rules of the forum – or of the state where the forum would be, if there was a dispute).

Here it is important to notice that some contractual terms that would be compatible with certain governing laws, would be in contrast with mandatory rules of other governing laws. The same contract, therefore, might be binding or not, according to what law is governing. If the parties had taken into consideration the governing law while drafting, they might have been able to structure the contract in such a way that it would not have contradicted the governing law.

Below we will see some cases that illustrate the relationship between contractual terms and mandatory rules of the governing law. As we will see, different legal systems may regulate the same aspects in different ways, and this shows how important it is to write a contract having in mind which law will regulate the relationship.

a) Firm Offer

We may first look at a situation where one party has sent an irrevocable offer to the other party, without considering the governing law. As long as the offer is not accepted, there is no contract between the parties. However, having made a written offer with a promise of irrevocability has legal consequences that are regulated by the contract law of each state. What would be the legal consequences, if the offeror decides to revoke the offer, before the term indicated in the firm offer has elapsed? The answer to this question varies, according to what law governs the offer, as well as the structure of the offer.
We can assume that the offer contains the following clause: “this offer is firm and cannot be revoked by the offeror before 30 days from the date hereof”. The remaining part of the offer is devoted to the specification of the offered goods or services, their price, the timing for performance, etc. The offer contains no other clauses, and is signed by the offeror. The question is, what are the legal effects of the revocation made before the firm offer’s term has elapsed?

As an illustration, we can examine two scenarios:

(i) A construction company intends to participate in a tender relating to the construction of some infrastructure. In order to prepare the bid, the contractor requests irrevocable offers from a series of sub-contractors. On the basis of the sub-contractors’ offers, the bid of the contractor wins the tender, and is awarded the construction contract. After the contract is awarded, but before the term contained in the sub-contractors’ offers elapses, one of the sub-contractors revokes its offer.

(ii) A commodity trader receives an irrevocable offer to buy a certain volume of commodity at a certain price. The trader does not accept the offer immediately, but takes contact with other potential sellers to verify whether the offered conditions are competitive. In the meantime, the offeror has found another buyer, who is willing to pay a higher price, and revokes its offer to the trader, before the offer’s term elapses.

The two scenarios differ from each other especially in one aspect, that is relevant here. In the first one, the offer has induced an action by the offeree with considerable consequences (the presentation of the bid, the award of the contract); in the second one, the offeree has only made some telephone calls, but has not committed himself towards third parties or has engaged in extensive activity as a consequence of the offer.

Under Civil Law legal systems, the irrevocability clause contained in the offer would be considered binding, and any revocation of the offer made before the term would not have legal effects. The offeror will continue to be bound by its offer in spite of the revocation, and any breach of this obligation will expose it to reimbursement of the damages suffered by the offeree as a consequence thereof.
Under Norwegian law, for example, The Contracts Act of 1918 implies in section 5 that an offer is binding on the offeror.\(^{21}\) This is somewhat restricted by section 7 of the same act, that permits the offeror to revoke its offer, though only as far as the revocation reaches the offeree prior to or simultaneously with the offer. Under Italian law, article 1329 of the Codice Civile specifies that a revocation of an irrevocable offer does not have any legal effect. Under German law, section 145 of the BGB specifies that an offer is binding on the offeror, unless by its terms it is revocable.

Under the English legal system, however, the offer would be considered as a unilateral obligation of the offeror, and as such not enforceable due to lack of consideration;\(^{22}\) therefore, the revocation of the offer would be considered as valid. If, on the contrary, the offeree had accepted the offer, then the irrevocability clause would be valid and binding on the offeror, as the obligations would be bilateral. Another possibility to make a unilateral offer binding on the offeror is to formalise it as a deed. The doctrine of consideration, which we will look at closer in section (b) below, significantly affects the enforceability of the expressed terms contained in the offer. Because the offer is a step in the process of formation of contract, and is not a concluded contract, the offeree cannot avail himself of the remedies that are available in equity to avoid unreasonable results caused by the strict application of the common law. Had the offer been a concluded contract, the English system would have made it possible to apply the equitable promissory estoppel, that we will look at more closely in section (b) below. However, a promissory estoppel is available when there is already a cause of action, i.e. where the parties already were bound to each other by a contract. English law does not consider an irrevocable offer as a cause of action, therefore the equitable remedy is not available and the doctrine of consideration remains applicable.\(^{23}\)

In the United States the obstacle of the doctrine of consideration has been overcome. The United States Restatement (Second) of Contracts (1981), similarly to English law, maintains that the offer would be considered a unilateral obligation and therefore unenforceable, unless the offer has been accepted by the offeree. However, in the first scenario the offer has induced

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\(^{21}\) Section 5 states that an offer ceases to binding on the offeror if it has been rejected by the offeree, even before the term of the offer has expired. This implies that the offer is binding if it has not been rejected.

\(^{22}\) It is a rule of English law that a promise to keep an offer open needs consideration to make it binding. A consideration is deemed to be given if the offeror gets a benefit or the offeree incurs a detriment in connection with keeping the offer firm. See, for more details, *Anson’s Law of Contract*, op. cit., pp. 53 f. On the doctrine of consideration see below, b).

some action by the offeree, and the Restatement would in this case consider the irrevocability clause as binding (par. 87.2) to the extent necessary to avoid injustice. The Uniform Commercial Code of the United States provides in par. 2-205: “An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.”

In conclusion, the offer, drafted as mentioned above, would be binding under Civil Law systems, and, according to the Uniform Commercial Code, in the US, but not in England. Had the offeree taken into consideration the English governing law, it would have accepted the offer, under certain conditions (for example, under the condition that the offeree is awarded the contract in the tender). The offeree could have requested that the offer provides a space for the offeree’s signature and the wording “for acceptance”, or could have sent a separate, written acceptance to the offeror); in this way, the offer would have become binding also under English law.

This shows how important it is to have in mind the governing law while drafting a contract. Knowing the existence of certain rules, such as the rule on consideration in English law, will permit to structure the contract in a way that is appropriate to render it enforceable – for example, providing for acceptance by the offeree.

b) Amendments to a Contract

A further illustration of the importance of having in mind the governing law while drafting a contract is the situation where two parties decide to amend an existing contract between them. We can assume that, because of misjudgement of the volume of work required under the contract, the parties agree that the price for the services to be rendered under their contract will have to be increased, whereas all other terms and conditions of the existing contract will remain unchanged.

We can assume that the amending contract properly makes reference to the contract that is intended to be amended, and contains a clause according to which “The parties agree to modify clause XX of the amended contract, so that the price to be paid by the sub-contractor is 100 instead of 80. All other terms and conditions of the amended contract remain unchanged.”

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The question is, if the constructor at a later stage decided not to effect payment to the sub-contractor according to the amended increased price, would the amendment contract be considered as binding? The answer differs, according to the law governing the amendment contract.

Would a contract formalising such amendment be enforceable? The answer to this question varies according to the law governing the contract. As an illustration, we can examine two scenarios:

(i) A constructor, engaged in a major project for the construction of various apartments, enters into a contract with a sub-contractor, who is to carry out some specialised carpentry work. They agree on a lump sum for the sub-contract; however, the sub-contractor soon realises that it had underestimated the amount of work required. If the carpenter was to continue performing its obligations under the sub-contract at the originally agreed price, it would not make any profit out of the sub-contract. The sub-contractor invites the constructor to renegotiate the price, and the parties reach an agreement on a price increase.

(ii) In the same scenario as under item (a), the carpenter realises that a continued performance of the sub-contract at the originally agreed price not only would mean that the sub-contract is not profitable to it, it would mean that the sub-contractor would face considerable losses. As a consequence of such losses, the sub-contractor might face insolvency and subsequent liquidation; this, in turn, would mean a considerable delay for the constructor, since it would have to replace the sub-contractor and would even run the risk of not finding a new carpenter capable of replacing the specialised skills of the sub-contractor.

If the amending contract were regulated by a Civil Law system, it would be considered as valid and binding. A properly signed document containing an obligation for one of the parties is binding, even if the obligation consists in the amendment of another obligation assumed by that parties under another contract. In the Norwegian Contracts Act, for example, the invalidity of a contract (like the amending contract in our case is) is regulated in chapter 3. A contract is deemed to be invalid if it has been entered into as a consequence of duress, error, or other similar circumstances that affect the will of one of the parties, or if it contains unfair terms, etc. Otherwise, a contract is valid and binding (apart from situations where one of the parties did not have the authority to enter into the contract, etc., but this is not relevant to our discussion here).
If the amendment contract were regulated by a Common Law system, it would not be automatically considered as binding, since it would have to be measured against the requirement of a consideration. The doctrine of consideration requires a contract to have bilateral obligations, providing for benefits and detriments for both parties to a contract. In the case of a sale agreement, for example, the seller has the benefit of receiving the price, and the detriment of delivering the goods; the buyer will have the benefit of receiving the goods, and the detriment of paying the price. In an amendment contract as the one envisaged above, however, the sub-contractor would have the benefit of receiving the increased price, but the detriment would consist simply in the performance of the carpentry work, that the sub-contractor anyway was already committed to perform under the original contract. There would, therefore, not be a detriment for the sub-contractor as a consequence of the amendment agreement. Similarly, the constructor would have the detriment of paying an increased price, but as a benefit it would only have the performance of the work that it was anyway entitled to obtain under the original contract. There would, therefore, not be a legal benefit for the constructor in entering into the amending contract. A contract that does not have a consideration is not enforceable under English law, therefore the amendment contract would not be enforceable under the strict law.  

The English legal system, however, has elaborated certain means to prevent that the strict application of the law leads to unreasonable results. These means are available not “at law”, but “in equity”: if the application of formal requirements of law leads to a result that under the circumstances of the case is inequitable, the affected party will be able to avail himself of some remedies in equity. The equitable remedy applicable in the case described herein is the promissory estoppel, that neutralises the effects of the rule of consideration in many cases. According to this remedy, if parties to a transaction have relied upon a promise that strict legal rights will not be acted upon, they will not be allowed to go back on that assumption, if it would be unfair to do so. If the parties have agreed to amend a contract, they have created for each other the assumption that they will not insist on applying the original terms of the contract, in spite of the fact that the lack of consideration renders the amendment agreement not enforceable at law. The promissory estoppel prevents one party from going back on its promise, insisting on application of its strict legal rights instead. A promissory estoppel, however, is not always applicable. Among the requirements that have to be met, two might affect the applicability of the remedy to the present case. The effect of going back on the

24 This principle was laid down in the *Stilk Myrick* [1809] 2 Camp 317, and is still prevailing, although with some qualifications as set forth in footnote 15 and accompanying text: see CHITTY, J., *Chitty on Contracts*, 28th ed., Volume I – General principles, Sweet & Maxwell, London 1999, para [ 3-046ff., particularly 3-051 and 3-052].

promise and insist on the strict legal rights must be inequitable. If the amendment of the contract was induced by one party that took advantage of the other party’s financial situations, for example, the result of not enforcing the amendment would not be considered as inequitable. Furthermore, the party that is relying on the amendment (the promisee) must have altered its position in reliance on the amendment. The scope of this requirement is not completely clear: it seems, however, that it implies that a party the promisee must have acted in reliance on the promise in such a way, that a revocation of the promise would be detrimental to the promisee. Moreover, a promissory estoppel is not considered to be permanent in its effects: it does not discharge the contractual party from the original obligation (i.e., from the obligation in the terms prior to the amendment), it simply suspends that obligation. This means that the original obligation might be enforceable in the terms prior to the amendment, if the other party serves prior notice to that extent.

The lack of consideration and the consequent necessity to apply a promissory estoppel, with the related restrictions, are true for the first of the two scenarios described above. In the second scenario, however, the sub-contractor faces bankruptcy if the original sub-contract is not amended, and this can have negative consequences on the constructor. Therefore, the constructor has an interest in avoiding bankruptcy of the sub-contractor. In this case, an evolution of the English doctrine of consideration would make the amendment contract binding and enforceable, since the constructor can be deemed to obtain a benefit from the amendment contract: Not a legal benefit, but a factual benefit, and that is considered sufficient to qualify as consideration.

3.1.3 Contractual Terms Supplemented by the Governing Law

If the contract is silent on certain aspects, it does not necessarily mean that no regulation is to be applied. The governing law may contain rules that apply to situations not regulated by the contract. However, the regulation implied by law might differ from state to state, so that the contract will be integrated by different regulations, according to which is the governing law.

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26 D.&C. Builders Ltd. v. Rees [1966] 2 Q.B. 617
29 This was held in Williams v. Roffey Bros. &Nicholls (Contractors) Ltd., [1991] I.Q.B., 11. See also Chitty on Contracts, op.cit., para [ 3-053].
This means that the parties might have to count on an integration of the contractual regulation through the governing law. The fact that the contract does not provide for legal effects under certain circumstances does not mean that the occurring of those circumstances during the fulfilment of the contract is going to remain without legal effects. If the parties want to exclude that legal effects take place under those circumstances, they will have to enquire whether the governing law contains a regulation of that situation. If the regulation is mandatory, the parties might still achieve the balance of interests they envisaged, but they might have to adapt the structure of their contract to have an enforceable regulation (see above, section 3.1.2). If the regulation contained in the governing law is not mandatory, it will be sufficient (but necessary) that the contract expressly regulates the relationship in the manner desired by the parties. If the contract is silent, the regulation (mandatory or not) of the governing law will be applied.

a) Force Majeure

As an illustration, we can look at a situation where the parties to a contract might have intended that they could not be excused for any kind of non-performance of their contractual obligations, not even if the failure to perform is due to a supervening event outside of their control. The parties may not have specifically written in their contract that no external impediment can be invoked to excuse a failure to perform, counting on the fact that, if the contract does not contain a force majeure clause, then no force majeure will apply to their transaction.

However, this is not a correct assumption: if the contract is silent on force majeure, than the principles contained in the governing law will be applied. These principles, however, vary from state to state, as shown above, under section 3.1.1.

b) Partial Impediment

As a further illustration of the supplementing role of the governing law, we can imagine a situation where a circumstance determining force majeure occurs, but the performance of the contractual obligations is prevented only in part. We can assume two scenarios:

(i) A manufacturer of certain products enters into a contract for the sale of its products to the buyer. As a consequence of a fire that destroys one of the
storage areas at the seller’s plant, the seller is capable of delivering only part of the agreed volume.

(ii) In the same scenario described under item (i) above, the manufacturer had entered into two contracts for the sale of its products to two different buyers. Because of the fire, the seller is capable of delivering only part of the agreed volumes, that would meet the commitment undertaken towards only one of the buyers, but not both.

We assume that the contract has not regulated the eventuality of partial impediment of the performance, nor the allocation of the risk of non-performance between the various buyers, in the event of plurality of contracts between the seller and several buyers. What can the seller do in respect of the buyer(s)? Is it able to excuse its non-performance on the basis of the force majeure principle? And in the second scenario, how can it allocate the non-performance between the two buyers?

If the governing law is of a Civil Law system, the solution will be to recognise the partial impediment as a partial force majeure, and to excuse the seller for a corresponding partial non-performance. In the case of plurality of buyers, the consequences of the partial impediment may be allocated pro rata among the buyers, thus protecting the seller from being deemed in default under one of the contracts. This is implicitly provided for in the Italian Codice Civile, articles 1258 and 1464, and in section 275 of the German BGB, that recognises the principle of partial impediment and corresponding reduction of the performance. Also Norwegian law recognises the principle of partial impediment, see, for example, the Sale of Goods Act, sections 27 and 40.

If the contract is governed by English law, the first scenario will probably be solved in the same way (although English law does not recognise the concept of partial frustration), but not applying the doctrine of frustration; and the second scenario will be solved in a different way.

In respect of the first scenario, it must be first observed that English law does not recognise the concept of partial frustration. Frustration is said to kill the contract, and there is no such thing as a partial killing. However, English law has developed a mechanism to ensure that, under certain circumstances, a seller may be excused for failure to deliver all the agreed goods, and yet remains liable for delivering part of them. The applicable English authority\(^{30}\) regards the contract of sale of a certain volume of crop, to be produced by the fields of the

seller. The harvest turned out to be poorer than foreseen, and the production corresponded only to a part of the agreed volume. The court found that the contract was not frustrated, that the seller was under the obligation to deliver whatever amount was produced, and that he was not liable for not delivering the balance. The court stated that the contract of sale was subject to an implied condition, that if the crop failed to materialise in the agreed volume, the buyer could still require such performance as remained possible, but the seller was excused from delivering the remainder of the goods.

In respect of the second scenario, however, English law does not reach the same result. According to the applicable English authority, the full performance of the seller’s obligations would self-induced, therefore no implied condition to the extent described above could be read into the contract. On the basis of this principle, the obligation of the seller in our second scenario would not be prevented by the fire, but by the fact that the seller has entered into more than one contract with several buyers. If the seller had entered into only one contract, it would have had sufficient volume to comply with the contract’s obligations, even after the fire (or otherwise the implied condition mentioned in respect of the first scenario could have been invoked). Therefore, the impossibility to perform is self-induced, and the seller is not discharged from any of its obligations. This authority is obviously not satisfactory, as it would force entities to enter into only one contract, notwithstanding their higher production capacity, and notwithstanding that entry into other contracts with other parties is legitimate and does not constitute any breach of the first contract. For this reason, this authority is strongly criticised, but is, nevertheless, prevailing authority.

The above shows that situations may be regulated in different ways, according to the governing law, even if the contract is silent. Since some of these regulations may bring to quite undesirable results, the parties should enquire about the consequences under the governing law of not providing for a contractual regulation of those circumstances, such as, for example, partial impediment and plurality of contractors. If the enquiry shows that the governing law has a regulation that is not deemed appropriate, and if that regulation is not mandatory, the parties should draft in their contract detailed clauses regulating those eventualities.

3.1.4 Contractual Terms Contradicting Mandatory Rules of Foreign Laws

a) Introduction

We have seen in section 3.1.2 above that mandatory rules of the governing law prevail over contractual regulation that is not compatible therewith. What happens if the mandatory rules do not belong to the governing law, but to the law of another state, that has close connection with the transaction?

b) Indemnification upon Termination of an Agency Contract

We can imagine, for example, an agency agreement entered into between an Italian producer and a Norwegian agent, containing a choice-of-law clause that provides for the agreement to be governed by the law of New York. Among other differences from the Italian and the Norwegian law on agency, the law of New York does not provide for a protection of the agent as extensive as the other mentioned laws do. Both Italian and Norwegian law, for example, contain rules providing that the agent shall be entitled to a certain indemnification, upon termination of the agency; these rules are mandatory, and cannot therefore be derogated from by contract. We can assume that the parties intended to avoid the payment of such indemnification, and that therefore they have specified in the contract that the agent is not entitled to any payment upon termination of the contract. Knowing, however, that both Italian law (the law of the state where the principal is resident) and Norwegian law (the law of the state where the agent is resident, and where the agency is to be carried out) are mandatory on this matter, the parties have decided to avoid these laws and have chosen the law of New York as governing, where there is no mandatory requirement of indemnification upon termination.

What happens in this situation? Certain mandatory rules, and the rules on indemnification upon termination of agency agreements are usually deemed to be among these, have the capacity of overriding the choice of law made by the parties. According to where the competent forum is, the applicable conflict rules may instruct the judge or the arbitrator to apply the overriding mandatory rules of his or her own law, or even the mandatory rules of another law, irrespective of the contractual regulation and the contractual choice of law.

In our example, if the forum is in Italy (because the defendant is the party resident in Italy, or because the contract contained a jurisdiction clause in favour

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33 See the Italian Codice Civile, article 1751, and the Norwegian Agency Act, section 28.
of Italian courts, or on the basis of the jurisdiction rules contained in article 5.1 of the Lugano Convention regarding claims based on contracts, or on the basis of the jurisdiction rules contained in article 5.1 of the Lugano Convention regarding claims based on contracts), the Italian judge will be entitled to apply the Norwegian rule on indemnification, on the basis of the conflict rule contained in article 7.1 of the Rome Convention of 1980 on the Law Applicable to Contractual Obligations. If the forum is in Norway (because the defendant is the party resident in Norway, because the contract contained a jurisdiction clause in favour of Norwegian courts, or on the basis of the jurisdiction rules contained in article 5.1 of the Lugano Convention regarding claims based on contracts), the Norwegian judge will be entitled to apply the Norwegian rules on indemnification on the basis of the conflict rule contained in the Norwegian law on agency.

The fact that the parties have chosen a governing law under which their contractual regulation is valid, therefore, not always ensures that other laws will not interfere, if these laws contain such overriding mandatory rules as described above. Overriding mandatory rules will be dealt with more in detail below, see sections 5.3.2 and 5.3.3.

3.2 The Difficulty to Coordinate Common Law Contract Models and Civil Law Governing Law

The interaction between an international contract and the governing law comes sometimes as an unpleasant surprise to the parties, who had counted on the contractual regulation as the only source regulating their relationship. The impression that the international contract is self-sufficient might be enhanced by the style often adopted by international contracts. Being based on models developed primarily within the English legal system, these contracts have usually a very extensive regulation of the underlying transaction, covering all imaginable aspects of the transaction, including also the parties’ assumptions by entering into the contract, the parties’ authority to enter into the contract, the consequences of various non-performances, as well as rules for interpreting the contract.

The reason why English-style contracts contain such an extensive and detailed regulation of the underlying transaction lies in the structure of the English legal system. An English judge would be very reluctant to interpret a contract in a way that is not clearly based on the wording of the contract itself. Similarly, an English judge would usually not be inclined to solve a supervening situation applying rules and principles that are not expressly regulated in the contract.
The underlying idea is that the parties are professional businessmen, who are experienced in negotiating transactions within their own sphere of activity, and who use experienced lawyers to draft the contracts regulating such transactions. If the negotiators or the lawyers have not drafted a contract that properly protects each party’s interests, it is not the role of a judge to provide for such protection. It is the task of the parties to foresee and regulate all aspects that may be or become relevant, and neither party can count on support by the legal system. This is summarised in the maxim “caveat emptor”: the buyer has to pay attention to its own interests and cannot count on the seller’s volunteering (or being forced by the legal system to offer) information, warranties or other forms for protection of the buyer’s rights). As a consequence, contracts tend to be interpreted literally by English judges; in turn, this means that a lot of attention is paid to details when drafting an English-style contract, and to regulate all possible eventualities that might affect the underlying transaction.

A contract based on a civil law system, on the contrary, is subject to the opposite interpretation by the judge. Civil Law systems have rules and principles that govern private law relationships, and these rules and principles are applicable to the contracts even if they are not specifically made reference to. In some systems there are entire Civil Codes, with extensive “General Parts” that provide regulation for how to interpret a contract, the liability of the parties in case of lack of authority to enter into the contract, the liability in case one of the parties has not given the other party sufficient information relevant to the underlying transaction, the consequences of various supervening events affecting the transaction, the consequences of various non-performances, etc. Even if the parties have not regulated these aspects, a civil law judge will consider the relevant rules and principles as implied by law, and will apply them to interpret the contract or to solve the dispute. As a result, contracts do not need to be drafted in such a way to cover all details and eventualities that might affect the transaction. Where extensive and systematic codifications are not available, like, for example, in Norwegian law, a judge is under the duty to interpret the contract in such a way that its terms and conditions are fair and reasonable. In order to ensure such a result, the judge will interpret the contract in the light of the parties’ assumptions, subsequent behaviour, and other relevant circumstances. The written contract, therefore, will not be read litterally, but will be integrated with terms and conditions that are considered implied.

35 See, for more details, Anson’s Law of Contract, op.cit., p. 323.
36 A whole section in the Italian Codice Civile (articles 1362 ff.) is devoted to the interpretation of the contracts. See also sections 133 and 157 of the German Civil Code (Bürgerliches Gesetzbuch)
37 See HAGSTRØM, Obligasjonsrett, Universitetsforlaget, Oslo 2003, pp. 43ff.
What happens if a contract based on the English model is governed by a Civil Law legal system? The contract might contain a detailed regulation of various aspects of the relationship that actually is unnecessary, because those aspects would anyway be regulated by law. This may have different consequences, as we will see below.

3.2.1 Contractual Terms Supplementing the Governing Law

The contractual regulation might be more detailed than the law’s regulation, or it might differ from that regulation: as long as the law’s rules that are being integrated or derogated from by the contract are not mandatory, the contractual terms prevail over the law’s regulation, and there is no negative consequence connected with the use of an unnecessarily detailed contract style.

As an example of regulation that is typical in contract models and that is not necessary under a Civil Law system can be named the clause where each of the parties represents to the other that the obligations contained in the contract are binding upon it. It is customary to see clauses having the following language or a language with the same purpose: “Party A’s obligations under this agreement are valid, binding and enforceable”. This clause is meant to confer upon A a liability for the eventuality that the obligations contained in the contract turn out to have been invalid or unenforceable at the moment when the contract was signed. By having expressly represented that the obligations were valid, binding and enforceable, party A has guaranteed for the validity and enforceability of the obligations. Should it turn out that the obligations were not valid or enforceable, party A is in breach of its guarantee, and must therefore be deemed liable. It is doubtful whether this structure is necessary under a Civil Governing law. If a party has duly signed a contract, and the contract contains certain obligations for that party, it is implied by law that those obligations are deemed to be valid and enforceable. The other contractual party may rely on protection by the legal system (for example, in terms of reimbursement of the unlawfully inflicted damages), without having to invoke a guarantee by the first party.

3.2.2 Contractual Terms Assuming English Legal Concepts

A contract might include legal terms that have specific legal implications under English law, but are not known under the governing law. For example, it is not uncommon to include in a contract various obligations or declarations by the parties, and to define them by using different terms: “conditions”, “terms”,

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“covenants”, “representations”, “warranties”. The use of each of these definitions implies different legal consequences for the respective clauses: breach of a condition, for example, implies that the contract may be terminated, whereas breach of a representation or a warranty only entitles to reimbursement of damages. If a contract has been written adopting this legal terminology, but the governing law does not have a corresponding terminology, what importance can the judge attach to the use in the contract of one legal term rather than another one? If the parties have not chosen English law to govern their contract, but use English legal terminology, does it mean that they want the terminology to be given the technical legal meaning that it has under English law? Were the parties at all aware of the technical legal meaning under English law, and were they aware that a corresponding legal meaning lacks under the applicable law?

An example of contractual terminology that is based on English legal concepts is the term of escrow. Under English law, an escrow is a special kind of deposit, according to which a certain object (documents, securities, money, etc.) is deposited with a person (the escrow agent), and can be released only upon the presentation of certain specified documents, or upon the occurring of certain circumstances. Often the escrow is utilised when there is a contract between two parties, and none of the parties wishes to perform its obligations before it has seen that the other party has performed its own obligations. We can assume, for example, that the buyer of certain technical equipment is supposed to pay for the equipment by issuing promissory notes to the supplier, maturing respectively upon the date of production, of shipment, of delivery and installation of the equipment. However, the supplier does not intend to start production of the equipment until the promissory notes have actually been issued. The solution in this case could be that the buyer issues all the promissory notes at once, and puts them in escrow with a bank. The bank has the instructions to keep the promissory notes and to release them to the supplier upon presentation of certain documentation, evidencing the production, shipment, etc. of the equipment.

If the bank is, for example, Russian, the escrow will be regulated by Russian law. However, Russian law does not have a legal regulation that corresponds to the concept of escrow as described above. Therefore, the use of the term escrow in the contract might be misleading: the supplier might rely on the fact that the promissory notes are deposited and can be released only to the supplier himself upon the presentation of the relevant documentation, whereas the bank and the buyer might rely on the regulation for deposits, that permits to change and revoke the conditions of the deposit. Therefore, the sole use of the term “escrow” would probably not be sufficient; it would be necessary to enter into a


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contract signed by all three parties, that regulate in the details the procedure for release and the irrevocability of the regulation.

3.2.3 Contractual Terms Contradicting Legal Concepts of the Governing Law

a) Introduction

A further question might arise in connection with the use of English contract models for transactions regulated by Civil Law systems. As known, English models contain a series of clauses that are normally unnecessary under Civil Law systems but necessary under the above mentioned Common Law “caveat emptor” principle. The contractual terms or the contractual structure may be tailored to suit the English legal concepts, but may be unknown to, or even contradict the legal tradition of the governing law. What is to prevail in this case, the concepts or the structure that the parties have assumed (may be even without being actively aware of it) by drafting the contract in that way, or the concepts or structure of the governing law (whereby that state law possibly also is not the result of an active choice by the parties)? We can see one example that can illustrate the question:

b) Representations

A usual feature of English model contracts is, as seen, an extensive clause containing representations made by one party to the other party. The representations aim at covering the totality of aspects that may affect the validity and enforceability of the contract, as well as the liability of the parties to each other: from the parties’ authority to enter into the contract, to the quality of the sold goods and services, etc.

We can assume, as an example, that the buyer of an enterprise has required the seller to make a long series of representations in the contract, covering numerous aspects of the sold enterprise such as the proper establishment and registration of the company (both the of the seller and of the sold enterprise), the accuracy of the accounts, the absence of pending or threatened litigation between the company and its commercial partners, the absence of disputes with employees, the absence of conflicts between the contract and the seller’s obligations to third parties, etc.). However, the buyer has forgotten to require representations on, for example, the absence of claims by tax authorities, or the presence of polluting wastes in the ground. What happens in this case, if the contract is regulated by a Civil Law system?
Civil Law systems contain some rules that regulate the seller’s duty to inform the buyer about circumstances that might affect the value of the sold enterprise, or that impose on the seller to guarantee the validity of the transfer and the quality of the transferred object.

In our example, the parties have decided to regulate themselves the seller’s duty of information, by including a long list of representations in their contract, or (what has now become a standard procedure by contracts with a certain economic dimension) by permitting the buyer to carry out a so called “due diligence”, an accurate evaluation of the technical, legal, financial etc. status of the sold enterprise. If the buyer has overseen some aspects in the due diligence analysis, or if it has forgotten something in the list of the representations: can the buyer invoke the seller’s duty of information which is implied by law? Or is the buyer deemed to have waived that protection, by embracing the “caveat emptor” inspired contractual regulation?

The buyer was given the possibility to request assurances in respect of the quality of the sold object, even to verify it directly by viewing all the relevant documentation and even interviewing the managers of the company or other relevant people. If the buyer has forgotten to ask for certain assurances, or has overseen some documents, it seems that the lack of information is due to the buyer’s lack of accuracy in the process, rather then to the seller’s breach of the duty of information. Does this mean that the buyer has waived the legal protection provided by the system, that it has decided to take in its own hands the list of matters it wants to be informed on, and that a deficiency in the list of requested representations has to be considered its own responsibility? It is probably impossible to give a general answer to this question, the circumstances of the transaction and the language of the contract will certainly cast some more light on the matter. However, it appears clearly that in this case adopting the English law-based approach threatens to weaken the legal protection that Civil

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39 See, for example, section 19 of the Norwegian Sale of Goods Act, imposing on the seller an information duty even if the purchase is made under “as is” conditions, i.e. whereby the buyer expressly accepts the status of the purchased object.
40 See, for example, section 41 of the Norwegian Sale of Goods Act, as well as article 1483 of the Italian Codice Civile.
41 See, for example, sections 30 ff. of the Norwegian Sale of Goods Act, as well as article 1490 of the Italian Codice Civile.
42 On the difficult co-ordination of the practice of carrying out a due diligence analysis with the protection granted to the buyer by Norwegian law see HAGSTRØM, V., “‘Due diligence’ ved virksomhetsoverdragelse”, Tidsskrift for forretningsfuss, 1999, pp.391 ff.
Law legal systems provide to the buyer. From a legal point of view, therefore, the interaction between these two systems can result problematic. From an economic or business point of view, however, it might be advantageous to adopt the “caveat emptor” approach and to try to verify as much as possible all the aspects of the deal before the transaction is concluded. Having to reverse a completed transaction upon discovery of information that was not disclosed under the negotiations can be very costly, both in terms of legal resources and in terms of organisation, economy, etc.

3.2.4 English Contract Models as International Contractual Practice?

Another side of the question mentioned above regards the consequences of the widespread use of English contract models, with the above mentioned long series of representations that the parties to international contracts have now become used to expect and demand. Can this contractual standard be considered as an established international contractual practice? Most of the operators habitually acting within international business are certainly used to this style of contracts and these clauses, and they would probably be surprised to see a contract that does not contain any representation, or only a short list of representations. How can this surprise be interpreted? The seller may be relieved in seeing that the buyer does not require a particular representation (in our example, about the absence of tax claims, or of polluting wastes) that might have a negative impact on the negotiations of the price. The seller has, however, not counted with the information duty implied by law. Could the seller argue that the inclusion of representations in a contract is an internationally recognised contractual practice, and that this international custom overrides the information duty implied by law? An international contractual practice would not have the effect of overriding mandatory rules of the governing law; but it would have to

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43 A recent decision by the Norwegian Supreme Court seems to confirm this trend: in the so-called Bodum case (Rt. 2002 s. 1110), the Supreme Court has increased the level of accuracy that is expected from the buyer under section 20 of the Sale of Goods Act. In this case, the purchaser of the shares in a company had sued the seller because the economic status of the company turned out to be much worse than expected at the time of purchase. The Act requires in the second paragraph of section 20 diligence by the buyer, if the buyer has carried out an investigation of the object of the purchase, or has been requested by the seller to do so. The Supreme Court has, in the Bodum case, extended the buyer’s duty to exercise diligence also to the cases where no investigation has been carried out or requested. Among other reasons to extend the buyer’s duties, the Supreme Court has made reference to the wide-spread use of carrying out a “due diligence” of the purchase object, as mentioned in the text accompanying this footnote.
be taken into consideration while interpreting the contract. If the inclusion of an extensive list of representations was seen as an internationally acknowledged contractual practice, for example, the buyer, by not requesting any representations to be inserted in the contract, could be deemed to have accepted to buy the enterprise “as is”.

The buyer would argue that the clauses on representations are based on the English system of the *caveat emptor*, whereas the contract is regulated by a civil law system providing for the seller’s information duty: The absence of the representations clause cannot be given the legal effects that it would have under English law, but has to be interpreted according to the principles of the governing Civil Law system. This line of reasoning is logic, but it is complicated by the inconsistency of using a Common Law contractual standard in a Civil Law system (as seen above, under section 3.2.3), as well as by the wide use that this kind of clauses enjoys internationally.

The use of English contract models is undeniably widespread in international business; most of the internationally distributed publications collecting model contracts, reproduce English-style contracts. As a result, law firms and corporate lawyers in a variety of jurisdictions (not only Common Law jurisdictions) learn to draft international contracts on the basis of these models. International financial institutions, like for example the European Bank for Reconstruction and Development, impose the use of English-style contracts for the transactions that they are financing, irrespective of the fact that the financed entities do not come from Common Law states (in the case of the EBRD, which finances projects in Eastern Europe, the legal tradition of the financed entity is Civil Law), many of the investors participating in the project are not from Common Law states, and most of the contracts are not to be governed by English law. As a result, operators in Civil Law states get used to drafting in the English style, in order to meet the expectations of financial institutions. Operators in states in transition to the market economy have during the ‘90s been brought up to draft contracts according to the English style, notwithstanding their Civil Law tradition. Contract types developed by practice, such as, for example, swap contracts and other contracts for the trade of financial derivate, are standardised by branch associations following the English contract style. As a result, new types of transactions are regulated exclusively by English-style contracts, and these contracts (in English or in a local translation) are used to regulate not only international transactions, but even domestic transactions within Civil Law systems.

Whether this is sufficient to consider the English-style as an international contractual practice, and, if so, whether this is sufficient to consider a specific
clause (such as, for example, the representations clause) as an international contractual practice, remains to be seen. Recognition as internationally acknowledged practice, in any case, is more likely to come first through international arbitration than through national courts of law, arbitration being more exposed to international practice than national courts usually are.
4. TRANS-NATIONAL LAW AND STATE LAW

4.1 Sources of Trans-national law

4.1.1 Introduction

The concept of a trans-national law, that does not stem from any specific national system and regulates international transactions, is gaining more and more recognition, especially in academic circles and in connection with arbitration. The importance of non-national and non-state codifications is increasing, and numerous sources of trans-national law are being adopted by contractual parties in the belief that they constitute a proper and exclusive source to govern their relationship. These instruments are very useful as a codification of the trans-national law: Rather than counting on the general and spontaneous recognition of principles or of contractual practices (which, as seen above under section 2.3, is rather difficult to determine), they present a set of rules, a list of principles, a code, a standard contract, a guide to use or other form for systematic collection, that can be used as a certification of general acknowledgement. Obviously, not all compilations of this kind have the same “certifying” value: To be useful, they shall be issued by entities that enjoy a wide recognition and that institutionally are in a position to issue creditworthy assessments of general commercial practices.

4.1.2 The United States Restatements of the Law

In the USA the American Law Institute compiles Restatements of the Law, to ascertain the status of the case law on certain areas: They are not binding, sometimes they are not followed in practice, but, in general, they have an important persuasive authority. The aim of the Restatements is to address uncertainty in the law through a restatement of basic legal subjects, so that judges and attorneys can be guided in the interpretation of the law. The first Restatement was developed between 1923 and 1944, and it regarded among other things agency, conflict of laws, contracts and torts. Restatement Second was launched in 1952, and was meant to update the first editions, as well as to expand to new subjects, such as the foreign relations law of the United States. In 1987 a third Restatement was started by the publication of a new edition of the restatement on the foreign relations law, and new subjects are being covered by this third series, such as unfair competition and product liability.

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4.1.3 The Publications by the International Chamber of Commerce

Within international commerce, it is natural to make mention of the International Chamber of Commerce, the world’s largest business organisation that issues codifications, compilations of rules and standard contracts, in addition to organising a successful arbitration court. Not all ICC publications have enjoyed a widespread success (the publications on demand guarantee, for example, have barely been adopted in practice), some of them undeniably have been for various years and still are generally acknowledged (such as the INCOTERMS on terms and conditions for sale contracts, and the UCP 500 on documentary credits), while others are often used, but have not reached an unquestionable generality of recognition (such as the standard agency contract, the standard force majeure clause).

4.1.4 The Publications by Branch Associations

Branch associations issue their own standard contracts and codes of conduct (the ISDA, International Swap and Derivatives Association, in respect of swap contracts and other financial contracts; ORGALIME, the European federation of national industrial associations representing mechanical, electrical, electronic and metal articles industries, in respect of consortium agreements, technology licence agreements; the FIDIC, International Federation of Consulting Engineers, in respect of civil engineering contracts; the BIMCO, Baltic and International Maritime Council, in respect of charter-parties, etc.

4.1.5 The Publications by the UNCITRAL

The United Nations Commission on International Trade (UNCITRAL) has prepared a series of documents, such as draft conventions and model laws. Some of these documents have reached a high level of recognition: the UNCITRAL documents are the expression of a consensus among the experts representing all members of the UNCITRAL, and therefore are based both on specific expertise and on a broad representation of political, social and economic environments. The Model Law on International Arbitration of 1985, for example, is a very successful document of the UNCITRAL, which not only is adopted by 34 states, but is broadly used as a reference by legislatures, academics and practitioners.

4.1.6 The Publications by the UNIDROIT

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Other international organisations have the purpose of enhancing harmonisation of the regulation of international business, and actively publish documentation in this sector. Among these, a special mention deserves the International Institute for the Unification of Private Law, UNIDROIT, which, among other initiatives, has issued the Principles of International Contracts. This non-authoritative codification has, in an international dimension, a purpose similar to the already mentioned US Restatements of the law. The UNIDROIT Principles are not binding, and they are not merely a record of existing practices; they are partially a codification of generally adopted principles of international contracts, and partially they present original regulations, that result from the work of a large group of experts from various parties of the world.

The ambitions of the UNIDROIT Principles are multiple, as it appears from their preamble, and they can be summarised as follows. Because the Principles are the result of an extensive comparative study and offer modern and functional solutions, they may be used by legislators as a source of inspiration when legislating in the field of general contract law. Because of the persuasive authority that derives from the high quality of the working group that prepared them, the Principles could be used by courts or arbitrators to interpret existing international instruments. Moreover, they may be used by contractual parties during the preparation of their contract, as a guide to the drafting. The parties to an international contract might decide to subject their contract to the regulation of the UNIDROIT Principles, as an expression of a balanced, international set of rules, rather than choosing a national governing law (on this particular use of the principles, however, it is necessary to make some reservations, see below, section 3.2). The Principles might be useful for arbitrators, specially if they are deciding a dispute on the basis of the trans-national law: rather than having to search for what could constitute international usages of trade, or similar undefined concepts, they could rely on a ready available set of rules. The last ambition of the Principles is to be used by courts or arbitrators instead of the governing law, should the content of the law be impossible or extremely difficult to establish.

4.1.7 The Publications by Universities, Institutes, Academies

Other initiatives towards the codification of trans-national law are taken within Universities. In Germany, for example, the Muenster University has established a Centre for Transnational law (CENTRAL) (now moved to the University of Cologne) that, among other things, develops and maintains lists of principles, rules and standards of the trans-national law.

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4.1.8 The European Work for a European Civil Code

The variety of state laws, and the significance that the governing law may have on the effectiveness of an international contract, are perceived by some observers as a serious obstacle to international trade; this concern has been taken up by the European Parliament, that in several occasions has adopted resolutions on the possible harmonisation of substantive private law, as essential to the completion of the internal market. A rather recent resolution balances between the aim of harmonising state laws on one hand, and that of enhancing the trans-national law, on the other hand. This has interesting implications for the evaluation of various aspects of the trans-national law, and we will therefore devote some place to its examination in this section.

In its resolution of 16 March 2000 the European Parliament called on the Commission of the European Communities to draw up a study in this area (OJ C 377,29.12.2000, p. 323); as a follow up thereof, the Commission issued the Communication from the Commission to the Council and the European Parliament on European Contract Law (11.7.2001, COM (2001) 398 final). In this Communication, seeking information from all interested parties, including also businesses, legal practitioners, academics and consumer groups, the Commission wished to have a response as to what extent the development of a common European private law is desirable or even necessary to enhance the internal market. Furthermore, the Commission wished to have a response as to what approach would be preferable in the harmonisation of the European private law (if the result of the former mentioned inquiry confirms that such a harmonisation is desirable). The Communication presented a non-exclusive list of four alternative approaches: (i) to leave the solution of any identified problems (due to the diversity in the various state laws) to the market; (ii) to promote the development of non-binding common contract principles; (iii) to review and improve existing EC legislation in the area of contract law, and (iv) to adopt a new instrument at EC level. The Communication made extensive reference to the academic engagement in this area: a draft of a European contract code (“European Contract Code – Preliminary Draft”) has been published by the Academy of European Private Lawyers, also known as the “Pavia Group”, the “Principles of European Contract Law Parts I and II” have been published by the “Commission on European Contract Law”, and an enlargement of the scope of the Principles is being worked upon by the “Study Group on a European Civil Code”.\footnote{It is interesting to notice that the scope of the project has been enlarged in respect of its original frame. From the original contract law, the Study Group is now looking at the whole area of private law, including also family law.}

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A variety of institutions, branch associations, governments, universities and other entities have responded to the Communication, and the variety of assessments that are made in such responses varies considerably. Some responses deem an harmonisation of the European substantive private law as strongly desirable, and the only possibility they see to achieve this goal is to give effect to the Option (iv), i.e. the enactment of an instrument at the EC level (see, for example, the responses by the German Federal Association of Banks, the Academy of European Private Lawyers, the International Chamber of Commerce, the Servizi Interbancari S.p.A., Prof. Pietro Rescigno of the Rome University La Sapienza, Lovells Boesebeck Droste); some responses question the necessity and even the desirability to harmonise the substantive private law of the European States (see, for example, the responses by the UK Government, the Financial Services Authority, the European Community Shipowners’ Association, the Law reform Committee of the General Bar Council of England & Wales); other responses affirm the desirability of an harmonisation, but do not deem any of the four options listed in the Communication as satisfactory (see, for example, the response by the London Investment Banking Association, that would rather see the enactment of the principle of mutual recognition of the state of origin’s requirements, that underlie the Directive on Electronic Commerce and the Investment Services Directive; others affirm the desirability of an harmonisation, and opt for the alternative of a non-binding set of rules and principles as described in option (ii) (see, for example, the position taken by the German Chambers of Commerce and Industry, the German Federal Industrial Association, The EEA EFTA, and the joint response by the Commission on European Contract Law and the Study Group on a European Civil Code).

Of particular interest is the response to the Communication made, jointly, by the Commission on European Contract Law (which is the author of the above mentioned Principles of European Contract Law), and its successor, the Study Group on a European Civil Code (which is preparing a restatement of the law on specific contract types and other areas of private law not already covered by the Principles published by the Commission).

The joint response to the Communication argues extensively in favour of harmonisation, showing with a series of illustrations that the state laws of the member states differ from one another, and stating that this difference is a barrier to the completion of the internal market primarily because it hinders businesses from adopting standard conditions of contracts throughout the European Union, and it increases the costs of the transactions and disputes by forcing the operators to assess the law in every single state they operate in. The preferred approach for achieving the desired harmonisation is, according to the
Commission and the Study Group, the adoption of a restatement of the law. The Commission and the Study Group seem to propose a semi-legislative status for such restatement, that would put it, in the hierarchy of the sources of law, somewhere between the traditional sources of trans-national law (such as, for example, the Uniform Commercial Code and the UNIDROIT Principles) and binding sources of law. For the achievement of such a semi-legislative status, the Commission and the Group envisage an amendment of the European private international law (which is embodied, in respect of contractual obligations, in the Rome Convention on the Law Applicable to Contractual Obligations of 1980; in respect of the other areas of private law, the conflict rules are to be found in the national private international law of the various member states): the long term aim is to render the restatement an “optional legal system”, that the parties can voluntarily choose to govern their relationship, and for doing that they need a conflict rule that permits the parties to make such a choice of law. The choice of such an optional legal system, in the vision of the Commission and the Study Group, would mean the exclusion of any applicability of state laws; the restatement, in other words, would not be an addition to the applicable state law, but a replacement thereof. The Commission and the Study Group admit, however, that the time for such an effect has yet to come, primarily out of two reasons: because the Rome Convention (and the national rules of private international law that cover the other areas of private law, I am tempted to add) at present does not provide for the possibility to replace state laws with trans-national rules, and because the restatement at present does not constitute a complete regulation of contract law.

4.2 The Scope of Application of Trans-national Sources

4.2.1 Introduction

Some of the authors and promoters of a restatement of a European private law are strong supporters of trans-national law and consider it a better regulation for international contracts than state law, it is, therefore, interesting to see that, when they are given the possibility to influence the future regulation of trade relations within the Europe Union by responding to the above mentioned Communication from the Commission of the European Communities, the aim to which they aspire is a restatement with a semi-legislative status, rather than an

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45 Response to the Commission Communication by the Commission on European Contract Law and the Study Group on a European Civil Code, p. 44
47 See, for example, LANDO, O., op.cit.
affirmation of the value of trans-national law in the way traditionally known. The primary source of trans-national law, the spontaneous development by market forces of appropriate regulations and models, is bluntly dismissed as not sufficient to bring about a uniform regulation of private law, whereas it was earlier priced as the most adequate source of regulation for international commerce. The existing Principles of European Contract Law, that represent (together with the UNIDROIT Principles) one of the best and most comprehensive codifications of trans-national law, are also dismissed, with the observation that for the moment such a restatement can not be reckoned to replace state law: what this restatement lacks, in addition to a more comprehensive and detailed scope, is the legal basis for being considered binding also in competition with mandatory rules of state laws. Hence the reference by the Commission and the Study Group of an “enactment” of the restatement, as well as the proposal to modify the Rome Convention so that the parties can choose to have their contract governed (by a state law, or, as an alternative) by a European restatement of law. It seems to me, incidentally, that a modification to the Rome Convention would only give a partial solution to the problem of effectiveness of the restatement: the choice of the restatement of governing law would have effect only within the scope of party autonomy, thus leaving unaffected areas where party autonomy is restricted (such as the law of property, pledge, company law, legal capacity, securities exchange, labour law, etc.). The restatement, in other words, would have a semi-legislative status only to the extent the parties are free to choose the governing law; and this is a much narrower scope than the one that the authors of the restatement aspire to, the restatement aiming at covering the whole private law.

The same doubts as to the effectiveness of a free development by market forces as well as to the usefulness of a restatement are expressed by the International Chamber of Commerce, which has been for numerous decades one of the most convinced supporters of the trans-national law as an efficient alternative to state laws: in its response to the Communication, the ICC’s Department of Policy and Business Practices expresses “concerns as to whether non-binding principles are sufficient”, though emphasising the importance of the Principles as a first step towards harmonisation.

If the spontaneous development by the market forces as well as a restatement of European law (without enactment or legal basis within private international law)

49 Op.cit., p. 35
51 Document 15 October 2001 AH/dhh Doc. 373/416, p. 3

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are described as insufficient to replace state law in the responses to the European Commission’s Communication by two of the most trans-national law-friendly entities, the authors of the restatement and the ICC, even stronger doubts seem to apply in respect of the other sources of trans-national law mentioned earlier, which (apart from the UNIDROIT principles, that in this respect can be compared to the European Principles) do not even have the ambition of being comprehensive or of restating the law, they simply provide a regulation of specific types of contract or of specific areas.

Yet it is possible quite often to meet strong arguments made in favour of the applicability of trans-national law in replacement of state law, primarily on the basis of the inadequacy of state law to govern international transactions. The argument is repeated so often and in such a strong tone (particularly, but not exclusively, when disputes are submitted to arbitration), that it seems advisable to devote some time to the analysis of the matter.

It is undeniable that many sources of the trans-national law represent a precious contribution to the regulation of international contracts. Thanks to these sources, the parties may rely on terms and conditions as they have been developed over the years in international practice. In addition, the more systematic among these sources (such as the UNIDROIT principles and the European principles) may be even used to interpret and integrate national systems of law, where there is no specific legislation or little case law.\footnote{For a clear analysis of how the interpretation of state law may benefit of these principles, see HAGSTRØM, V., \textit{Obligasjonsrett}, op.cit., pp.61 ff.}

The thesis of this course is that, as a general rule, trans-national law is a very useful tool to regulate international transactions, as it is developed by practitioners, by branch organisations having close contact with the practitioners’ requirements, or by academic circles having deep insight in the relevant areas. Therefore, it responds to the specific requirements of international practice, and it quickly adapts to new technologies or new business practices. However, the use of trans-national law is not an alternative to the use of state laws, it is an addition thereto; the interaction between these two systems has different consequences, according to the kind of rules of state laws involved. We will analyse this interaction in the following sections.

\textbf{4.2.2 Matters Outside of the Scope of Application of a Trans-national Source}

\footnote{For a clear analysis of how the interpretation of state law may benefit of these principles, see HAGSTRØM, V., \textit{Obligasjonsrett}, op.cit., pp.61 ff.}
The limitations to the applicability of trans-national law are obvious, when the dispute arises outside of the scope of application of the trans-national sources. A dispute regarding the existence of a *force majeure* event, or the validity of a contract, for example, are clearly outside the scope of application of the INCOTERMS, which regulate the allocation of risk and liabilities between the buyer and the seller, in respect of transportation, insurance, customs clearance, etc. Therefore, even if the parties have made reference in their contract to the INCOTERMS, the disputed matters will have to be evaluated in the light of the state law governing the contract.

In the case of the INCOTERMS it is relatively easy to identify the scope of application, because the object of these general terms is clearly restricted to the allocation of risk and liability between the buyer and the seller. In other sources of trans-national law, however, it might not be as easy: the UNIDROIT Principles, for example, have the ambition of regulating contracts in their totality.

However, there is a borderline between areas that may be subject to trans-national law and areas that must be regulated by state law or international conventions (treaties or conventions). Broadly speaking, it could be said that any matters that cannot be typically characterised as private law matters, are outside the scope of trans-national law and necessarily regulated by state laws or international conventions. For example, rules about taxation, customs clearance, import-export, foreign exchange, securities exchange, registration of companies, accounting, anti-trust, etc., are subject to the applicable state laws or international conventions. Furthermore, there are certain rules that, even if they qualify as rules of private law, are subject to regulatory intervention in a number of states: for example, rules protecting the weaker contractual party, such as in labour contracts, insurance contracts, carriage of goods contracts. Also here, rules of trans-national law will not be applicable.

### 4.2.3 Matters Within the Scope of Application of a Trans-national Source supplementing the Applicable State law

#### a) Introduction

The disputed matter may be within the scope of application of the trans-national source, and the trans-national rules may be more detailed than the governing law, or may contain a different regulation. As long as the rules of the governing law that are being derogated from or supplemented are not mandatory, the trans-national rules are fully applicable.
b) Contracts of Sale and the INCOTERMS

To continue the example of the INCOTERMS, a dispute regarding whether the delivery has been effected properly, when the goods have been physically delivered at the place of delivery, but have not been cleared for export, will be easily solved by verifying which term of the INCOTERMS the parties have chosen: the chosen term will determine whether the obligation to clear the goods for export was of the seller or of the buyer.

The INCOTERMS represent the ICC standard for the interpretation of trade terms. They apply to cross-border delivery of goods, and are divided into 13 different terms, all expressed by three-letters abbreviations (such as FOB, CIF, etc.). To each of these abbreviations corresponds a definition of the respective responsibilities of the seller and the buyer, within the scope of regulation of the INCOTERMS. The scope of regulation is clearly determine, and it covers the responsibility for customs clearance, for arranging and paying transportation and insurance, as well as the place of delivery and the passage of the risk from the seller to the buyer. We can assume, in our case, that the parties have agreed that the delivery shall be ExW, and then have named the place of production of the goods. The use of this term means that the parties have agreed that the delivery shall take place at the production premises, and that the buyer shall be responsible for customs clearance and transportation. The delivery, therefore, is made according to the contract if the goods are made available to the buyer at the production premises, not cleared for export. If, on the contrary, the contract say that the delivery has to take place FOB (followed by the name of a port), then the delivery is not effected properly until the goods are delivered at the named port and have been cleared for export.

In cases such as this one, the disputed questions may easily be solved on the basis of the contractual terms or on the basis of the adopted sources of trans-national law.

4.2.4 Matters Within the Scope of Application of a Trans-national Source Conflicting with Mandatory Rules of the Applicable State law

In some situations, however, the trans-national law might conflict with some mandatory rules of the applicable state law. In these situations, the relationship between contractual terms and trans-national law on one side, and state law on the other side, becomes apparent.
a) Letters of Credit, the ICC Uniform Customs and Practices for Documentary Credits and Mandatory Rules of the Governing State law

Letters of credit, also called documentary credits, are a widely used method of payment, applied when the creditor does not intend to take the commercial risk connected with the creditworthiness of the debtor. Letters of credit are mainly used as a method of payment in sale contracts (whereby it is the buyer who is requested to open a letter of credit in favour of the seller), but they can be used in any situation where a party owes a determined amount of money to another party: Often, for example, letters of credit are used to support payment under performance guarantees, whereby it may be the seller, who is required to open a letter of credit in favour of the buyer.

A letter of credit is structured as follows: the debtor (called applicant) requests a bank (called the issuing bank) to issue a letter of credit in favour of the creditor (called the beneficiary). The application contains the instructions for the issuing bank, and must state the precise amount of money that has to be paid, as well as the documents, upon the presentation of which the bank has to effect payment. This is the main characteristic of a letter of credit: the bank has to effect payment upon presentation of the documents that are named in the instructions. The bank has simply to verify the conformity on the face of the presented documents, and is not requested to assess the proper performance of the underlying transaction, or any other matter. Presentation of the documents is necessary and sufficient to trigger payment by the bank (which explains why letter of credits are also known under the name documentary credits); the obligation to pay is the bank’s own obligation, which means that the beneficiary bears the commercial risk connected with the creditworthiness of the bank, and not of the applicant. An implication of the fact that obligation to pay is the bank’s own obligation, is also that the bank’s obligation is an autonomous obligation that does not have any contact with the underlying transaction upon which the beneficiary’s credit towards the applicant is based. The bank’s obligation to pay is based on the letter of credit, and not on the underlying transaction between the applicant and the beneficiary. Therefore, the bank cannot withhold payment invoking defences arising out of the underlying transaction, as long as the listed documents have been presented for payment. The autonomous character of the bank’s payment obligation is one of the most characteristic aspects of a letter of credit, and is codified in the Uniform Customs and Practices for Documentary Credits issued by the International Chamber of Commerce (UCP 500), articles 3 and 4.53

53 Article 3 reads as follows: "(a) Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with
Another aspect characteristic of letters of credit regards the different roles that banks can assume. In the event of international payment, the applicant will normally request a bank in its own state to act as issuing bank; the beneficiary, however, would usually find it more convenient to refer to a bank in its own state, for presenting the documents and obtaining payment. Therefore, the issuing bank will use a bank in the beneficiary’s state for the purpose of receiving the documents and making payment. This bank can have two very different roles: It can be engaged as a simple agent of the issuing bank, in which case it will not have any obligations in its own name towards the beneficiary, and will simply carry out the instructions of the issuing bank, on behalf of the issuing bank. In such case, the bank is called advising bank. In other cases, the bank assumes an independent obligation towards the beneficiary, and, as a result, the beneficiary will have two banks which are jointly and severally responsible in their own name to effect payment upon presentation of the listed documents. In this case, the bank is known as confirming bank. The different implications of acting as an advising or a confirming bank are regulated by the UCP 500 in article 7.

The UCP 500 enjoy, as already mentioned, a general recognition as regulation of letters of credits; they are, at the same time, source of regulation, and codification of generally acknowledged practices within that area. In particular the two aspects mentioned above, the autonomy of the payment obligation and the implication of the roles as advising or corresponding bank, are uniformly applied in letters of credit, irrespective of the fact that the particular letter of credit makes express reference to the UCP 500 or not.

However, in some cases these principles of the letters of credit have been considered to conflict with rules of the governing state law, and have been overridden by state law. We can look at the following cases:

(i) Case 1

The Beneficiary of a Letter of Credit presents documents to obtain payment under the Letter of Credit. The Bank refuses payment, because not all the documents listed in the instruction have been presented. In particular, a ”Receipt signed and proving delivery of the goods” was listed as one of the documents to be presented, and was not presented. The Beneficiary claims that payment is due or bound by such contract(s), [...]” Paragraph (b) of this article and article 4 confirm this independence.


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in spite of the lack of these documents, because the delivery can be proven by other means. Is the Beneficiary entitled to obtain payment under the Letter of Credit?

According to the principles that rule documentary credits, as seen above, the obligation of the bank to pay is strictly dependent on the instructions that it has received. If the instructions provide for payment upon presentation of specific documents, then payment has to be effected upon presentation of those documents (irrespective of any supervening circumstance), and only upon presentation of exactly those documents. Payment on presentation of documents different from those listed in the instructions, can expose the bank to liability towards the applicant.

In the case described here, the receipt was one of the listed documents, and was not presented. An application of the principles governing the documentary credits, therefore, should lead to the conclusion that payment was not to be effected by the bank. The creditor maintains its claims towards to the debtor, but the bank cannot effect a payment in violation of the instructions. The creditor will have to satisfy its claim directly with the debtor.

However, the Swiss Supreme Court, in the analysed case, decided in the opposite way. The reason for deciding that the bank had to effect payment was that, by not effecting payment invoking the instructions, and in spite of the presence of other documentation showing that payment was due, the bank would abuse its rights. This abuse of right would be in contrast with article 2 of the Swiss Code of Obligations, which is mandatory. We have here an example of conflict between a principle of trans-national law (irrelevance of the underlying obligation to a letter of credit), and mandatory rules of the national governing law, whereby the state law prevailed.

(ii) Case 2

55 The inclusion of a signed receipt among the documents to be presented is a rather inefficient means: if the receipt has to be signed by the buyer, who is also supposed to make the payment, it will easily be able to stop any possibility of effecting payment by withholding the signature on the receipt. It is an important principle that the production of none of the listed documents should be in the power of none of the parties. Otherwise, the parties may influence the circumstances that trigger payment, and the neutrality and independence that a letter of credit should provide is seriously undermined.

56 J.Zeevi & Sons v. Grindlsy’s Bank (Uganda)
A Letter of Credit is issued by an Ugandan bank. Citibank of New York acts as an advising bank. In 1972 the Ugandan government prohibits the Ugandan bank from making foreign exchange payment to the Israeli beneficiary. Consequently, the issuing bank instructs the advising bank to cancel the Letter of Credit. The Beneficiary claims payment under the Letter of Credit from Citibank. Is the Beneficiary entitled to payment in accordance with the Letter of Credit?

As we have seen above, there is a clear distinction between the role of an advising bank and the role of a confirming bank. An advising bank does not assume obligations in its own name, it just acts on behalf of the issuing bank. If the issuing bank instructs the advising bank not to effect payment, the advising bank is obliged not to effect payment. If it nevertheless does, than it will not be in a position to obtain reimbursement from the issuing bank, because it did so in violation of the agreement between them.

In the case mentioned here, Citibank was an advising bank, and it had received instructions from the advising bank not to effect payment; therefore, Citibank was not obliged to effect payment.

However, the Court of Appeal of New York found that the bank had to pay. The reasoning was as follows: New York is the financial capital of the world, and if it wants to maintain this pre-eminent position, it is important that the operators under New York law protect the justified expectations of the parties. The fact that payment had become illegal under Ugandan law does not affect the role that a New York bank should play. This is a situation where a recognised principle of trans-national law (the diversity in responsibility between an advising bank and a confirming bank) conflicts not with some mandatory rules of the governing law, but with some policies, that in the eyes of the court must have been so important that they represented public policy and had to override.

(iii) Case 3

DCA has entered into a contract for the supply of certain military equipment to the State of India, and has issued a Letter of Credit as a performance guarantee. The main document to be presented to obtain payment under the Letter of Credit is a certificate by the State of India stating that DCA is in breach of contract. War breaks out between India and Pakistan, and the USA announce an embargo on India. The military equipment is delivered FOB at the DCA’s plant; DCA alleges that it has performed its obligation to supply the equipment at its plant.

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The embargo prevents the shipment abroad, and the State of India presents to the banks a certificate of breach of contract, as provided for under the instructions of the Letter of Credit, and requests payment under the letter of Credit. Is the Beneficiary entitled to payment under the Letter of Credit?

The principles governing documentary credits, as we have seen, clearly state that payment has to be effected upon presentation of the listed documents, and that the bank shall not be concerned with the underlying transaction. If the State of India has presented a certificate of breach of contract, and this was the document that had to be presented according to the instructions, then payment should be made.

However, the District Court of Georgia resolved to grant a preliminary injunctive relief and a permanent injunction against the bank, protecting the debtor from claims relating to its obligation to effect payment.

The Court confirmed first the known principles governing Letters of Credit: that payment has to be made by the bank, irrespective of the circumstances of the underlying transactions, if the listed documents have been presented. However, the Court went on considering the matter of fraud, and affirmed that, in case of fraud, the bank should nevertheless have the obligation to effect payment to “innocent third parties”, whereas, in case the beneficiary is not “innocent”, the bank has not the obligation, but the option to effect payment. The Court went on affirming that, in this case, the beneficiary was not an innocent third party, because there was a dispute as to the validity of the certificate of breach of contract presented to the bank for payment. The Court affirmed that the certificate of breach was unspecified (the wording being “failed to carry out certain obligations of theirs”). The Court affirmed, further, and correctly, that the beneficiary did not have to prove that the breach actually had taken place, since this would a question relating to the underlying contract, and the court had no jurisdiction on that matter (the contract had chosen arbitration in India for settlement of disputes arising out of the contract). The Court then justified its issuance of the injunction on the basis of its alleged duty to guarantee that the beneficiary does not take “unconscientious advantage of the situation and run off with plaintiff’s money on a pro forma declaration which has obviously no basis in fact”. In this case, therefore, the principles governing documentary credit have been superseded by the governing law’s rules on fraud. Several comments are possible on this decision: we will concentrate on the quality of the listed documents and on the question of fact.

When it comes to the quality of the document, the court is concerned with the fact that the certificate was unspecified. This, however, should primarily have
been a concern of the parties, when they drafted the instructions to the bank. Allowing payment upon presentation of a certificate issued by the beneficiary is not advisable, as it can open to possible abuses. Allowing such a certificate, without specifying its contents, is even less advisable, since it means that there are no parameters that have to be met before the beneficiary issues such a certificate. What surprises, in this case, is that the court has found it appropriate to override the agreement between the parties, because the list of documents had not been written with the appropriate diligence.

The next comment is a matter of fact, and as such does not belong to the dispute upon which the court had jurisdiction. However, the court invites this comment, by mentioning that the beneficiary should not run off with the money with no basis in fact. If the goods had to be delivered FOB, then the responsibility for clearing for export was of the seller.\textsuperscript{58} If the goods could not be exported, the seller had not complied with its obligations, even if the goods were made available at the place of delivery. The goods could not be exported because of an embargo and not because lack of diligence of the seller, and therefore it might be questioned whether this can amount to a default by the seller. However, the adoption of the term FOB indicates that the risk for not obtaining the export licence relies on the seller, and not on the buyer.

b) Firm Offer, the UNIDROIT Principles and Mandatory Rules of the Governing State law

Another illustration of the relationship between the trans-national law and mandatory rules of the governing law is the situation of revocation of an irrevocable offer, which was examined above, under section 3.1.2 (a). As we saw above, Civil Law Systems and Common Law systems have different solutions to the problems arising out of such situation. Under Civil Law systems, the irrevocable offer would be binding on the offeror according to its terms, and a revocation thereof before the term of the offer elapses would be without legal effect. Under Common Law systems, however, the answer is not as easy: the United States have adopted a position similar to the mentioned Civil Law position, whereas English law is strictly keeping to the doctrine of consideration. Under the doctrine of consideration, a unilateral promise (in our case, the irrevocable offer) is not binding on the offeror for lack of consideration, and therefore it can be revoked even before the term has elapsed. Therefore, under English law a firm offer can be revoked, notwithstanding its terms.

\textsuperscript{58} Another matter is that the term FOB assumes that the place of delivery is a port, and not the seller’s plant, as it apparently had been agreed in the contract.

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What would happen in the scenarios examined above under section 3.1.2 (a), if the parties had chosen to subject the offer to the UNIDROIT Principles, or if the arbitrators had decided to apply the Principles to solve a dispute arisen between the parties?

Firm offers are regulated in article 2.4 of the UNIDROIT Principles. The article starts by setting forth a general rule, according to which offers can be revoked until they have been accepted. The second paragraph of the article is devoted to irrevocable offers, and reads as follows:

”(2) However, an offer cannot be revoked
(a) if it indicates, whether by stating a fixed time for acceptance or otherwise, that it is irrevocable; or
(b) […]”

The solution provided by the UNIDROIT Principles, therefore, coincides with the solution provided by Civil Law systems. But what if the relationship is subject to English law, which might be law determined as the governing law by the applicable choice-of-law rules? We have seen above that English law has a different outcome for this situation, due to the applicability of the doctrine of consideration. The doctrine of consideration is mandatory, and cannot be derogated from by agreement of the parties, or by a non-binding source of trans-national law with persuasive authority. If the relationship is subject to English law, therefore, the solution suggested by the UNIDROIT Principles would not be applicable.

That the UNIDROIT Principles, and trans-national law in general, cannot prevail over mandatory rules of the applicable law is also confirmed by the Principles themselves. Article 1.4 contains a clear description of the relationship between the Principles and state law (or applicable international conventions): in case of conflict with mandatory rules, the mandatory rules will prevail. It can be wondered whether it was at all necessary to specify this hierarchy between the trans-national law and mandatory rules of state laws; in the light of the passionate support sometimes enjoyed by trans-national law, however, whereby the total inadequacy of state laws to govern international contracts is vigorously affirmed, it is welcomed to see confirmed that even a trans-national source of law such as the UNIDROIT Principles recognise the applicability and the supremacy of state law.

This is a significant reduction of the scope of application of trans-national law, as well as of its main function, namely the harmonisation of the regulation of international commerce. If the application of these sources is subject to the
mandatory rules or whatever state law is governing according to the applicable choice-of-law rules, than the scope is rather limited. This does not mean that the trans-national sources are not useful; trans-national sources are extremely useful, because they reflect the state-of-the-art regulation for the operations of commercial parties. However, they must be used in accordance with the limitations of their scope: in case of dispute (present or potential), it will not be sufficient to look at the text of the contract and at the applicable trans-national sources. It will also be necessary to look at the governing law, and the governing law might supplement or even contradict the text of the contract and the trans-national sources, as is being shown here in chapter 3 and chapter 4.

4.2.5 Matters Within the Scope of Application of a Trans-national Source But Not Specifically Regulated

One of the criticisms moved against the trans-national law is that it is not a systematic and comprehensive body of rules, and that therefore often it is not possible to find a rule applicable to a specific case. Furthermore, the rules contained in the trans-national law, these critical voices continue, are of such a general nature, that they rarely provide a detailed guideline to solve disputes. A recognised principle of the trans-national law, for example, is the “rebus sic stantibus”, according to which a party is not obliged to perform its contractual obligations, if supervened events prevent performance under the agreed terms. This principle would, therefore, excuse a failure to perform in the case of force majeure. But what about the detailed implementation of this principle; for example: Is the prevented party supposed to notify the other party of the occurrence of the force majeure event? Within how many days? Is the occurrence of the force majeure event to be certified by an independent party? Which one? What happens if the force majeure event persists for a long period, should the contract be terminated? How long should the force majeure situation persist, to justify termination of the contract?

Where trans-national law does not provide detailed rules, it seems necessary to supplement the regulation by applying the governing state law. A series of instruments have been prepared and are under constant production for giving trans-national law a systematic character: these range from the private codification of rules relating to a specific sector or area (such as the already mentioned INCOTERMS for the contract of sale, the ISDA codes for the contract of swap, the UCP 500 for the documentary credits), to the ratification of international conventions on specific areas (such as the Vienna Convention on the Contracts of International Sale of Goods of 1980 (CISG) and the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards of
1958), to the compilation of general principles applicable to international contracts (such as the UNIDROIT Principles for International Contracts or the European Principles of Contracts). These instruments certainly enhance the ability of trans-national law to solve specific questions, by reducing the eventuality of lacunas; however, this eventuality is not excluded. We will look at two cases and measure them against two of the most important “systematic” sources of trans-national law: the UNIDROIT Principles, and the Vienna Convention on international sale (which, even if it is an international convention, is often looked upon as the expression of trans-national law).

a) Partial Impediment, Plurality of Creditors and the UNIDROIT Principles

In section 3.1.3 (b) above we have seen that the choice of the governing law may influence considerably the liability of one contractual party who is prevented only in part from performing its contractual obligations by a force majeure event. In particular, we have analysed the case of a seller that has entered into a plurality of contracts, for example, with several buyers, for the supply of the products manufactured by the seller. If the force majeure event prevents the production of part of the volume that the seller has committed to the totality of its buyers, the position of the seller will vary according to the governing law. If the governing law belongs to a Civil Law system, the buyer will most probably be entitled to reduce the supplies to each buyer pro rata. If the governing law is English, the seller will not be excused by frustration of the contract: the judge will consider that the non-performance is self-induced, and not caused by an external event outside of the seller’s control. The non-performance is the consequence of the seller’s commitment to deliver part of its production to other buyers, and therefore the impediment was not outside of the control of the seller.

One of the most important functions attributed to trans-national law is to eliminate discrepancies like this one, that exist among the various state laws, and to provide a uniform and reasonable treatment that can be used to govern international contracts in the respect of the expectations of the parties.

If we assume that the situations described above under section 3.1.3 (b) are subject to the UNIDROIT Principles (because the parties chosen the principles as governing law in the contract, or asked the arbitrators to apply them), what will the solution be?

The UNIDROIT Principles do not contain an answer to the situation arising in case of partial impediment and plurality of creditors. Article 7.1.7 of the Principles regulates force majeure circumstances, both preventing in total and in
part the contractual performance, but they do not regulate the allocation of risk in case of plurality of creditors.

How can this lacuna be filled? The UNIDROIT Principles contain, in articles 1.6 and 1.8, a guideline to the interpretation and application of the Principles, where there are lacunas.

Article 1.6 establishes first the principle of autonomous interpretation of the Principles: the Principles shall be interpreted having regard to their international character, and bearing in mind their purpose to promote uniformity in their application. This paragraph of article 1.6 aims, in other words, at avoiding that the Principles are interpreted in the light of state laws.

The second paragraph of article 1.6 provides that, in the case of lacunas within the Principles, the interpreter will have to apply, to the extent possible, the general principles underlying the Principles. The autonomous interpretation is enhanced by this provision: lacking an express regulation of a certain aspect, the interpreter will first have to look at the principles that inspire this codification, and construe them so as to elaborate a regulation in line with the fundamental ideas upon which the principles are based. It cannot be excluded, however, that even the underlying principles are not sufficient to provide the regulation of a certain aspect; that is why this second paragraph of article 1.6 requests the interpreter to apply this method “as far as possible”. What happens if such a construction of the Principles is not possible?

Article 1.8 provides that the parties shall be bound by usages and practices established between themselves, as well as by usages that are “widely known to and regularly observed in international trade by parties in the particular trade concerned”. A lacuna of the Principles, therefore, could be filled by applying usages and practices, either established between the parties or generally recognised in the relevant trade.

Not always, however, the parties have established usages that can be useful to solve a certain dispute; and not always there are generally acknowledged practices to the same extent, or such uses are easily determined. In these cases, therefore, it seems that the lacunas will have to be filled by applying the governing law. The ideal of uniformity that inspires the Principles, consequently, might fail, if the solutions provided by state laws differ from state to state. As an illustration of a lacuna that weakens the Principles’ ideal of uniformity, we will look at the situation of partial impediment and plurality of creditors under section c) below.
In the case of partial impediment and plurality of creditors, it does not seem that the interpretation rules contained in articles 1.6 and 1.8 of the Principles can offer any specific help. Principles underlying the codification, referred to in article 1.6, don’t seem to be relevant to this particular situation. It could be possible to interpret article 7 on the basis of an analogy with the solution presented by Civil Law systems, that provide for a corresponding reduction of the performance in case of partial impediment, and are construed to permit a pro rata reduction among the various creditors. However, how could such an interpretation by analogy with state laws of the Civil Law system be compatible with the above mentioned article 1.6, that wishes to avoid that the Principles are interpreted in light of state laws? As far as article 1.8 is concerned, it does not seem easy to determine what generally recognised principles might say in this situation. The principle “rebus sic stantibus”, which is the expression of the force majeure rule in the trans-national law, does not seem to have generally recognised rules on partial impediments and plurality of creditors. Therefore, the consequences of the situation arising in our scenarios have to be solved by applying the governing law.

In this situation, in conclusion, the trans-national law has not achieved its aim of providing uniform and reasonable regulation of international contracts.

b) Sale Agreements and The Vienna Convention on International Sale of Goods (CISG)

As another example of lacunas in trans-national law that might lead to the application of the national governing law, we can look at an arbitral award rendered in the framework of the International Chamber of Commerce. The dispute was between a Korean seller and a buyer from Jordan, and was based on a complex sale agreement, that provided for the seller to issue a performance guarantee, and for the buyer to open a letter of credit for the payment of the goods; the buyer had also to issue a performance guarantee in favour of the final buyer of the goods, an Iraqi buyer. Due to several delays, the delivery was rescheduled and the duration of the letter of credit was extended; a dispute then arose on whether the actual delivery was delayed in respect of the extensions, and whether payment was due under the guarantees.

The claimant asked the arbitral tribunal to solve the dispute applying the trans-national law, in this case defined as lex mercatoria, and affirmed that in that case the lex mercatoria was to be deemed equal to the CISG.

The CISG is one of the international conventions that mostly enjoy recognition for having created a uniform regulation of the contract of sale in a variety of states. Like the UNIDROIT Principles, the CISG aspires at being interpreted in a way that is not affected by the rules and principles of the system within which it is being applied, because this would undermine its goal of representing a uniform regulation. Therefore, article 7 of the CISG provides for an autonomous interpretation of its provisions: “(1) In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.” However, when it comes to lacunas, the CISG makes reference to the national governing law more directly than the UNIDROIT Principles do: “(2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.”

As seen in the arbitral case mentioned above, the CISG is taken in such a high consideration, that it is sometimes invoked as a source of trans-national law, even if it is not applicable as a binding international convention in the particular dispute. The genesis of the CISG and the ideals that inspired it actually confirm that the ambition of the Convention is to provide a “universal” uniform treatment for the most important type of contract within international trade, thus eliminating the barriers to international business that might arise as a consequence of different national regulations. The actual success of the CISG slightly contradicts the universality of its ambitions, since the number of states that ratified it (62) is not overwhelming, compared to other conventions (the New York Convention on arbitration has been ratified by 133 states), and taking into consideration that a state of the paramount importance within international trade and international commercial law like England has not ratified it.

However, the CISG is certainly an important instrument, and, in addition to being sometimes invoked by the disputing parties as a source of trans-national law, it is also accepted by arbitral tribunals as such. As seen above, the autonomous interpretation of the convention is meant to give the tools for applying the convention as an independent system, finding on the basis of its underlying principles the solution to legal problems that might not be solved expressly by the articles of the convention. However, not always the convention or its underlying principles are sufficient to give specific solutions.

In the arbitral case mentioned above, the arbitral tribunal found first noticed that the applicability of the *lex mercatoria* is not undisputed. However, assuming
that in that case the *lex mercatoria* could be identified with the CISG, it would have been impossible to solve the dispute on that basis. The tribunal noticed that in that dispute it might be necessary to evaluate situations such as the unjust enrichment or limitation of rights, which are not regulated by the CISG. Therefore, the tribunal decided to apply choice-of-law rules for the purpose of identifying the national governing law, and resolved to apply Korean law to the dispute.
5. INTERNATIONAL CONTRACTS AND CHOICE-OF-LAW RULES

5.1 The Parties May Choose the Governing Law

In the previous chapters we have shown that international transactions ultimately are subject to a state law, even if the transaction is governed by some transnational sources. The next question that has to be answered is then: Which state’s law regulates an international transaction? There are rules that have the function of identifying the laws governing international relationships, so-called conflict rules, or choice-of-law rules. The area of law that regulates the choice of the governing law is called private international law (or conflicts law).

The governing law has to be identified by the conflict rules of the state where the court has its venue (lex fori). Each state has its own conflict rules. Some of the national choice-of-law rules are part of the state law because they are contained in international conventions that were ratified by that state, such as, for example, the European Communities Convention on the Law Applicable to Contractual Obligations of 1980, or the Hague Convention on the Law Applicable to International Sales of Goods. Some choice-of-law rules are contained in national legislation, such as the Swiss Private International Law Act of 1987, which is a systematic codification, or the Norwegian Act on the Law Applicable to Insurance Agreements of 1992, which is an act regulating choice of law in a specific sector. Other choice-of-law rules are customary or based on judicial precedents, such as most of the Norwegian private international law is. For the purpose of predictability of the governing law, it is highly desirable that the various national conflict rules are harmonised and interpreted, to the extent possible, in a uniform way.

5.1.1 Choice of the Governing Law is Determined by the Conflict Rule of Party Autonomy

The most important conflict rule for contracts is the rule of party autonomy. Party autonomy gives the parties the power to choose in their contract the law that will govern their relationship. In Norway this rule is expressly mentioned in the Act on the Law Applicable to International Sale of Goods of 1964, section 3, which is based on the above mentioned Hague Convention of 1955. This act refers only to the contract of sale; however, party autonomy is generally recognised as conflict rule in the area of contracts. Norwegian legal literature considers party autonomy applicable also to other contracts, based on an

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application of the mentioned act by analogy. The above mentioned Rome Convention, which constitutes the private international law of all states in the European Union, recognises the rule of party autonomy (article 3), and so do the Swiss Private International Law Act (section 116) and the Russian Civil Code (article 1210), just to name some important codifications of conflict rules.

The widespread recognition of party autonomy may enhance the impression that an international contract is a self-sufficient regulation of the underlying transaction, detached from the state laws of the states with which the transaction is connected. Not only may the parties may choose the law that will govern their contract; in many systems (such as all the above mentioned systems) they may choose a law that does not have any connection whatsoever with the transaction. The parties may therefore end up with an extremely liberal law that contains very little regulation beyond the regulation made by the parties in their contract. The parties may even choose not to subject their contract to any state law, and may make reference to trans-national sources of law instead, although within the limitations analysed in chapter 4 above.

Party autonomy is recognised as a conflict rule in the vast majority of states participating in international trade and business. However, this does not mean, as some voices enthusiastically maintain, that party autonomy is a universal principle of trans-national law, generally recognised and therefore not rooted in any specific state law.

Party autonomy is a conflict rule that is, undeniably, generally recognised; however, the conditions for the exercise of party autonomy may vary according to the rules contained in the private international law of each different state. It goes without doubt that a judge has to apply the law of the legal system to which he or she belongs. In disputes having an international character, the private international law of the judge’s system (of the lex fori) will instruct the judge to apply foreign law, if the conditions for that application, as set forth in the applicable conflict rules, are met. This means that the condition that have to be met in order to allow the choice of the law made by the party may vary from state to state. For example, some systems permit a choice of law even if the contract is not international, but domestic (for example, English law, assuming that the choice was made in good faith), some do not permit it at all, even if the

60 LUNDGAARD, H.P., Gaarders Innføring i Internasjonal Privatrett, Universitetsforlaget, Oslo 2000, p. 242.
62 A definition made by Lord Wright in the case Vita Food Products Inc. v. Unus Shipping Co.[1939] A.C. 277, P.C., is often quoted when describing the requisites of party autonomy.

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contract is international (for example, the in some Latin American states), others if there is a foreign element in the transaction (for example, the already mentioned Hague Convention of 1955). Moreover, some systems require that the choice of law be made expressly or appear clearly from the provisions of the contract (for example, the Norwegian Act on the Law Applicable to the International Sale of Goods, section 3), others consider it sufficient that the choice of law appears with reasonable certainty from the circumstances of the case (for example, the Rome Convention, article 3.1).

The parties do, as a matter of fact, enjoy a large freedom in choosing the governing law. However, this detachment from the connected state laws is not as limitless as it is sometimes perceived to be. The private international law of the lex fori might contain, in addition to conditions for the exercise of party autonomy as seen above, considerable limitations to the scope of party autonomy. In section 5.3 below we will look at the most significant limitations to the scope of party autonomy.

5.1.2 The Choice of the Trans-national Law

The parties may choose any foreign law, or a plurality of foreign laws to govern their transaction, if the applicable rule of party autonomy permits them to do so. Similarly, the parties may choose to subject their transaction to trans-national law, as long as this is within the limit of party autonomy recognised by the private international law of the forum. Choice of trans-national law as governing law may be made in many ways, for instance expressly choosing a certain source, such as the UNIDROIT Principles, the UCP 500 of the standard engineering contract of the FIDIC. Alternatively, the parties may make reference to no specific source, and simply may refer to generally recognised principles in international trade or some similar language indicating the intention of the parties to exclude application of a state law.

A choice of this kind would be effective, as long as its effects are within the sphere of the party autonomy. The parties may choose to regulate their relationship by expressly writing the regulation in the terms of the contract, by reference to non-authoritative codifications or by invoking general principles. However, as soon as the scope of party autonomy is restricted by other rules (as we will see in section 5.3 below), also the choice of a trans-national law will be affected accordingly.

According to this definition, the choice of a foreign law is valid “provided the intention expressed is bona fide and legal, and provided there is no reason for avoiding the choice on the ground of public policy.”

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5.2 **What if the Parties Have not Chosen the Governing Law?**

International contracts very often contain a clause on choice of law, as we have seen above. Sometimes, however, the parties do not exercise their party autonomy. There may be various reasons for the parties’ failure to choose the governing law: either the parties have not managed to reach an agreement on what law should be applicable to their contract (for example, because each party insists on the application of its own law), or because the contract is very simple and does not contain regulation of other matters than the mere commercial terms, or because the parties have forgotten or have not deemed it necessary or desirable to make a choice of law. In this situation, it is not apparent from the face of the contract what law is governing. However, we have seen in chapter 3 above that an international contract is always, ultimately, governed by a state law. How can the governing law be determined?

5.2.1 **First Step: Determination of the Forum**

As already mentioned, the governing law is determined by conflict rules; conflict rules may vary from state to state. Therefore, the first step that has to be made in the process of determining the governing law is to find out what conflict rules are applicable. The applicable conflict rules are those of the *lex fori*. Therefore, it will be necessary to determine what the *forum* is, or what the *forum* would be, in case of dispute.

The *forum* is the court of a state that accepts jurisdiction on the case. As a general rule (but with the significant exception of conventions on jurisdiction, as we will see below), the jurisdiction is regulated by the civil procedure law of each state. The rules on jurisdiction, therefore, may vary from state to state: some rules might be very expansive, thus permitting to exercise jurisdiction on a very slim basis (so called exorbitant *forum*),63 other rules are more restrictive, and permit to exercise jurisdiction only if there is a serious connection between

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63 For example, under the Norwegian Civil Procedure Act, section 32, Norwegian courts have jurisdiction on a defendant resident abroad if the defendant has some assets on the Norwegian territory. The definition of assets is very broad, and its requirements are met even if the assets of the defendant consist in a claim that the defendant has against the plaintiff, and even if the claim has already been satisfied (Rt. 1990 s. 899). Application of this exorbitant *forum* is excluded if the defendant resides in one state signatory to the Lugano Convention, see article 3.2 of the Lugano Convention.

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the dispute and the state where the legal suit is filed. As a general rule, a court will have jurisdiction if the defendant is resident in that state. However, there might be alternative fora, such as the place where the disputed obligation had to be performed. Also, there might be exclusive fora, such as the court of the place where a real estate is registered, if the dispute regards that estate.

Therefore, there might be more than one potential forum; this means that there might be more potential conflict rules. In this case it is advisable to verify the conflict rules of each of the potential fora, to see if they point at the same governing law or at different laws. In the latter case, it will be advisable to verify the content of all the substantive laws that are pointed at by the different conflict rules of the potential leges fori. One substantive law might be more favourable to a party, and that party might therefore want to file a suit in the state whose lex fori contains the conflict rule that points at that governing law. This is called forum shopping, and is a practice that might bring very favourable results to the party that exercises it, but has the detrimental general effect of creating uncertainty in the application of the law, because a party may run the risk of being sued in various different states, may be even without a real connection with the subject-matter. In order to prevent this detrimental result, and to facilitate the exercise of cross-border justice, bilateral treaties, regional conventions or international conventions are being drafted and ratified, for the purpose of clarifying what courts have jurisdiction and to exclude the jurisdiction of exorbitant fora. The most notable example of such convention is for Norway the already mentioned Lugano Convention of 1988, ratified by the member states of the European Community and the member states of the European Free Trade Area, as well as by Poland. The Lugano Convention is, as known, based on the Brussels convention of 1968, ratified by the member states of the European Community; the Brussels convention has now been transformed into a Council Regulation (44/2001), and is directly applicable in most of the states of the European Community (in Denmark the Council Regulation is not applicable, as a consequence of Denmark’s reservations in connection with the Amsterdam Treaty of 1997 on the Union, and the Brussels Convention is therefore still applicable there).

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64 For example, under the Norwegian Civil Procedure Act, section 25, Norwegian courts have jurisdiction on a defendant if the claim upon which the dispute is based has to be performed in Norway. The place of performance is a rather recognised forum, see for example the Lugano Convention, article 5.1.

65 See, for example, the Lugano Convention, article 2.

66 See, for example, the Lugano Convention, article 5.1.

67 See, for example, the Lugano Convention, article 16.

68 Denmark, as a consequence of the results of a referendum, does not participate in the acts of the European Community based on Title IV of the Treaty. The Brussels Regulation is based...

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To summarise very briefly the rules of the Lugano Convention in respect of the *forum* for disputes relating to international contracts, we will have to look at articles 2, 5.1 and 17 of the Convention. Article 2 is the general rule, and provides for jurisdiction of the courts in the state where the defendant is resident. Article 5.1 provides for an alternative *forum*, the courts of the state where the disputed obligation has been or should have been performed. Article 17 permits the parties to choose the *forum* (and choice of *forum* in the contract is certainly the most preferable alternative, to avoid uncertainties). As mentioned, the Lugano Convention is largely based on the Brussels Convention; however, the text of the Brussels Convention has been slightly changed when it has been transformed into a Council Regulation, and this has not been reflected in corresponding changes to the Lugano Convention. The most important difference between the two texts, in the context of international contracts, is a definition of what is deemed to be the place of performance of the obligation in question. The general rule remains the *forum* of the defendant, and the parties still have the possibility to choose the competent *forum*. Lacking a choice of the parties, the alternative *forum* for disputes based on contractual obligations is still the *forum* of the place of performance of the obligation in question (article 5.1(a) in the Regulation). However, while the Lugano Convention does not specify how to determine the place of performance, the Brussels Regulation defines in article 5.1(b) the place of performance as the place of delivery of goods (if the dispute is based on a sale contract), or the place where the services are to be rendered (if the dispute is based on a services contract). This definition is not exempt from interpretative problems. In article 5.1(c), the Regulation refers to the general rule of article 5.1(a), for the eventuality that the rule under 5.1(b) is not applicable (for example, in joint venture agreements there is no delivery of goods or rendering of services, and in licence or agency agreements having a territory that covers more than one state, it might be difficult to choose one particular state), or if the application of 5.1(b) would point at a state that is outside of the European Community.

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on article 65 of the Treaty, which is contained in Title IV, and therefore the Brussels Regulation does not apply to Denmark: see the preamble of the Regulation, item (21). Also Great Britain and Ireland do not participate in the acts based on Title IV of the Treaty, but they have the possibility to do so, if they so elect. In the case of the Brussels Regulation, Great Britain and Ireland opted in, and the Regulation is therefore applicable to them: see the preamble, item (20).

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5.2.2 Second step: Application of the Choice-of-law Rules of the Lex fori

Once identified the *lex fori*, it will be necessary to look at its private international law. The conflict rules contained therein will determine what state’s law governs the contract (and the dispute). In respect of contracts, we have seen above that the main conflict rule generally is party autonomy. Failing a choice by the parties, the judge will apply the conflict rule set forth in his or her private international law. In modern private international law legislations, the most common conflict rule is that of the closest connection. The rule according to which, failing a choice of law by the parties, the contract is to be governed by the law with which it has the closest connection can be found, for example, in Norway,\(^69\) in the Rome Convention,\(^70\) and in the Swiss Private International Law Act.\(^71\) This apparent harmony between the various legislation, however, is misleading: as we will briefly see below, not all systems construct the criterion of the closest connection in the same way.

5.2.3 Various Interpretations of the Rule on the Closest Connection

a) The Closest Connection under Norwegian Law

The criterion of the closest connection, well known in Scandinavian states, assumes that the judge assesses the various elements of the disputed matter, balances the involved interests against each other and resolves which elements of the specific case are so important that they are to determine the closest connection. In Norway, this criterion has been laid down by the Supreme Court in 1923 in a case regarding maritime law, the so-called Irma-Mignon case.\(^72\) The rule of the closest connection has since been also called “Irma-Mignon Rule”, or the “individualising method”, and has been applied irrespective of whether the dispute regarded contractual law, tort law or other areas. The name of the method is quite indicative of the rationale of this rule: the court is supposed to analyse the dispute in its individuality, examine all the circumstances and identify to what state, under the specific circumstances, the dispute more closely

\(^69\) This is not codified in Norwegian law, but legal doctrine and practice are unanimous in the application of the so-called individualising model, according to which a contract has to be regulated by the law of the state with which it has the closest connection. See GAARDER, op.cit., pp. 244f.

\(^70\) Article 4. Special rules are provided for some types of contracts involving interests that require exceptional protection, such as consumer and labour contracts.

\(^71\) Article 117.

\(^72\) Rt. 1923 II s. 59.

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belongs. This method gives wide discretion to the judge, and is therefore positively considered by the courts, which may reach a solution that they consider just in the specific case. However, the high degree of discretion has a negative side for the parties to the dispute, namely the lack of predictability. For this reason, the individualising method is strongly criticised by part of the Norwegian legal doctrine.\(^{73}\)

b) The Rome Convention Provides for Presumptions

The Report on the Rome Convention defines the concept of the closest connection as too vague,\(^{74}\) and considers it necessary to give it specific form and objectivity by laying down a series of presumptions. The presumption that is of greatest interest here is that contained in article 4.2: a contract is presumed to have the closest connection with the state in which the party who is to effect the most characteristic performance has his habitual residence or (if a legal entity) its central administration at the time of conclusion of the contract. If the contract was entered into in the course of that party’s business, the criterion of central administration is substituted with that of the principal place of business or with the place of business specified in the agreement.

The performance which is to be considered characteristic of a contract is the one that determines the social and economic function of that particular legal relationship. Characteristic performance is, for example, the delivery of goods in a sale agreement, the performance of services in a service agreement, the transfer of rights or technology in a licence agreement. The monetary obligation that compensates this performance, on the other hand, cannot be considered as being characteristic. If we assume a licence agreement between an Italian licensor and a Norwegian licensee, therefore, the characteristic performance would be that of the Italian licensor, the place of business of the licensor would be in Italy, and the licence agreement would be governed by Italian law.


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Further presumptions are set forth by article 4, in subsections (3) and (4), for contracts regarding immovable property and those for the carriage of goods respectively; however, we will limit our observations to the presumption of the habitual residence contained in article 4.2.

c) The Rome Convention Provides for Exceptions to the Presumptions

Article 4.5 permits to rebut the presumption of article 4.2 in two situations: if the characteristic performance of a contract cannot be determined, or if all the circumstances of the case show that the contract has a closer connection with another state than that where the party effecting the characteristic performance resides. In case the presumption of article 4.2 cannot be applied, the criterion of the closest connection must be applied.

d) The Relationship between the Presumption and the Exception

There are two conflicting interpretations of the relationship between article 4.2 and article 4.5 of the Rome Convention:

(i) Loose interpretation: article 4.2 as a weak presumption

The presumption may be interpreted, loosely, as a pure indication of one of the elements that could be relevant to find the closest connection. According to this interpretation, the major role would be played by the exception of article 4.5, which refers to the circumstances of the case as the basis for determining the closest connection.

This loose interpretation seems to have been applied, for example, by the Danish Supreme Court in 1996 in the context of a construction agreement. In a dispute between a Danish sub-contractor and a German constructor, the Danish Supreme Court applied Danish law, reaching the same result determined by the presumption of article 4.2. However, the result was based not on the presumption but on the evaluation of all the circumstances of the case, which all showed a connection with Denmark (the language of the agreement, the place of conclusion of the agreement, the currency in which the price was invoiced, etc.). The Danish Supreme Court, in summary, seems to have applied the principle of the closest connection rather than the presumption of the habitual residence of the characteristic performer.75

75 UfR 1996, 937; for more extensive comments see LOOKOFSKY, J., *International privatret på formueretts område*, Jurist- og Økonomforbundets Forlag, Copenhagen 1997, 85

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(ii) Strict interpretation: article 4.2 as a strong presumption

The presumption of article 4.2, however, is also interpreted, more strictly, as the criterion that is to be applied by the judge as a general rule. Accordingly, the exception provided by article 4.5 should be interpreted, restrictively, as an escape to be applied only if the criterion set forth in the presumption has no real connecting value in the specific case. This strict interpretation was made, for example, by the Dutch Supreme Court. In a dispute concerning the sale of a paper press by a Dutch company to a French company, the Dutch Supreme Court applied the presumption of article 4.2 and decided that the governing law was that of the habitual residence of the seller (Dutch law). Dutch law was considered applicable despite the fact that French law had a closer connection with the contract: the negotiations had been carried out in France in the French language through a French agent, the agreement was written in French, and the press was to be delivered and installed in France.76

It is obvious that the coexistence of these differing interpretations of the role of article 4.2 results in considerable uncertainty as to the application of the criterion of the closest connection. This undermines the very purpose of the Rome Convention.

To ensure a uniform interpretation, the Rome Convention is accompanied by two protocols establishing an interpretation mechanism by the Court of Justice meant to give an authoritative interpretation of the Convention and a uniform application thereof in all states.77 Unfortunately, none of these protocols has entered into force yet; until the Court of Justice is given the authority to rule on the Rome Convention, therefore, the application of the criterion of performance as a basis for the choice of law will not be uniform. Even if the courts of the

76 Société Nouvelle des Papeteries de L’Aa Sa v. BV Machinefabriek BOA, IPRax 1994, 243. The Dutch Court operated an anticipatory application of the Rome convention, which had not yet come into force. See, for extensive comments and further references, LENNEP, W.H. van, ”Anticipatory application of a multilateral treaty with uniform conflict rules”, Netherlands International law Review, XLII, 1995, pp. 259ff. In the same sense has decided also the German Supreme Court (Bundesgerichtshof), see the decision made on 25.2.1999, Neue Juristische Wochenschrift, 1999, pp. 2442 f.

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various contracting states make an effort, as they should, to interpret the Convention in a uniform way, the contradiction between these two interpretations of article 4 persists.

If the Rome Convention is to achieve its purpose of enhancing the predictability of the law, my opinion is that the presumption of article 4.2 shall be interpreted as a strong presumption. What matters mostly is that the parties are in a position to find out which law governs their contract; that the governing law has a close, a closer or the closest connection with the agreement seems to be less important. In so far as it is of particular importance to ensure the applicability of a certain law, for example because it contains provisions protecting the weaker contractual party, special conflict rules permit the application of the appropriate connecting factors or the direct application of the relevant rules. In the other contractual situations, however, where there are no important policies to be taken into account, it may be the same for the parties whether the governing law is that of the seller or that of the buyer. What is crucial, is that the parties know which of these laws governs, so that they can assess their own rights and obligations. That a court might prefer application of its own rather than of a foreign law, cannot be deemed a valid or relevant argument, since it contradicts the very essence of private international law. This approach seems to be in line with the intention of the Rome Convention, as it appears from the Report on the Convention.

A loose interpretation of the presumption of article 4.2, therefore, does not seem to be appropriate: it might serve the purpose of determining a law that has a closer connection than the law of the performer’s residence, but it does not serve the even more important purpose of ensuring the predictability of the law, since it leaves too ample room for the judge’s discretion.

e) Brief Comparison

To exemplify how the rule of the closest connection works, we can assume that the above mentioned Italian/Norwegian licence agreement provides that payment of the royalties owed by the Norwegian licensee to the Italian licensor are to be effected in Switzerland (which, because of more or less openly admitted tax reasons, is absolutely not unusual). Which law governs the contract, if the parties have not chosen the governing law?

The first step is to find which courts have jurisdiction to decide a dispute based on this contract. According to the Lugano Convention, if the plaintiff is the Norwegian licensee, acting on the licensor’s failure, for example, to provide the required training and know-how, the competent court is an Italian court: Italy is
both the state of the defendant’s domicile (which is relevant to the general rule of article 2) and it is the state where the obligation in question was to be performed (which is relevant to the special rule of article 5.1).

If the plaintiff is the Italian licensor, the competent court could be either in Norway or in Switzerland: in Norway, as the state of the defendant, or in Switzerland, as the state where the monetary obligation in question was to be performed.

According to who brings the suit, therefore, the courts of Italy, Norway or Switzerland may be competent. Which law does the court have to apply in resolving the dispute based on this licence agreement?

According to the Rome Convention, and if article 4.2 is interpreted as containing a strong presumption, the law of Italy has to be applied, Italy being the state of residence of the licensor, who is the party effecting the characteristic performance. Irrespective of where the competent court is, therefore, the applicable law will be Italian law if the Rome Convention is applied, and if the presumption of article 4.2 is interpreted in a strict way.

The same result will be achieved if the competent court is Swiss, even if Switzerland has not ratified the Rome Convention, because the Swiss Private International Law Act in this context substantially corresponds to the Rome Convention.78

It is more uncertain what the result would be if the competent court was the Norwegian one. The principle of the closest connection is well known in Norway, as the “individualising method”; however, as we have seen above, the closest connection is found by evaluating all the circumstances of the case and balancing all the involved interests according to the discretion of the judge, and there is no certainty that a Norwegian judge will find the residence of the party effecting the characteristic performance more important than the place where the negotiations were carried out or the language of the agreement, just to name some examples.

The same uncertainty would affect the application of the Rome Convention, if the presumption of article 4.2 is interpreted as a weak presumption.

In the interest of harmonising the conflict rules, it is my opinion that a Norwegian judge should give considerable importance to the presumption

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78 See article 117.

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contained in article 4.2, and interpret it as a strong presumption, even though the Rome Convention is not binding on Norway. Another argument in favour of applying the criterion of the characteristic performer’s residence, rather than freely evaluating all circumstances of the case, is also that the criterion of the characteristic performer’s residence is already known in the Norwegian system (section 4 of the 1964 Act relating to the international sale of movable property), and could be applied by analogy.

5.3 *Are All Rules of Any Other Connected Laws Excluded, Once the Governing Law is Chosen?*

Often the parties to a contract do not ascertain the regulation prevailing in the states connected with their transaction, because they rely on the fact that their contract will be regulated by the law of a third state. By choosing a foreign governing law, the parties may believe that any regulation of the connected states has become irrelevant.

This is true to a great extent: by submitting the contract to a third law, the parties have moved their transaction out of the sphere of the laws of the connected states, and into the sphere of the chosen law. However, this does not happen without any limitation, as we will see below.

5.3.1 *Exclusive Conflict Rules*

a) *Introduction*

Each system of private international law may contain other conflict rules in addition to party autonomy or the rule on the closest connection (or any other rule that that private international law provides for the eventuality that the parties have not chosen the governing law). These other conflict rules are to be applied exclusively in certain areas, preventing thus the applicability of party autonomy (or of the rule on the closest connection).

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80 That the 1964 Act can be extended, by analogy, to other contractual obligations, thus representing the main source of conflict rules within that area, is not disputed in Norwegian literature or judicial practice. See GAARDER, op.cit., pp. 242f.
In the following fields, for example, party autonomy is traditionally not allowed, and the applicable law will be the law designated by the conflict rules of the *lex fori*, even if the parties might have expressly chosen another law to govern their relationship: legal capacity of the parties, transactions relating to real estate, security by pledge, incorporation and regulation of legal entities.

**b) Company Law**

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81 See, for Norwegian law, THUE, H.J., *Internasjonal Privatrett. Personrett, familierett og arverett*, Gyldendal Akademisk, 2002, pp. 269ff.: the main rule is that the legal capacity of a person is governed by the law of the state where the person has his or her habitual residence. The same rule can be found in article 25 of the Swiss Private International Law Act. In other states, such as in Italy (Private International Law Act, article 20) and Germany (Introduction to the Civil Code Act - EGBGB, article 7), the principle of nationality prevails (*i.e.*, the legal capacity is regulated by the law of the state of which the person has the nationality). In states of common law, the legal capacity is generally considered a question of contract, and is therefore governed by the law that governs the contract (without taking into consideration any choice of law made by the parties): see MORRIS, J.H.C., *The Conflict of Laws*, Sweet & Maxwell, London 2000, pp. 342ff. The Rome Convention has excluded legal capacity from its scope of application, which means that each state has its own conflict rules to determine the law governing the legal capacity of the parties. See, however, article 11 of the Rome Convention, according to which, in the event of a contract entered into by persons in the same state, the foreign party cannot invoke the foreign applicable law on legal capacity to assert his or her own legal incapacity, if that person had legal capacity under the law of the state where the contract was entered into (unless the other party was aware of the incapacity of the other party).

82 The law governing the rights *in rem* to real estate is generally the so called *lex rei sitae*, *i.e.* the law of the state where the real estate is located. See, for Norwegian law, GAARDER, op.cit., p.283. See also, for example, article 51 of the Italian Private International Law Act, article 99 of the Swiss Private International Law Act and article 43 I of the German EGBGB. For English law, see MORRIS, *Conflict of Laws*, op.cit., pp. 391 ff.

83 The law governing securities such as the pledge and mortgage is generally the so called *lex rei sitae*, *i.e.* the law of the state where the object representing security is located. See, for Norwegian law, KONOW, B., *Løsorepant over landegrenser*, Bergen, 1999.

84 There is no generally acknowledged rule on what law governs the establishment and organisation of legal entities. Broadly speaking, there are two different conflict rules: the conflict rules that designate the law of the state where the legally entity is incorporated or registered (such as the Italian Private International Law Act, article 25, the Swiss Private International Law Act, article 154, and English law, see MORRIS, *Conflict of Laws*, op.cit., pp. 43ff.), and the conflict rules that designate the law of the state where the legal entity has its central administration (such as Germany, see SIEHR, K., *Internationales Privatrecht*, C.F. Müller Verlag, Heidelberg 2001, pp. 308ff.). For Norwegian law, see footnote 85. The Brussels Regulation has adopted a compromise solution for the purpose of determining where a legal entity is deemed to have a domicile, and makes reference to the state or states where the entity has its statutory seat, its central administration or its principal place of business.

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We can assume that two parties have incorporated a company in Norway and have chosen Russian law to regulate the shareholders agreement as well as all other documentation relating to the incorporation of the company. Matters relating to the incorporation of the Norwegian company, as well as its formal organisation, will nevertheless be subject to Norwegian law. The parties, therefore, will not be able to rely on Russian rules regarding the increase of capital, that in some circumstances permit the capital increase to be resolved without the involvement of the General Assembly. A company registered in Norway is subject to Norwegian rules on capital increase; the choice of Russian law is not effective in respect of the company regulation. There is an exclusive conflict rule in respect of company law, which points at the law of the state where the company is registered or has its place of business.\(^{85}\) The choice of law made by the parties, therefore, does not have legal effect in respect of all matters subject to company law. However, other parts of the shareholders agreement may be subject to the law chosen by the parties (for example, the liability in case of breach of a condition of the contract).

### 5.3.2 Overriding Mandatory Rules

In addition to being limited by exclusive conflict rules, the scope of party autonomy is being restricted by the increased regulatory activity of states in areas where the policy interests at stake are deemed to be more important than the interests inspiring the party autonomy.

These overriding mandatory rules will be applied if the parties have chosen a different governing law, or if they have chosen not to apply any state law. As we have seen under section 5.2.4 above, one of the major sources of trans-national law, the UNIDROIT Principles, expressly confirms, in article 1.4, that mandatory rules of law prevail, in case of conflict with the Principles; even more, this will apply to overriding mandatory rules.

\(^{85}\) The Registration in the Registry of Enterprises Act is applicable to all legal entities that have their central administration on the Norwegian territory; the Limited Partnership Act provides for a similar conflict rule, whereas the Private Company Act and the Public Company Act do not specify any conflict rules. The conflict rule of the central administration will probably apply also to private and public companies having their central administration in Norway, but it is questionable whether it is applicable also to designate foreign laws. GAARDER, op.cit., p. 186, seems to prefer the rule of the state of incorporation, and so does WOXHOLT, G., “Lovvalgsreglene i selskapsforhold, herunder legitimasjon og personlig erstatningsansvar overfor tredjemann”, *Lov og Rett*, 1993, pp. 579ff., 587 ff. ANDENÆS, M.H., *Aksjeselskaper & Almennaksjeselskaper*, Oslo 1998, p. 59, mentions the law of the seat.
a) Not all Mandatory Rules Are Overriding

Overriding mandatory rules, that are rules of substantive law and not of private international law, override the choice of law that is made in accordance with applicable conflict rules, and become directly applicable on the basis of their function and the interests that they represent. It must be emphasised here that not all the rules that are mandatory are also overriding.

This follows from a systematic interpretation of private international law, and also from the wording of, for example, article 7 of the Rome Convention, which regulates these rules. In article 7 of the Rome Convention, which regulates the overriding rules, the adopted terminology is: rules that must be applied “irrespective of the otherwise applicable law”. This is an important qualification to the general definition of “mandatory rules”. As a comparison, we can look at article 3.3 of the Rome Convention: this article regulates the eventuality that the parties to a domestic (not international) contract have chosen a foreign governing law. The Rome Convention allows in this case only a restricted choice of law. This choice of law shall not affect the applicability of the mandatory rules of the law of the state with which all the elements of the contract are connected. These rules are defined in article 3.3 as “mandatory rules”, and described as the rules “that cannot be derogated from by contract”. There is in article 3.3 no qualification of these mandatory rules, stating that it should be the kind of mandatory rules that must be applied whatever the governing law, as can be found in article 7. In other words, the Rome Convention operates with two different concepts of “mandatory rules”: the “ordinary” mandatory rules, that cannot be derogated from by contract if they belong to the governing law, and the “overriding” mandatory rules, that may be given effect to even if they do not belong to the governing law. That these two concepts are different is confirmed also by the other language versions of the convention: in the French version, for example, the mandatory rules of article 3.3 are called “dispositions imperatives” and those of article 7 are called “lois de police”, whereas in the German version they are called, respectively, “zungende Bestimmungen” and “zungende Vorschriften”.

There are rules that cannot be derogated from by the parties, if they belong to the governing law (for example, the rules on limitation of rights under Civil Law systems, or the doctrine of consideration under English law). Not all of these rules remain applicable, if the governing law is a foreign law. As a general rule, none of the mandatory rules of a law are applicable to a transaction, if the

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86 See, for example the Norwegian Act on Prescription, section 28.
87 See above, section 3.1.2

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governing law is a foreign law, even if that is a third law with no contact with the transaction. It should be regarded as an exception, and a rather unwelcome one due to the uncertainties that it creates, that some rules are deemed to maintain their applicability even if the governing law if foreign.

b) What Mandatory Rules are Overriding?

How can it be determined whether a mandatory rule also has an overriding character? Where the answer is not given expressly in the law, it will be a matter of the interpreter’s discretion. The decision will have to be based on the function of the rule, the policy that underlies the regulation, as well as on the balancing of the various interests that are involved in the specific case.

What the interpreter should have in mind is that, by disregarding the choice of law that follows the applicable conflict rules, a significant uncertainty is created in the predictability of the law. It is extremely unsatisfactory for the parties to have to wait for the judge to exercise his or her discretion, before they know if the chosen law will be applied in full or will be overridden by some other law’s rules. The parties would not be in a position to evaluate their legal position before they file a suit; knowing whether the chosen law will be applied or not can mean knowing whether the dispute will be won or not, as we will see in the example below.

c) The Importance of Predictability of the Applicable Law

We can assume the case of a contract between an Italian and a Norwegian party, for example, where the parties have chosen Italian law as the governing law. One party has a series of claims against the other one, whereby some are 2 years old, some 5 and some 8. The claimant will look at the rules on limitations of rights contained in the Italian governing law, and will ascertain that all its claims are enforceable, the term for limitation of rights being 10 years. However, the legal situation of the claimant would change completely if the Norwegian rule on limitation of rights were to be applied in a Norwegian court in spite of the governing Italian law, because the judge considers the Norwegian rules on limitation of rights to be not only mandatory in a domestic context, but also overriding in an international context. Some of the claims might be already time barred, because the term for limitation is three years under Norwegian law. How can the claimant evaluate its situation? If some of the claims are time barred, an out-of-court settlement would be economically more satisfactory than a lawsuit. If, on the contrary, the claims are all enforceable, a lawsuit would be the best

88 Codice Civile, article 2946.
solution. If the claimant does not know whether the judge will consider the rule on limitation of rights as overriding, an efficient solution is impossible to reach. This example is meant to show the detrimental effects of interpreting too extensively the scope of what is overriding. Rules on limitations have the purpose of enhancing the certainty of the law by preventing that accrued situations are disrupted by enforcing old claims that had not been acted upon for a long time. The underlying policy is certainly important and, in our example, it is implemented both in Italy and in Norway. However, how important is the specific rule that implements that policy? The specific term of prescription should not be considered as overriding; as long as the principle of limitation of rights is present in both legal systems, the underlying policy is protected. Any protection beyond this, tending at imposing also the application of the specific term, would have disproportional effects. The autonomy of the parties would be emptied of any significance, since the effect of a choice of law would not be considered to extent to mandatory rules. The choice of law, in other words, would not create any certainty as to what law is governing.

Predictability of the applicable law is of the essence to evaluate the legal position of the parties. The interpreter should then evaluate whether the policies underlying some mandatory rules weigh more than the certainty in the law that we have just explained. If the interests that are protected by the policies underlying the mandatory rules are not more important than the parties’ interest in predictability, then the mandatory rules should not be deemed overriding. If the interests underlying the mandatory rules are more important than the interest in predictability, but are sufficiently protected under the governing law, also then the rules should not be deemed overriding. It is only when these interests do not receive a satisfactory protection under the governing law, that an interpreter should consider the relevant rules as overriding.

d) Attempt to Non-exhaustive List of Overriding Mandatory Rules

It is not always easy to determine whether a mandatory rule is overriding or not, and rules that are deemed overriding in one state might not be in another state, as we soon will see. Also, as mentioned above, the overriding character of a rule should be evaluated in light of the protection that the same interest enjoys under the governing law.

One of the interests that increasingly is being considered as particularly important, is the protection of the weaker contractual party. Overriding
mandatory rules may be found in fields such as labour law, consumer law, insurance, carriage or agency.

Overriding mandatory rules (also known as “lois de police”) may be found also in respect of other interests, such as the protection of the national economy (for example, import-export regulations, foreign exchange regulations, securities exchange regulations, competition regulation, etc.), or public interest (for example, embargo).

e) The Rule on Compensation upon Termination of a Contractual Agency

We can assume that a French principal and a Norwegian agent enter into an agency agreement, whereby the promotion of the principal’s products will be carried out on the territory of Norway. We assume here that the agent has its central administration in the same state where the agency is carried out (which is the most common situation, since an agent is supposed to have closeness to the market in which it operates).

This would be sufficient to determine, as the governing law, the law of the place where the agent has its central administration, i.e. Norway, unless the parties have made another choice. The state where the agent has its central administration is presumed to be the state with the closest connection under the Rome Convention, as we saw in section 5.2 above. Also under the Norwegian rule on the closest connection the result should be the same. The first reason for coming to this conclusion is that it is in the interest of the certainty of the law that conflict rules are interpreted in the same way across the borders. The second

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89 See, for Norwegian law, the Protection of Employees and Working Environment Act, section 5. The Rome Convention provides in article 6 for an exclusive conflict rule in the event that the law chosen by the parties gives the employee a worse protection than the law that would otherwise have been applicable.

90 See, for Norwegian law, for example, the Financial Agreements Act, section 2.3. The Rome Convention provides in article 5 for an exclusive conflict rule in the event that the law chosen by the parties gives the consumer a worse protection than the law that would otherwise have been applicable.

91 See, for Norwegian law, the Act on the Law Applicable to Insurance Agreements, section 5. The European Community has issued several directives to harmonise this field, see specially directive 88/357 and 90/619. On this matter see, extensively, BULL, H., _Det indre marked for tjenester og kapital_, op.cit.

92 See, for Norwegian law, the Maritime Code, section 430 and section 252 combined with section 310. This area is regulated by a series of international instruments, such as the so-called Hague Rules of 1924, the Hague-Visby Rules of 1968 and the Hamburg Rules of 1978.

93 See item (e) in this section.

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reason is that in this factual situation there does not seem to be a state with a closer connection.

Contrary to mandatory Norwegian law, the parties have agreed in their contract that no compensation shall be due to the agent upon termination of the contract. The parties have chosen the law of New York to govern their contract; the law of New York does not provide any mandatory protection of the agent in the case of termination. Therefore, the contract is valid under the chosen New York law, but invalid (in the part excluding compensation upon termination) under Norwegian law.

If a dispute between the parties were submitted to a Norwegian court, the Norwegian judge would apply the Norwegian rule on protection of the agent, which is considered overriding in Norway (Agency Act, section 3). Therefore, the Norwegian judge would disregard the contractual terms and the choice of law made by the parties, to the extent it is necessary to apply his or her overriding mandatory rule. This is evident in the case presented here, because the Agency Act expressly regulates this situation. However, Norwegian judicial practice has long affirmed that overriding interests of Norwegian law have to be applied even in international relationships, notwithstanding different governing laws, and this irrespective from a codification of their overriding nature.94

If the dispute were submitted to a French court, the situation would be different. The Rome Convention, which constitutes the private international law of France, contains a provision in article 7.1, that permits the judge to apply overriding mandatory rules of third states, if there is a sufficiently close connection with the dispute (see below, section 5.3.3). This would mean that the French judge might decide to disregard the chosen New York law, to the extent it is necessary to give effect to the Norwegian overriding mandatory rule protecting the agent. However, it is doubtful, whether the French judge would do that. Also French law contains mandatory rules on compensation to the agent similar to the Norwegian rules; however, the French Supreme Court (Cour de Cassation) does not consider these rules to be overriding.95 It means that the French legal system does not attach too much importance to that particular protection of the agent, when the agency is international and the parties have chosen a foreign governing law. It seems, therefore, unlikely that a French judge would replace his or her own system’s evaluation of the importance of these rules with the Norwegian

94 See, the recent Supreme Court decision published in Rt. 2002 s. 199, which reaffirms this principle, and makes reference to judicial practice on the same: Rt. 1953 s. 1132, (with the reference made by the Supreme Court starting on page 1139), Rt. 1931 s. 1185, Rt. 1934 s. 152.
95 Cass. Com. 28 November 2000, JDi, 2001, 511
system’s evaluation, and find it appropriate to apply article 7.1 of the Rome Convention.

We can now assume the opposite scenario, whereby the agency is to be carried out by an agent with central administration in France and a Norwegian principal, the parties have excluded compensation upon termination and have chosen New York Law to govern. If the dispute is submitted to a Norwegian court, the Norwegian judge should first verify whether the Norwegian overriding mandatory rule would be applicable if the parties had not chosen a foreign governing law. As we have seen above, the governing law in the absence of a choice by the parties is the law with the closest connection to the dispute, in this case French law. Therefore, the Norwegian overriding rule would not be applicable. The question is now, whether Norwegian private international law contains a rule similar to article 7.1 of the Rome Convention that we saw above, whereby it can disregard the law chosen by the parties for giving effect to the overriding rule of another state. The Norwegian system, however, does not contain such a rule, as we will see below, under section 5.3.3. Therefore, in this scenario the choice of law made by the parties would have to be upheld in full, and the contract would have to be enforced according to its terms.

If the dispute were brought before the courts of France, the result would be the same. We have seen above that the French Supreme Court considers the rules protecting the agent as mandatory, but not as overriding. Therefore, the French judge would uphold the choice of law and the contractual regulation. If, however, the rule at stake had been considered as overriding by the French judge, he or she would have had the possibility to apply it directly, under article 7.2 of the Rome Convention.

This example shows how difficult it is to determine which rules have an overriding character. The rules on compensation to the agent upon termination are mandatory both in France and in Norway, but one state considers them not as overriding rules, while the other one does.

5.3.3 Overriding Mandatory Rules of Third States

Application of the law chosen by the parties may be limited also by overriding mandatory rules belonging to laws different from the lex fori. A judge will normally apply the overriding mandatory rules of the lex fori, as we have seen in the previous section. Some systems of private international law recognise the possibility to give effect to overriding mandatory rules of third states, if there is a sufficiently close connection between the dispute and the third state. The
already mentioned article 7.1 of the Rome Convention is an example, as well as article 19 of the Swiss Private International Law Act.

We have seen in the previous section how this possibility would operate in the example of the French-Norwegian agency contract.

In addition to the discretion connected with the uncertainty of determining whether the rule has an overriding character, these rules grant a further degree of discretion to the interpreter. First of all, the interpreter will have to ascertain the overriding character of a rule that does not belong to his or her system, thus encountering significant difficulties due to the lack of familiarity with (or at least the difficulty to access to) the foreign law’s underlying policies and principles. Moreover, the interpreter will have to determine whether the connection with the third state is sufficient for, and the circumstances of the case justify, the application of those rules.

These aspects have rendered the rule of article 7.1 quite controversial, and even the Rome Convention itself permits its signatories, in article 22.1(a), to reserve against the application of this rule. Among others, England and Germany have reserved against the application of article 7.1 of the Rome Convention.

The principle underlying article 7.1 appears in other European instruments, i.a. some directives96 on the law applicable to insurance contracts. These directives have been implemented in Norwegian law, as a consequence of the Agreement on the European Economic Area to which Norway is a signatory. The Norwegian Act on the Law Applicable to Insurance Contracts, however, has not implemented the rule that gives the judge the possibility to give effect to overriding mandatory rules of third state laws.97

5.3.4 Impossibility of the Performance Due to a Foreign Law

As we have seen so far, the choice of the governing law made by the parties does not exclude the application of rules belonging to other laws. In addition, there are situations were the rules of a law that is not governing the contract are not applied, but create legal effects that have to be taken into consideration under the governing law. In these cases, the effects of the foreign rules will be considered as facts, that are given the legal effects that the governing law gives to similar facts. The foreign rules will not be applied, but the factual

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96 88/357 and 90/619.
97 The rule was contained in the bill, but was strongly criticised and was therefore not inserted in the final text: see Ot prp nr. 72 (1991-92), p. 66.
consequences that the foreign rules have created in the foreign state will be taken into consideration when applying the chosen law.

We can assume, for example, that a Norwegian and a Russian company enter into a contract for the purchase by the Norwegian buyer of certain raw materials produced by the Russian seller. The parties agree to have their contract governed by Norwegian law. The export of those raw materials is subject to licensing by the competent Russian authorities; due to reasons outside the control of the seller, the competent authorities do not issue a licence for the export of the sold goods. The goods, therefore, are ready to be delivered, but cannot physically leave the state, because the customs authorities will not allow them to pass the Russian border without the export licence.

The Russian seller invokes the Russian export rules to excuse its own non-performance; the Norwegian buyer does not accept the failure to obtain the export licence as an excuse for non-delivery. The buyer argues that the rules on export licence are rules of Russian law, and the parties have chosen Norwegian law to govern the contract.

The buyer’s allegation that Russian law should not be applied is correct; however, this does not mean that a Norwegian judge can completely disregard the existence of the Russian export rule, or, better, the consequences of its existence. The goods have been stopped at the customs, and cannot be exported: this is a factual situation, which happens to derive from the existence of a licensing system in Russia, and prevents the export. Should this impossibility to export be considered differently by the Norwegian judge, from impossibility deriving from a flood, fire or other natural event beyond the control of the seller?

The judge will ascertain a supervened impossibility of performing the agreement, and will evaluate, on the basis of the contract’s terms and conditions and of the applicable law (Norwegian law, chosen by the parties), what legal consequences are to be attached to this.

Whether the seller will be excused on the basis of a force majeure clause or considered to be in breach of contract for not having complied with all the conditions required to perform its obligations, depends on the examination of the factual circumstances and on the allocation of risk provided for in the contract. Failing a contractual regulation of this eventuality, the judge will decide by applying the force majeure rule contained in the governing law (Norwegian law): the exporter will be excused, if the circumstances that brought to the

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refusal to issue the export licence qualify as force majeure circumstances under the governing law.

In conclusion, the Russian export rules are not applied, but their application made by Russian authorities can be considered as facts and be given legal effects under Norwegian law. Accordingly, the buyer’s allegation that Russian export rules are inapplicable is correct, but does not mean that Russian export rules should not be taken into consideration.

### 5.3.5 Illegality of the Performance under a Foreign Law

What happens if the contract, valid under the chosen law, violates mandatory rules of other laws, and this violation does not result in a physical impossibility to perform the contract as examined above?

We can assume the case of a Norwegian seller and a Russian buyer, who enter into an agreement for the sale of certain goods. Import of these products is subject to payment of import duties under Russian law. The parties agree to circumvent Russian customs regulations, by dividing the invoicing of the price into two parts. One invoice, expressing only part of the value of the goods, would accompany the goods for customs clearance; the balance of the price would be invoiced separately, and paid for not by the Russian importer, but by an off-shore company affiliated to the importer. In this way, the Russian importer obtains (illegally) to pay lower import duties, since the import duty is a percentage of the invoiced price. The Norwegian manufacturer would properly account both invoices in its books, and feels therefore that it has not violated any Norwegian law. Violation of Russian law would not be relevant, since the contract contains a governing law clause choosing Norwegian law. The seller feels safe in its opinion not to have violated any governing law. Is the seller’s opinion justified? Does violation of (or assistance in violating) foreign law really have no consequences under the chosen law?

The opinion of the seller is not, at least not always, justified: different states have different approaches to the question of violation of foreign law, but often it is possible to find in the governing law a rule on illegality, sanctioning behaviours that conflict with foreign laws. Therefore, as in the previous section in respect of impossibility to perform a contract due to a foreign law, also in the case of illegality of a contract according to a foreign law it may be possible to apply the chosen law and yet take into consideration the foreign law.
In the particular case mentioned above, for example, the seller would have contributed to a violation of Russian customs rules; the Norwegian judge would not be in a position to apply Russian customs rules that are outside of his or her jurisdiction, and are not part of the governing law. However, Norwegian Customs Act contains a rule (section 64), that considers violation of foreign customs rules as a violation of Norwegian customs rules. Therefore, the behaviour, illegal under the foreign law, has consequences also under the governing law.

A Norwegian Supreme Court decision has applied this principle in a broader area.\textsuperscript{98} The Court affirmed that, if a party agrees with another party to violate (in the particular case) foreign tax laws, it is criminally punishable under the Norwegian rule on receiving proceeds from a crime (Criminal Act, section 317). In this case, the Norwegian party had agreed to enter into certain simulated transactions, so that the Russian party could evade Russian tax law. The reasoning was as follows: if the evaded tax law had been Norwegian, the parties would have violated Norwegian tax law and would have been liable under the relevant legislation. However, the evaded tax law is foreign, and a Norwegian judge cannot apply foreign tax law. The Norwegian party had a gain in entering into the arrangement with the other party, and this gain must be considered the result of an illegal action. Obtaining gain from illegal actions is a crime under Norwegian law, and the fact that the illegality is under a foreign law is not relevant, as long as corresponding actions carried out on the territory of Norway would be illegal under Norwegian law (requirement of double illegality).

In other legal systems, a choice of governing law leading to the violation of another law might result in a conflict with the governing law’s or the \textit{lex fori}’s own sense of justice; therefore, the choice of law may be considered invalid. The German BGB, for example, contains a rule on Sittenwidrigkeit that can be applied in similar circumstances (§ 138).

Other systems might adopt concepts such as that of comity of nations, whereby recognition of a fraudulent choice of law would result in a hostile act towards the state issuing the violated laws. Some English decisions have this approach, particularly when recognition of the contract would lead to carrying out illegal action in the foreign state.\textsuperscript{99}

\textsuperscript{98} Rt. 1997 s. 1637.
English law has traditionally requested that a choice of law be made in good faith;\textsuperscript{100} a choice of law made for the purpose of evading foreign law may be considered not to be in good faith, and therefore invalid. However, it might be difficult to ascertain whether the choice of law was made in bad faith to evade the otherwise governing law, or whether there were other reasons to make the choice. In both examples mentioned above, for example, choice of Norwegian law to govern the contract is a perfectly natural choice, Norway being the state of the seller.

Finally, there is always the last resort of the \textit{ordre public} clause: a judge will not accept a choice-of-law clause, if the effects of that choice conflict with fundamental principles in the judge’s legal system. The application and interpretation of the \textit{ordre public} clause should be restrictive and narrow, as we will briefly see in the next section, but can certainly be justified in case of contracts violating fundamental policies of another state, particularly when these policies are common to the \textit{lex fori}. Contracts violating foreign laws in respect of smuggling, corruption and entry into a contract under duress, for example, have been considered to violate the \textit{lex fori’s ordre public};\textsuperscript{101} contracts violating foreign exchange regulations on the contrary, have not.\textsuperscript{102}

In conclusion, choice of a governing law different from the law that is being violated may not always permit the parties to escape the consequences of their violation.

\textbf{5.3.6 Violation of the \textit{Ordre public} of the \textit{Lex fori}}

A general principle of private international law is that a judge will not apply a foreign law if application thereof will result in an intolerable violation of the basic principles on which the \textit{lex fori’s} system is based (\textit{ordre public}, or public policy).

In Norwegian law, this is expressly set forth in the Act on the Law Applicable to the International Sale of Goods,\textsuperscript{103} and is recognised as an underlying principle

\textsuperscript{100} The requirement that the choice of law must be made \textit{bona fide}, mentioned by Lord Wright in the case \textit{Vita Food}, is often quoted in English literature. See above, footnote 62.  
\textsuperscript{101} See the references made in my \textit{International Commercial Arbitration}, op.cit., footnotes 226, 227 and 228.  
\textsuperscript{102} See the references made in my \textit{International Commercial Arbitration}, op.cit., footnote 225.  
\textsuperscript{103} Section 6.

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in all areas of law.\textsuperscript{104} The Rome Convention contains the same regulation in article 16, and so do the Swiss Private International Law Act in article 17, and the Russian Civil Code in article 1193.

These regulations have in common one feature that is essential to the proper interpretation of the \textit{ordre public} clause: they have a very narrow scope.\textsuperscript{105} The \textit{ordre public} clause is not intended to be used whenever there is a discrepancy between the foreign governing law and the legal system of the \textit{forum}. The clause it is to be used only under exceptional circumstances, when the result to which the judge would come by applying the rule of the foreign governing law would conflict with the basic principles upon which the society of the \textit{forum} is based. A simple difference between a foreign rule and a mandatory rule of the \textit{forum}, or even an overriding mandatory rule of the \textit{forum}, therefore, would not in itself qualify as violation of the \textit{ordre public} of the \textit{forum}.\textsuperscript{106}


\textsuperscript{105} See GIULIANO, LAGARDE, “Report on the Convention”, op.cit., A 5.76; see also the references made in my \textit{International Commercial Arbitration}, op.cit., footnote 222.

\textsuperscript{106} For some examples of cases where ordre public has been considered violated, see the previous section and see, more extensively, under section 6.2.1 below.
PART II – INTERNATIONAL COMMERCIAL LAW APPLIED BY INTERNATIONAL ARBITRAL TRIBUNALS
6. INTERNATIONAL CONTRACTS AND ARBITRATION

6.1 Introduction.

It is sometimes argued that the considerations made in the previous chapters are not generally relevant to international transactions, because international contracts often have a clause that submits any disputes arising out of the contract to international arbitration. The reasoning is as follows: as opposed to national courts, that belong to a specific national system of law, international arbitration is by its nature international and not subject to any state law. Moreover, the arbitral tribunal is dependent on the will of the parties, and therefore cannot decide a dispute by applying national rules that the parties have not made reference to.

To verify the correctness of this reasoning, we have to look at the two assumptions that it is based on: is international arbitration really international? In other words: is there no link between international arbitration and national systems of law? And: is international arbitration really completely and solely dependant on the will of the parties? In other words: is there no possibility for national courts to control the activity of international arbitral tribunals? We will verify these aspects in the following sections. Before doing that, however, it might be useful to give a short presentation of arbitration as a method for solving disputes.

6.1.1 Briefly on Commercial Arbitration

Commercial arbitration, whether domestic or international, is an alternative method of dispute resolution. This means that it is an alternative to the courts of law: If the parties so elect, and if the governing law permits to submit that kind of disputes to arbitration, the parties may decide to exclude the jurisdiction of ordinary courts and to subject their dispute to arbitration instead. It is very common to see an arbitration clause in a commercial agreement, specifying that disputes arising out of that contract are to be submitted to arbitration. We will below briefly look at the advantages that are usually mentioned as reasons for preferring arbitration to litigation before the courts of law.
a) Advantages

**Enforceability.** International transactions concern the movement or organisation of assets across the borders of two or more states, and might involve the entities of different states. In the case of disputes regarding international transactions, it is important to ensure that the decision resolving the dispute is enforceable in (at least) all the states affected by the transaction, preferably in all states where the losing party has assets that can be attached to satisfy the credit of the winning party. The enforcement of foreign arbitral awards is regulated primarily by the New York Convention of 1958, which has been ratified by very many states (including Norway) and therefore ensures, to a great extent, a uniform and effective treatment of arbitral awards’ enforceability. The enforcement of foreign judicial decisions, on the other hand, does not enjoy the same uniform treatment: the principles of international co-operation and of economy of judicial proceedings are recognised in a large number of states, but implementation of the principles, which results in the recognition and enforcement of foreign judicial decisions, is left to the internal legislation of the single states or to bilateral or multilateral treaties concerning specific areas. As already mentioned, among treaties of outstanding significance is the 1988 Lugano Convention on the recognition and enforcement of decisions issued on civil matters by courts in the states of the European Union and the European Free Trade Area, in its turn based on the 1968 Brussels convention, that recently became a regulation within the European Community.

As a consequence of the foregoing, the enforceability of foreign judicial decisions is not subject to uniform regulations to the same extent as the enforceability of arbitral awards is.

**Jurisdiction.** The already mentioned New York Convention contains, in article II, the obligation for the courts of each ratifying state to recognise a written arbitration clause, and to refer to arbitration (upon the request of one party) any dispute in respect of which the parties had entered into an arbitration agreement. As a consequence thereof, an arbitration clause is relatively easy to enforce; this in turn creates a desirable predictability in the question of the competent forum, particularly if the dispute has an international character. In the absence of an arbitration clause, the parties to an international contract might face difficulties in identifying the competent courts, or might run the risk of seeing parallel proceedings before the courts of different states. This is because not all states have national legislation or are party to international conventions regulating the question of international jurisdiction and of international *litis pendens*. Conventions that regulate both these aspects are the already mentioned Lugano and Brussels Convention (the latter having become a Council
Regulation): therefore, for disputes involving the jurisdiction of any of the states signatory to these conventions, the question of jurisdiction and of *litis pendens* has a clear regulation. If, however, the dispute involves also the jurisdiction of another state, it will be necessary to verify also the regulation (if any) of that state.

**Neutrality.** An arbitral tribunal consists of arbitrators nominated by the parties, or appointed by an authority selected by the parties (or, lacking any choice by the parties, appointed by an authority determined by the governing arbitration law). The choice of the arbitrators usually ensures a certain neutrality, at least as far as the nationalities of the arbitrators is concerned. In an international commercial transaction, neither of the parties usually wants to accept the jurisdiction of the other party’s state: this is partly due to the fear that a national court might be biased in favour of the party of the same nationality as the court, and partly because the party in whose state the proceedings take place enjoys the advantage of knowing the applicable law, procedural rules, and legal environment and mentality better than the other party. Agreeing on international arbitration allows the parties to avoid this imbalance: the venue of the arbitral tribunal is usually chosen in a state different from the state of each party, and the nationality of the arbitrators is also determined so as to avoid the over-representation of one party’s nationality.

**Expertise.** The arbitrators can be chosen according to criteria that can be tailored to the particular dispute, so as to ensure that they possess the necessary expertise to understand and evaluate the matters at stake. If a dispute is submitted to national courts of law, the dispute will be resolved by one or more judges with a general knowledge of private and commercial law; in some circumstances, this general knowledge might not be sufficient to appreciate all the aspects of complicated transactions with technical implications or transactions based on international commercial practices. This might lead to lengthy proceedings to permit the judge to acquire the appropriate knowledge, or to errors in the judge’s evaluations due to underestimating the technical aspects or commercial practices. Agreeing on arbitration permits a reduction of these difficulties, by selecting experts in the particular field as arbitrators.

**Confidentiality.** Arbitration is a way of solving disputes that, as opposed to proceedings before courts of law, permits confidentiality to be maintained with respect to the content, the outcome and even the existence of the dispute. Confidentiality can be important in certain situations, for example to avoid damaging the commercial reputation of the parties.
**Finality and rapidity.** An important characteristic of arbitration is that in most situations the award made by an arbitral tribunal is final and binding upon the parties: either because the parties have agreed this expressly in the arbitration clause, or because the arbitration rules referred to by the parties exclude any appeal against the award. By excluding the possibility of retrying the case in front of an appeal instance, therefore, the length of the proceedings is considerably reduced as compared to proceedings before courts of law.

Moreover, arbitration may ensure that the dispute is solved rather quickly, as opposed to proceedings before courts of law, which in some states may last for several years due to overloaded judges and bureaucratic proceedings.

The above shows the main advantages that render it advisable, particularly in an international contract, to agree on submitting any disputes to arbitration, rather than to courts of law. There are, however, also some disadvantages to arbitration, as opposed to courts of law, as we will see below.

**b) Disadvantages**

**Procedural Difficulties in case of ad hoc arbitration.** In the event that the arbitration clause stipulates ad hoc arbitration,\(^{107}\) without providing for a detailed regulation of the proceeding or without making reference to applicable arbitration rules, and if the applicable arbitration law does not contain details on the procedure to be followed, the arbitral tribunal might face procedural difficulties. For example, one party may refuse to cooperate, or may attempt to delay the process by inserting new claims or asking for the production of excessively time-consuming evidence. If the agreement of the parties, the applicable arbitration rules or the arbitration law do not contain guidelines to solve these situations, the arbitral tribunal will have to solve the difficulties in its own discretion. This might be unproblematic, if the tribunal consists of arbitrators genuinely interested in rendering an award effectively. However, one of the disadvantages of permitting the parties to appoint the arbitrators is that a party might appoint as arbitrator someone who feels more as a representative of the appointing party than as an independent arbitrator. Therefore, in some situations, it might be difficult for the panel to reach an agreement, if one arbitrator tries to pursue the interests of one party.

**High costs.** Another possible disadvantage of arbitration is the cost. If a dispute is submitted to arbitration, and particularly if it is submitted to an institutional

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\(^{107}\) See below, item (b) of section 6.1.2.

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arbitration with a developed infrastructure, the parties will have not only to pay the costs of their attorneys, they will also have to pay the fee of the arbitrators, as well as the costs of the infrastructure. The total arbitration costs might even exceed the value of the dispute, if the disputed matter is not of a considerable dimension. Ordinary court proceedings are generally cheaper than arbitration; however, they may become as expensive, and much more lengthy, if all appeals against the court decision are made use of.

To meet the disadvantage of the costs, it is sometimes possible to see arbitration clauses where the parties agree to submit a dispute to court, if the value of the dispute is up to a certain threshold, and to arbitration, if the value of the dispute exceeds that level. This, however, does not seem to me an advisable arrangement, unless the clause is drafted very carefully, so that to avoid possible misuse.

**Finality.** Finality is usually considered as one of the advantages of arbitration, as we have seen above. The award cannot be appealed, therefore the parties know that they can rely on a speedy process. However, finality has also a negative side: the ascertainment of the facts and the application of the law cannot be reviewed, therefore the parties are exposed to the risk of having to accept a decision that might not have been taken sufficiently accurately. To avoid the worst consequences, most of national arbitration laws permit the losing party to file a suit with the courts of the place where the arbitral award was rendered, in order to verify the validity of the award. It must be noted, however, that the validity of an award can generally be proved on the basis of procedural principles (such as the respect of the due process, the correct composition of the arbitral tribunal, etc.), and not on the basis of a review of the tribunal’s decision. The restrictive scope of the challenge of the award’s validity, therefore, does not protect the parties against the risk of an inaccurate arbitral award (nor should it, otherwise much of the nature of arbitration would be prejudiced). The parties should minimise the risk of an inaccurate decision by choosing carefully the arbitrators.

### 6.1.2 Briefly on International Commercial Arbitration

Among the advantages described above, particularly the first three mentioned are especially relevant to international arbitration. An arbitral award is enforceable, with a short procedure, in 133 states (which have ratified the New York Convention); an arbitration agreement has to be recognised by the courts.
of the same 133 states, which have to decline jurisdiction for the benefit of arbitration; the parties may appoint a neutral arbitral tribunal in a neutral state. These three aspects are of extreme importance for the effectiveness of a dispute, and make international arbitration by far preferable to international litigation in courts (unless the dispute is subject to a convention such as the Lugano Convention, that achieves many of the above mentioned results also for court litigation). In this section we will look briefly at some features that apply specifically to international commercial arbitration.

a) The Basis for the Jurisdiction of Arbitration

The jurisdiction of an arbitral tribunal on a certain dispute, and the consequent exclusion of jurisdiction by courts of law on the same dispute, is based, for international arbitration, on the already mentioned New York Convention. In article II the convention provides that: “Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.”

An arbitration agreement is usually contained in a simple clause of the contract regulating the commercial relationship between the parties. If the contract does not contain an arbitration clause, the parties might elect to enter into a separate arbitration agreement, may be after the conclusion of the commercial contract, or even after the dispute has arisen between the parties. It is, however, usually difficult for the parties to agree on anything once a dispute has arisen between them, therefore it is advisable to enter into the arbitration agreement or write the arbitration clause at the time of closing the contract, rather than waiting until a dispute has arisen.

From the New York Convention follows that an arbitration agreement has to be recognised as a sufficient basis for the jurisdiction of an arbitral tribunal, as long as the matter is deemed arbitrable. Arbitrability is regulated by the law of the state whose courts are supposed to recognise the arbitration agreement. We will come back to the scope of the rule on arbitrability below, under sub-section 6.2.2(a). For the moment, it may suffice to notice that a dispute is usually deemed to be arbitrable if it regards a subject-matter that is within the free disposal of the parties.

b) Ad Hoc and Institutional Arbitration
Once established that arbitration is chosen by the parties in an arbitration clause or arbitration agreement, it remains to look quickly at what kind of arbitration may be chosen. There are two kinds of arbitration: the so-called “ad hoc” arbitration, and the institutional arbitration.

**Ad Hoc Arbitration.** An arbitration is ad hoc when it is constituted purely on the basis of the agreement of the parties. The parties decide to submit the dispute to a panel of arbitrators, they decide how the members of that panel have to be appointed, where the venue of the tribunal has to be, what rules of procedure the tribunal will have to apply, etc. The parties may decide to regulate all these aspects in their arbitration agreement, or they may elect to make reference to a set of arbitration rules that is already available. The UNCITRAL, for example, produced in 1976 the UNCITRAL Arbitration Rules, a set of procedural rules that regulate all the aspects of the conduct of an arbitral proceeding. If the parties have not regulated the arbitration procedure in the arbitration agreement, and if they have not made reference to a set of arbitration rules, they may empower the arbitrators to decide the procedural aspects according to their discretion. Otherwise, the ad hoc arbitration will be regulated by the arbitration law of the state where the arbitral tribunal has its venue.

**Institutional Arbitration.** An arbitration is institutional if the parties have made reference in the arbitration agreement to a certain arbitration institution. Arbitration institutions are organised, for example, within the International Chamber of Commerce, within national Chambers of Commerce, such as in Stockholm and in Oslo, within branch associations, such as the London Metal Exchange, or independently, such as the London Court of International Arbitration. The chosen arbitration institution will administer the arbitral proceeding, applying its infrastructure and the arbitration rules that it has produced. The International Chamber of Commerce, for example, has published its latest edition of the arbitration rules in 1998, the Arbitration Institute of the Stockholm Chamber of Commerce in 1999 and the London Court of International Arbitration in 1998. Having made reference to arbitration within a certain institution, therefore, the rules of that institution will be applied automatically to the proceeding, and the parties do not need to provide for extensive regulation in their agreement.

c) **The Rules of Procedure Applicable to Arbitration**

Generally, arbitration is governed by the arbitration law of the place where the tribunal has its venue (territoriality principle). The territoriality principle is affirmed, for example, in the Swedish Arbitration Act, section 46, the Swiss Private International Law Act, section 176, the English Arbitration Act, section 111.
The territoriality principle applies only to the law governing the arbitration, and does not extend to cover also the law governing the merits of the dispute. The law governing the merits of the dispute is the law chosen by the parties or, failing such choice, the law applicable according to the conflict rules that the tribunal considers applicable (for example, UNCITRAL Model Law, section 28.2, English Arbitration Act, section 46.3), or the law that has the closest connection with the disputed matter (for example, Swiss Private International Law Act, section 187.1, Italian Code of Civil Procedure, section 834), or the law that the tribunal deems applicable (for example, French Civil Procedure Code, section 1496). Some states have opened also for the parties to choose the law governing the arbitration. Therefore, in these states the parties may derogate the territoriality principle in respect of the arbitral procedure: see, for example, the Swiss Private International Law Act, section 182.1, and the French Civil Procedure Code, section 1494. Choice of the law governing a contract between the parties, however, is not equal to choice of the law governing the arbitration. If the parties wish that the arbitral proceeding is regulated by a law different from the law of the place where the arbitral tribunal is seated, they have to refer the choice expressly to the arbitration (assuming that the arbitration law of the place of arbitration permits to make such a choice).

In England, a High Court decision commented that in theory it would be possible to submit arbitration to a procedural law different from the law of the state where the arbitral tribunal has its venue, but the result would be highly unsatisfactory or absurd.\(^{110}\)

Irrespective whether the parties have chosen to submit their dispute to an ad hoc or an institutional arbitration, the arbitral proceeding will generally be subject to the arbitration law of the state where the arbitral tribunal has its venue. If the parties have provided for arbitration rules (either directly in the agreement or by reference to arbitration rules such as the UNCITRAL, or indirectly via the choice of an institutional arbitration), the rules provided by the parties will apply to their proceeding and will prevail over the rules contained in the national arbitration law, if the latter permits to be derogated from by agreement of the parties. In the case of mandatory provisions of the national arbitration law, however, the arbitration law will override the arbitration rules chosen by the parties. An example of mandatory provision is the already mentioned rule on

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arbitrability; other examples are the rules ensuring due process of law, such as the necessity to give both parties the possibility to be heard.\textsuperscript{111}

Arbitration laws are, usually, quite liberal in their regulation of arbitration. The parties desire to have as much flexibility as possible in the organisation of this mechanism for dispute resolution that is chosen precisely because it leaves ample room for private determination. If state law started to regulate arbitration in detail, this method of dispute resolution would probably loose much of its appeal to commercial parties. However, if there were no regulation at all, the parties might fear that fundamental principles of process might be neglected. Therefore, a successful arbitration law is an instrument that manages to ensure a high degree of flexibility, though providing certain rules to protect the principle of due process.

The UNCITRAL Model Law on International Commercial Arbitration of 1985 is generally considered as a good regulation of arbitration, that permits both a flexible regulation and the protection of fundamental principles. The UNCITRAL Model law has been adopted by a large number of states, and is generally used as a reference even by the states that have not adopted it. The draft Norwegian Arbitration Act is largely based on the UNCITRAL Model Law.

d) The Private International Law Applicable to Arbitration

Once having established that the arbitral tribunal is subject to the arbitration rules chosen (directly or indirectly) by the parties, as well as to the arbitration law of the state where it has its venue, we will have to ask ourselves which private international law applies to an international arbitral tribunal. As we have seen above in chapter 5, private international law contains the conflict rules that permit to identify what substantive law governs the dispute. The applicable conflict rules represent also the framework within which the parties may choose the governing law, as well as the applicability of overriding mandatory rules from laws different from the chosen law. Therefore, finding out which private international law applies is relevant even if the parties have chosen the governing law.

First of all, choice of the governing law in an arbitral proceeding is subject to the conflict rules chosen by the parties. If the parties have chosen a certain law to govern the contract, however, they have chosen the law that shall be applied to

\textsuperscript{111} The UNCITRAL Model Law contains provisions to this extent, for example, in articles 18, 23.1, 24.2 and 24.3.

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the merits of the dispute, not the applicable private international law; an arbitration clause only seldom chooses the law that is applicable in respect of the conflict rules. However, the parties may have chosen the law regulating the procedure of the arbitration. As seen above, such choice may occur directly, if the parties have chosen ad hoc arbitration and have regulated these aspects in the arbitration agreement or have made reference to arbitration rules such as the UNCITRAL Arbitration Rules. The choice of procedural rules may also occur indirectly, by choosing an institutional arbitration and consequently submitting the procedure to the arbitration rules of that institution. The chosen arbitration rules might contain the answer to the question of what is the applicable private international law. The answer varies, according to the chosen arbitration rules; we will see the various approaches below, together with the various approaches followed by arbitration laws.

If the parties have not, directly or indirectly, determined the applicable private international law, it will be necessary to look at the arbitration law of the state where the arbitration takes place. The arbitration law might contain an answer to the question of the applicable private international law: here, as in respect of the arbitration rules, the answer differs according to the state laws.

It is possible to identify at least five approaches to the question of the applicable conflict rules:

(i) **Application of the conflict rules of the *lex fori***

The most traditional approach, which is also the least followed, assumes that the tribunal shall apply the conflict rules of the state where it has its venue. Modern arbitration laws and modern arbitration rules do not assume that an arbitral tribunal is bound to the law of its venue, when it comes to choice-of-law.

(ii) **Application of the conflict rules that are deemed appropriate**

Another approach specifies that the tribunal shall apply the conflict rules that it deems appropriate in that particular situation. This may lead to the application of the private international law of the state where the tribunal is seated, or the conflict rules of other laws, if their application seems more appropriate in view of the circumstances of the dispute. Often, this approach leads to the application of the conflict rules of no specific state. The tribunal may make a comparison between the conflict rules of the states with which the dispute has some connection, and apply a common minimum denominator thereof, or it may
resolve to apply generally acknowledged principles of private international law. The approach that gives the tribunal the discretion to determine what conflict rules are most appropriate, is followed among others in the UNCITRAL Model Law (and all the states that have adopted the model), the UNCITRAL Arbitration Rules, as well as English arbitration law.

(iii) Application of the conflict rule contained in the arbitration rules

A third approach follows a different rationale, and, instead of referring to an applicable system of private international law, it contains a choice-of-law rule. For example, Swiss arbitration law and Italian arbitration law specify that the arbitral tribunal, failing a choice of law made by the parties, will apply to the merits of the dispute the law with the closest connection to the dispute. The rule of the closest connection is a conflict rule; by containing a conflict rule, these arbitration laws have avoided to determine what private international law is applicable to arbitrations that take place in those states. This approach, therefore, does not help us in determining what rules will be applicable to the verification of the borders of party autonomy.

(iv) Application of the direct approach

A fourth approach contains another conflict rule. French arbitration law, as well as the arbitration rules of the International Chamber of Commerce and of the London Court of International Arbitration, give the arbitral tribunal the authority to apply the rules that the tribunal deems appropriate. In other words, the tribunal is not bound to apply the conflict rule of the closest connection or to take in consideration any other connecting factor; it can directly identify the substantive rules that it deems mostly suited to solve the dispute (also called voie directe, or direct approach). Among the rules that the tribunal deems appropriate, are also rules of the trans-national law. This approach does not help us in finding out what system of private international law determines the scope of the choice of law made by the parties.

(v) No guidance

Finally, a fifth approach consists in not specifying anything in respect of the applicable private international law. Swedish and Norwegian arbitration laws, for example, as well as the arbitration rules of the Arbitration Institute of the Stockholm Chamber of Commerce and of the Oslo Chamber of Commerce, are silent as to the method to be followed by the arbitral tribunal for determining the
applicable law. This approach, obviously, does not give us any tools in our search for an applicable system of private international law, and leaves us without answers to the question relating to the scope of the party autonomy admissible in arbitration. Lacking any indication to the contrary, it seems appropriate to assume the applicability of the private international law of the state where the arbitral tribunal has its seat.

e) The Application of Trans-national law in Arbitration

After having seen that an international arbitral tribunal has a rather flexible framework in respect of conflict rules, it is natural to ask ourselves whether the same flexible framework is valid also in respect of the substantive law that the tribunal is to apply to the merits of the dispute. Assuming, in other words, that the parties have not chosen the law governing their contract and their dispute, we may ask ourselves whether the arbitral tribunal necessarily has to apply the substantive law of a certain state, or whether it is free to apply trans-national sources.

(i) Decision at law or *ex bono et aequo*

Most arbitration laws, as we will see below, permit the parties to request that the arbitral tribunal renders 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 specific law, but is acting as an *amiable compositeur*, 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 apply also the trans-national law. An award rendered *ex bono et aequo* 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*. These limits will be analysed in the following sections, and will clarify to what extent the considerations made in the previous chapters on the relationship between trans-national law and state law are relevant even to a dispute that is submitted to arbitration.

We have mentioned the eventuality that the parties have directed the arbitral tribunal to act as an *amiable compositeur*, and that the tribunal has applied the trans-national law 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 trans-national law? The answer to this question assumes the answer to another question: would a decision taken on the basis of trans-national 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 ex bono et aequo only if the parties have expressly instructed it to do so. Otherwise, the award will have to be rendered 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 amiable compositeur) 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).

(ii) Is trans-national law the basis for a decision at law or ex bono et aequo?

The above would seem sufficient to exclude the power of an arbitral tribunal to apply trans-national law on its own initiative; however, there are some voices that do not deem this sufficient to exclude that an arbitral tribunal may apply a trans-national law on its own initiative. These voices do not qualify a decision taken according to trans-national sources as a decision taken as an amiable compositeur: trans-national law 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 trans-national sources would be a decision taken at law, not ex bono 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 (see above, section 5.23(d)), 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 to any system of rules, including also trans-national 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 trans-national 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”.

According to this interpretation, the tribunal would be empowered to apply trans-national rules 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) and the London Court of International Arbitration (article 22.3), 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 UNCITRAL Model Law (article 28.2), the English Arbitration Act (section 46.1), the Italian Code of Civil Procedure (article 834), as well as the UNCITRAL rules (article 33.1).

Therefore, if the above mentioned logic is accepted, arbitration rules and legislation would provide for three kinds of decisions. Decisions that are not at


113 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 trans-national law on its own initiative (the so-called Valenciana case): see Clunet, 1992, 177, with a note by Goldman, and Revue de l’Arbitrage, 1992, 457, with a note by LAGARDE. The Austrian Supreme Court has not considered as invalid an award (rendered in the case Palbalk v. Norsolor) that applied the trans-national law on its own initiative: see Yearbook Commercial Arbitration IX (1984), pp. 159ff., with a note by MELIS). A decision by the English Court of Appeal, Deutsche Schachtbau- und Tiefbohrgesellschaft mbH v. Ras Al Khaimah National Oil Co., C.A. [1987] 2 Lloyds 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, BONELL, M., An International Restatement of Contract Law, Transnational Publishers, Inc., New York, 1997, p. 201, footnote 110, and LANDO, “Lex Mercatoria”, op. cit., 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 trans-national law: see my International Commercial Arbitration, op.cit., pp. 290 f. The interpretation of the trans-national law as a body of “rules of law”, however, is far from uncontroversial: see, criticising it, DASSER, F., Internationale Schiedsgerichte und
law, that are admissible only upon the direction by the parties; decisions based on rules of law, including also trans-national sources; and decisions based on state laws. As seen above, not all, but some systems permit the tribunal to apply rules of law on its own initiative.

**f) The Legal Effects of an Arbitral Award**

An international arbitral award is an enforceable decision, on the basis of the New York Convention of 1958. This means that, if the losing party does not comply with the award voluntarily, the winning party may present the award to the enforcement court of any state where the losing party has some assets, and the court will have to enforce the award after having carried out a rather restricted, mainly formal review of its enforceability. The grounds for refusing to enforce an award are set forth in article V of the New York Convention. In Norway, a foreign arbitral award which is enforceable under the New York Convention will be directly enforceable by the enforcement courts under section 9 of the Arbitration Bill.114

In the following sections we will verify whether our previous observations on the relationship between state law and trans-national law are relevant to the enforceability of an international arbitral award.

**g) Is there a Difference between International Arbitration and Domestic Arbitration?**

When the terminology ”international arbitration” is used, the term international usually refers not to the arbitration, but to the dispute that is being arbitrated. Some special arbitrations, however, take place in the framework of international conventions, and are therefore international themselves. The ICSID arbitration between on investment disputes between foreign companies and host states, for

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114 The enforcement of foreign arbitral awards is regulated today by section 4-1 (f) of the 1992 Enforcement Act, see also section 168 of the 1915 Civil Procedure Act. It is rather unclear whether the grounds for refusing enforcement are today regulated by section 4-2 of the Enforcement Act or section 470 of the Civil Procedure Act, see 8.12 of the Report on the Arbitration Bill, NOU 2001:33. The new arbitration law will clarify that an arbitral award is directly enforceable, and that the only grounds upon which enforcement can be refused are those exhaustively listed in the arbitration law itself.

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example, is based on the Washington Convention of 1965 on the Settlement of Investment Disputes between States and Nationals of Other States. The legal regime to which an ICSID arbitration is international, therefore an ICSID arbitration can be defined as international. Most of the other commercial arbitrations, on the contrary, are subject to the legal regime of a state law, even if they are defined as international. Generally, an arbitration will be subject to the arbitration law of the state where the arbitral tribunal has its venue, unless the parties have chosen a different law to govern the proceeding.\textsuperscript{115} If a dispute between a Norwegian and a Russian party, for example, is submitted to arbitration is Stockholm, the arbitration will be Swedish. The dispute is international, but the arbitration is subject to Swedish arbitration law. The rendered award will be considered as a Swedish arbitral award, and will be enforceable in Sweden according to Swedish enforcement rules, and in other states according to the respective rules on enforcement of foreign (Swedish) arbitrations. The vast majority of states have ratified the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Award. The New York Convention will therefore be the basis for enforcing the Swedish award in these states, including Norway and Russia.

The term ”international”, therefore, may be misleading. We are, generally, in the presence of a \textit{national} arbitration that deals with an international dispute, and can be enforced abroad as a foreign award. Some national arbitration laws have different legal regimes for arbitrations taking place on their territories, according to whether the dispute is domestic or international,\textsuperscript{116} others have the same regime.\textsuperscript{117} A widely recognised model for state laws on international arbitration is the 1985 UNCITRAL Model Law on International Commercial Arbitration. This model law has been adopted in 43 states, and has been largely followed or used as term of reference in a series of other states. The reform of arbitration

\begin{footnotesize}
\textsuperscript{115} Some national arbitration laws permit that the parties to an arbitration located on their territory choose the procedural law of another state to govern the arbitral proceeding. It is, however, very seldom and not advisable that the parties choose an arbitration law that is different from the arbitration law of the place where the tribunal has its seat. They may choose arbitration rules (such as the UNCITRAL, the ICC or other rules), but this does not exclude the applicability of the arbitration law. The parties very often choose the law that the arbitral tribunal shall apply to the dispute, but that is the substantive governing law, and does not extent also to cover the procedural aspects of the arbitration. See above, item (c) under the same sub-section 6.1.1.

\textsuperscript{116} For example, the Swedish Arbitration Act, section 51, the Swiss private International law Act, article 192, and the Belgian Civil Procedure Code, article 1717.

\textsuperscript{117} Norway will, in accordance with the Bill on Arbitration that has been presented for enactment (NOU 2001:33), have the same regime for domestic and international arbitration, and it will be based on the UNCITRAL Model Law. See also the Dutch Arbitration Act and the German arbitration law after the reform of 1997.
\end{footnotesize}
that is presently being enacted in Norway is also based on the UNCITRAL Model Law. The Model Law, originally designed for arbitrations solving international disputes, is often used also for arbitrations solving domestic disputes. In Norway, for example, the new law will not differentiate between arbitrations regarding international or domestic disputes.

An arbitral tribunal resolving an international dispute, however, might feel less bound to state law than a tribunal resolving a national dispute. We have seen above, for example, that international arbitral tribunals seldom feel subject to the conflict rules of the law of the state where they have their seat. International tribunals might also feel that they owe obedience more to the parties that have appointed them, than to a national legal system of which they are no permanent body. Hence, sometimes it is possible to encounter the already mentioned opinion according to which state law is not as relevant to international contracts if the dispute is submitted to international arbitration as it would be if the dispute were submitted to a national court of law. In the following sections we will analyse to what extent this opinion is justified.

6.1.3 When Does State law become Relevant to International Arbitration?

As known, international arbitration is an alternative method of settling contractual disputes, which is based on the consensus of the parties. If the parties agree to submit disputes between them to arbitration, then the ordinary courts will have to decline jurisdiction on those disputes, and the only possible mechanism to solve the dispute will be the arbitration that has been chosen by the parties. If, on the contrary, the parties have not entered into an arbitration agreement, disputes between them will have to be solved by the national court that has jurisdiction (according to international treaties, regional regulations or national civil procedure law). An arbitral tribunal, in other words, bases its existence upon the agreement by the parties. Moreover, the parties determine the composition of the arbitral tribunal, the procedural rules that have to be followed by the arbitral tribunal, the scope of the tribunal’s competence and power. The arbitral tribunal is bound to follow the instructions of the parties, otherwise it exceeds the power that the parties have conferred on it. If the arbitral tribunal exceeds its power, neither its jurisdiction nor its award are founded on the parties’ agreement, and there is, consequently, no legal basis for any of the two. There is a uniform legal basis for the above mentioned features of arbitration. The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958, ratified by 133 states, specifies, in article II, that a national court has to decline jurisdiction on a dispute, if the parties had entered into an arbitration agreement regarding that dispute. When it comes to the

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invalidity of arbitral acts not based on the parties’ instruction, we will revert to that below, in the context of the control that the courts may exercise on arbitration.

Arbitration’s dependence on the parties’ will, which is so uniformly recognised, is an important factor strengthening the opinion that arbitration is a private matter between the parties, and that national courts or state laws have no possibility to interfere with the parties’ will. This opinion is certainly confirmed by the observation that the vast majority of arbitral awards are complied with voluntarily by the losing party. The parties agree to submit the dispute to arbitration, then they instruct the arbitral tribunal as to the scope of the dispute, the rules to be applied, etc., then the losing party recognises the arbitration’s result and complies voluntarily with the award. In situations such as this one, the totality of the arbitration takes place in the private sphere of the parties. There is no point of contact between the national courts and the arbitration. Consequently, there will be no national judge that decides to override the parties’ contract or expectations by considering a firm offer not binding because there is no acceptance, or a partial impediment not sufficient to excuse partial non-performance. The arbitrators may or may not decide to apply these national rules, but, as long as the losing party accepts the result of the arbitration, there will be no possibility for any judge to verify the arbitrator’s acts. In these cases, therefore, the considerations made in the previous chapters are relevant only to the extent that the arbitral tribunal is requested by the parties or elects to apply state law to the dispute.

a) Challenge of the Validity of an Arbitral Award

However, not all the losing parties accept the arbitral tribunal’s decision. As we will see below, a losing party has the possibility to challenge the validity of an award before the courts of the place where the tribunal had its seat. Therefore, by challenging the arbitral award, the losing party may create contact points between the arbitration and the courts of the state where the arbitration took place. As we will see below, this contact point allows the courts to exercise a certain control on the arbitral award; however, the scope of this control is rather restricted. Consequently, the impression that the parties are freer from state law when their contract contains an arbitration clause, is correct, but only to a certain extent, as we will see below. The explanation of the scope of judicial control in the phase of challenge will be made, in the next sections, on the basis of the UNCITRAL Model Law on International Commercial Arbitration. This Model Law, as already mentioned, has been adopted as the arbitration law of a large number of states, including also the Norwegian Bill on Arbitration that is in the process of being enacted. Therefore, the considerations made in the subsequent

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paragraphs will be applicable to the challenge of arbitrations rendered in a large number of states, including also Norway, if the bill is enacted in the present form.

b) Court Enforcement of an Arbitral Award

A losing party, by refusing to pay the amount decided in the award, may force the winning party to seek the enforcement of the award from an enforcement court. The enforcement proceeding will take place before the court, or courts, of the state (or states) where the losing party has some assets. Also in this situation, therefore, a contact point is created between arbitration and the court or courts of the states where the losing party has some assets. The scope of the judicial control in the phase of enforcement will be examined, in the next sections, on the basis of the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards, which has been ratified by a very large number of states, including also Norway. Therefore, the considerations made below will apply to the enforcement of awards that are sought enforced in wide number of states, including Norway.

6.1.4 International Arbitration and the State law of the Place of Arbitration

A statement that is often to be met, in respect of international arbitration, is that arbitration is international, and as such it does not have a *forum*. Particularly, no importance should be attached to the legal system of the place of arbitration. It is alleged that the circumstance that an international arbitration happens to have its seat in a certain state is not generally meant to create any link with the legal system of that state. The choice of place of arbitration should be based on considerations of practical convenience, such as the relative vicinity to the states of both parties, the possibility to have convenient flight connections, or the availability of modern and efficient meeting facilities.

Personally, I have never experienced that the parties, when drafting the arbitration clause in a contract, pay attention to the mentioned practical aspects

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of the venue. On the contrary, there is either a struggle to locate the venue in each party’s own state or a state having a similar legal system, or a consensus on locating the venue in a legal system generally known as neutral and having extensive experience within that kind of arbitration. For example, in contracts between Western parties and Russian or former Soviet parties it is very common to see an arbitration clause locating the venue of arbitration in Stockholm. Sweden has traditionally been considered as a neutral state, and the Arbitration Institute of the Stockholm Chamber of Commerce has developed a considerable expertise in this field.  

a) The Relevance of the Lex arbitri to the Challenge of an Arbitral Award

The assumption that the legal system of the seat of arbitration (lex arbitri) has no link with the arbitration itself is not correct. As mentioned above, the losing party may, in most jurisdictions, challenge before the national courts the validity of an arbitral award that has been rendered in that state. This means that the courts of the state of arbitration have the possibility to control the validity of the award; and this is definitely an important link between international arbitration and the forum. The judicial control on arbitral award in the phase of challenge is regulated by national arbitration law. This means that the arbitration law of the lex arbitri determines whether the award is valid or not. The already mentioned UNCITRAL Model Law has created a certain harmonisation in numerous national arbitration laws; and the Model Law provides, in article 34, a list of grounds upon which a national court may set aside an arbitral award rendered in that state. However, since national arbitration laws belong to each national legal system, it will always be necessary to verify the state law of the state of the seat, in order to ascertain what possibility the judge has to annul an award.

In some states, awards rendered in disputes without any contact with that state enjoy a certain detachment from the system of the forum. Swiss and Belgian law permit the parties to enter into an exclusion agreement, thus excluding the

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court’s jurisdiction to challenge the validity of the award. Also Swedish law permits the parties to exclude the control by Swedish courts, but only in respect of the so-called relative invalidity grounds, i.e. grounds that have to be invoked by one of the parties. Exclusion agreements are not allowed by Swedish law in respect of absolute invalidity grounds, upon which the judge can act on his or her own motion. In most other states, as well as under the UNCITRAL Model Law, the control jurisdiction of the courts cannot be excluded.

The list of grounds upon which a court may declare an award invalid, varies, as mentioned, from state to state. In some states, like in England, the judge has relatively wide powers. Among others, an English judge may verify the arbitral tribunal’s application of law, although the possibility to set aside an award for error in law has been significantly restricted in the English Arbitration Act of 1996. In most other European states, the list of invalidity grounds can be broadly said to coincide with the list contained in article 34 of the UNCITRAL Model Law which, in turn, coincides with the list of grounds upon which an award may be refused enforcement under the New York Convention. These grounds may be summarised as referring to invalidity or irregularity in the following areas: the arbitration agreement, the composition of the arbitral tribunal, the procedure of the arbitration, the scope of power exercised by the tribunal. In addition, the award can be declared invalid if there is a contrast with that state’s *ordre public* or with that state’s rule on arbitrability.

b) The Relevance of the *Lex arbitri* to the Enforcement of an Arbitral Award

The *lex arbitri* is relevant also in the context of the enforcement of an award. In article V.1.(e) the New York Convention considers it as a sufficient ground to refuse enforcement of an award, if the award has been set aside by a competent authority in the state where the award was made. The New York Convention, however, does not specify on what grounds an award may be set aside; this is for the arbitration law of the court of challenge to determine. Therefore, even if enforcement is uniformly regulated by the New York Convention, reference to the annulment of an award opens a channel between the enforcement of an award and the not harmonised grounds for annulment of the *lex arbitri*. Usually, an award that has been annulled in its state of origin is considered without any legal effect; however, French courts enforce awards that have been set aside, and there are some precedents – albeit not undisputed – also in the USA.\(^{120}\)

\(^{120}\) For references to cases and literature, as well as an analysis of the matter, see my *International Commercial Arbitration*, op.cit., pp. 240 ff.

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6.1.5 International Arbitration and the State law of the Place(s) of Enforcement

As already mentioned, if the losing party refuses to abide by the award, the winning party will have to seek enforcement with the courts of a state where the losing party has some assets. The enforcement of foreign arbitral awards is regulated uniformly by the New York Convention, which provides a simple and arbitration-friendly procedure. The only reasons that a court may invoke to refuse enforcement of an arbitral award are listed in article V of the New York Convention. These grounds correspond to those contained in the UNCITRAL Model Law in respect of challenge of the validity (article 34), as well as in respect of enforcement (article 36). Therefore, the enforcement of an arbitral award can be refused in case of invalidity or irregularities relating to the arbitration agreement, the composition of the arbitral tribunal and the arbitral procedure, as well as excess of power, contrast with *ordre public* of the state of enforcement, contrast with the arbitrability rule of the state of enforcement. In addition, as seen above, an award may be refused enforcement, if it has been set aside in the state of origin.

6.2 The Impact of the National Applicable Law on the Effectiveness of an Arbitral Award

We have seen so far that, if the losing party does not accept an arbitral award, this can be controlled by the courts of several states: the courts of the place of arbitration, as well as the courts of the place or places of enforcement. The courts will verify the validity of the arbitral tribunal’s jurisdiction and the correspondence of the tribunal’s decision with the instructions given by the parties. The courts will also, as seen above, verify the tribunal’s compliance with procedural rules (that, lacking a clear choice made by the parties, mostly will be the arbitration law of the place of arbitration), as well as with the *ordre public* and the arbitrability of their respective legal systems.

Our initial question is about the relevance of national governing law to international contracts containing an arbitration clause. To answer this question, we will have to verify whether an arbitral award is effective even if it does not apply the governing law or the other applicable rules, or whether it can run the risk of being set aside or refused enforcement. If the award remains effective, this confirms the opinion that the parties to an international contract may disregard state laws if they have inserted an arbitration clause in their contract. If, on the other hand, the award is not effective, then the considerations made in the previous chapters on the impact of state laws on international contracts are
relevant even if the parties have decided to submit to arbitration any disputes arising out of the contract. In the following sections we will analyse this matter.

a) First scenario: The Award applies the Will of the Parties and Disregards the Applicable Law

We can assume the situation described above under section 3.1.2(b). A constructor and a carpenter have entered into a contract for the performance of certain work by the carpenter, and later they have entered into an amendment agreement to increase the price that the constructor shall pay to the carpenter for that work. We can assume that an arbitral tribunal, having its seat in Stockholm, is deciding a dispute on the amendment agreement. The constructor claims that the amendment agreement is invalid for lack of consideration, and refuses to pay the increased price. The carpenter claims that the parties had intended to be bound by that amendment agreement, that the doctrine of consideration makes the agreement invalid only under English law, and that they have not chosen English law to govern their contract.

We assume that the arbitral tribunal comes to the conclusion that the contract is governed by English law. This would be the case, for example, if the party making the characteristic performance, i.e. the carpenter, has its main place of business in England. However, the tribunal decides not to apply the English doctrine of consideration, and deems the amendment contract valid and binding, thus ordering the constructor to effect payment of the increased price.

The constructor decides to challenge the validity of the award before the courts of the state where the award was rendered, i.e. Swedish courts; will it be in a position to invoke the wrong application of English law as a ground for setting aside the award?

Alternatively, if the constructor refuses to pay the increased price, the carpenter must seek enforcement with the courts of the place where the constructor has some assets, for example Russian courts. Will the constructor be able to invoke error in the application of the governing law, to resist enforcement of the arbitral award?

What if the constructor has some assets in England, and the carpenter seeks enforcement of the award in England. Will the award be enforceable in England, even if the disregarded doctrine of consideration is a doctrine of English law, and therefore enforcement of the award would result in a violation of English law?

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b) Second Scenario: The Award Disregards the Will of the Parties and Applies the Governing Law

In the same factual situation as described in the previous item, we can assume that the constructor claims that the amendment agreement is not binding, because the carpenter allegedly had given the constructor incorrect information regarding the volume of work to be done. In other words, the parties have not invoked the English doctrine of consideration; as a matter of fact, they have not even mentioned that English law is the governing law. We can assume that the arbitral tribunal does not find sufficient evidence to corroborate the constructor’s allegations on the incorrect information and the link with the decision to amend the price. However, the tribunal, on its own initiative, applies choice-of-law rules, determines that the contract is subject to English law, and concludes that the contract is invalid under the English doctrine of consideration.

May the carpenter invoke the invalidity of the award before the Swedish court of challenge, because the tribunal has applied the mandatory doctrine of consideration of the governing English law, while the parties had not invoked English law?

If the constructor wishes to have the award enforced in the carpenter’s state (for example, because the carpenter does not effect payment of the arbitration costs, as the award may have directed it to do), may the carpenter ask for refusal to enforce, on the same grounds?

c) Third Scenario: The Award Applies Trans-national Law

In the same factual situation as described above, we can assume that the arbitral tribunal recognises that the amendment contract would be invalid under English law. However, the tribunal decides not to apply English law in a strict manner, since the dispute has an international character, and the peculiarity of English law would manifestly run counter the intention that the parties manifested in the amendment contract. The tribunal decides to apply the generally acknowledged principle *pacta sunt servanda*, according to which the parties to an agreement are bound by their commitments. The tribunal, consequently, considers the amendment agreement as valid, and orders the constructor to effect the higher payment contemplated therein. The tribunal, therefore, bases its decision on trans-national law, without having been empowered by the parties to do so.
May the constructor challenge the award before the Swedish court, on the basis of the fact that the tribunal disregarded the applicable state law and applied a trans-national law without having being empowered to by the parties?

May the constructor invoke the same defence in case the award is presented to a court for enforcement?

d) Criteria to Evaluate the Award’s Effectiveness

In respect of the first of the above-mentioned scenarios, the award’s effectiveness has to be measured against the allegation of error in the application of the law. Neither in Swedish nor in Russian law, error in law is an independent ground to consider an award invalid or unenforceable. In England, error in law is (to a certain extent) a reason for annulling an award in the phase of challenge; however, in our scenario, the English court is acting not as a court of challenge, but as a court of enforcement. Enforcement is regulated by the New York Convention, and under the convention error in law is not a ground to refuse enforcement. Therefore, the only possibility available is to verify whether error in law can be considered to fall within the scope of any of the above mentioned grounds for invalidity or for refusing enforcement.

Excluding the grounds that are obviously not relevant, such as those that refer to the validity of the arbitration agreement, the composition of the arbitral tribunal, etc., two grounds remain theoretically available to sanction the disregard of the doctrine of consideration by the tribunal: contrast with the ordre public of the lex fori, or violation of the arbitrability rule of the lex fori. We will see below to what extent these grounds can be applied to sanction disregard by the tribunal of the governing law.

In respect of the scenario mentioned under item (b) above, one of the above listed grounds could theoretically be available to sanction the tribunal’s own initiative to apply the doctrine of consideration: excess of power. We will see below to what extent this ground can be invoked to sanction the tribunal’s application of the governing law and to invalidate the effectiveness of the award.

The ground of excess of power may be relevant to sanction also the arbitral tribunal’s application of trans-national law on its own initiative, as occurs in the scenario mentioned under item (c) above. Also this will be verified in the following sections.
6.2.1 Contrast with *Ordre public*

a) Contrast with Principles, not with Rules

The exception of *ordre public* (or public policy) is, in the context of international arbitration, unanimously interpreted very narrowly. Its rationale is not to permit a judge to refuse enforcement or annul an international award on the basis of any difference between the result of the award and the result to which the judge would have come applying his or her own law. This would run counter the spirit of the New York Convention, of the UNCITRAL Model Law, all practice that is generally recognised and legal doctrine in the international scale.\(^\text{121}\)

The exception of *ordre public* has the purpose of permitting the judge not to give effect to an award that would contradict the fundamental principles of the judge’s social system.

By defining *ordre public* as the fundamental principles of a system, we have already established an important dimension: it is not the rules of positive legislation that constitute *ordre public*, but the principles that inspire those rules. This is an important distinction: if an arbitral award is in contrast with the result that the judge would come to by applying a rule of his or her system, this is not sufficient to consider the award as contrary to the judge’s *ordre public*. However, if the award differs so considerably, that it might be considered as contradicting the policy that underlies that rule, than the award may be deemed to violate *ordre public*, if that policy can be considered fundamental.

As an illustration, we can refer to the example of the agency agreement between the French principal and the Norwegian agent, made in section 3.1.4(b) above. We can assume two scenarios:

(i) The agency agreement contains a clause, according to which the agent is entitled, upon termination, to a compensation equal to the provision that was earned during six months of agency;

(ii) The agency agreement contains a clause, according to which the agent is entitled, upon termination, to a compensation equal to the provision that it earned during one day of the agency.

\(^{121}\) For references to literature and an analysis of the matter, see my *International Commercial Arbitration*, op.cit., pp. 300 ff. See also above, section 5.3.6.
The contract, as we remember, contains a clause choosing the laws of New York, and New York law does not contain any requirement of compulsory compensation. Since the agency is to be carried out in Norway, and Norwegian rules on the compensation to the agent are not only mandatory, but they also override the choice of law made by the parties, it is relevant to look at the rule of Norwegian law. Norwegian law assumes that, upon termination, the agent is entitled to a compensation to be determined according to the circumstances of the case, but in any case not to exceed the provision that was earned during one year.\footnote{Agency Act, section 28.} What happens if the arbitral award disregards Norwegian law on agency? Can the award nevertheless be enforced in Norway, or (in case the award was rendered in Norway) can it resist a petition for annulment before a Norwegian court?

The effectiveness of the award would have to be measured against the exception of ordre public. The first question to be answered is whether the policy underlying the mandatory rules on agency can be considered so important in the Norwegian society, that it qualifies as principle of ordre public.

Assuming that the answer to this question is affirmative, there is a further question to be answered: has the award violated (not the Norwegian mandatory rule on compensation, but) the policy underlying the Norwegian rule on compensation?

The answer will most probably be different in the two scenarios.

In the first scenario, the award has implemented a contractual regulation that gives the agent a slightly worse treatment than it might have obtained under the Norwegian rule. However, the ordre public defence is there not to impose application of a particular rule, but to ensure that certain interests are protected. The interest of the agent in obtaining compensation may be considered sufficiently protected by giving effect to the contractual terms, even if the agent would have received a higher amount if the Norwegian rule had been applied.

In the second scenario, on the contrary, the contractual regulation does not protect the interests of the agent. The level of the agreed compensation is so low, that it is as if no compensation was agreed. In this case, the agent is left totally without protection, and this runs counter the policy underlying the Norwegian rule on mandatory compensation.
b) What is a Fundamental Principle?

We have established that it is not the national rules that must be applied through the *ordre public* clause, but it is their inspiring principles that have to be given effect to. It remains to attempt to define what inspiring principles can be deemed to be of *ordre public*. Not every principle inspiring a mandatory rule can be considered a public policy principle. Not even every principle inspiring an overriding mandatory rule can be considered of *ordre public*. It is only the fundamental ones, those that constitute the basis of the society. But how can these principles be identified?

There is no absolute rule to determine *ordre public*: what is fundamental may vary from state to state, and, even within the same state, the conceptions develop, and what was deemed public policy a decade earlier, may not be it any more.\(^{123}\)

Court decisions in the various states annulling an award or refusing to enforce it because the award is in contrast with the court’s public policy, are reported in the ICCA Yearbook, Commercial Arbitration. A survey of these decisions, from the first volume in the mid seventies to our days, shows that such decisions are not numerous. In some cases there is relative uniformity of consensus from state to state, and these are the cases that interest us the most here. Awards that violate rules on bribery\(^{124}\) or smuggling,\(^{125}\) are usually considered in the international legal doctrine as being against *ordre public*.

There are some instances where rules on insolvency procedures have been considered as *ordre public* principles. A United States court, for example, balanced against each other, on one hand the interest in ensuring enforcement to international awards, and, on the other hand, the interest in ensuring an equal

\(^{123}\) The example of swap agreements and other financial derivate instruments is quite descriptive: this kind of contracts developed into a recognised financial activity in the course of the 1980s, and is not considered as being against fundamental principle. However, until as late as the 1980s courts in Germany and in Austria were considering them against the basic moral principles of the system that forbid gambling (so-called *Differenzeinwand*). See, for example, the decision of the Austrian Supreme Court no 3 Ob 30/83 of 1983, and of the German Supreme Court (Bundesgerichtshof) of 15 June 1987. The Bundesgerichtshof did not consider these agreements as violating any fundamental principles of the German legal system, see for example the decision dated 26.2.1991, XI ZR 349/89. On Norwegian law, see TJAUM, A., *Valuta- og renteswaper*, Universitetsforlaget, Oslo 1996, pp. 273ff.

\(^{124}\) For further references see my *International Commercial Arbitration*, op.cit., footnote 765 and accompanying text.

\(^{125}\) For further references see my *International Commercial Arbitration*, op.cit., footnote 894 and accompanying text.
treatment to the creditors when an insolvency procedure has been opened. The court resolved not to enforce an award that, ordered payment under a certain contract, notwithstanding that the ongoing insolvency proceedings against the defendant in another state prevented it from effecting payment under any contract, thus preferring one creditor to the detriment of the others.\footnote{\textit{Salem Dry Cargo AB v. Victrix Streamship Co}, in \textit{Yearbook Commercial Arbitration XIV} (1990), pp. 534 ff., a United States Court of Appeal decision (Second Circuit).}

Rules that would at first sight seem to be of public policy, like embargo, have in several cases not been considered as such, under the consideration that, even if embargo are important from a foreign policy point of view, they cannot be considered of public policy.\footnote{\textit{National Oil Corporation (Libya) v. Libyan Nun Oil Company}, 733 F.Supp. (1990), 800, and \textit{Belship Navigation, Inc. v. Sealift, Inc.}, 1995, in \textit{Yearbook Commercial Arbitration XXII} (1997), 789 ff.}

Recently, the European Court of Justice has determined that European Competition rules have to be considered part of public policy.\footnote{\textit{Eco Swiss China Time Ltd. v. Benetton International N.V.} (1999) ECR I-3055.} The European Court was acting upon a reference made by the Dutch Supreme Court. The Dutch Supreme Court had affirmed that an award violating Dutch competition rules would not be deemed against Dutch public policy, and requested a decision of the European Court as to whether European competition policy could be treated in the same way or not. As a result of the European Court’s decision, we can observe that there are two different standards: while national (or, at least, Dutch) rules are not public policy, European ones are.

c) \textbf{International \textit{Ordre public} as a Corrective to Positive \textit{Ordre public}}

Sometimes the term “international \textit{ordre public}” is encountered, and sometimes the term “truly international \textit{ordre public}”. The former term does not designate a category of public policy different from the one just explained above, but simply a different use of the terminology; the latter term, on the contrary, refers to a different concept. We can briefly analyse the two terms.

International public policy is usually deemed to refer to those principles in a legal system that are so fundamental, that they should be respected even if the context of the dispute is international. In other words, the principles should have such an importance for that legal system, that they should be considered as basic irrespective of the existence of a close link between the legal system and the

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\textsuperscript{126} Salem Dry Cargo AB v. Victrix Streamship Co, in Yearbook Commercial Arbitration XIV (1990), pp. 534 ff., a United States Court of Appeal decision (Second Circuit).
disputed matter. The judge who is to determine the validity or enforceability of an award cannot be expected to run counter these principles, not even if the award does not have any link with the judge’s legal system. This concept of international ordre public does not differ considerably from the restrictive concept that has been described in the previous section, according to which it is only fundamental principles, and not rules (not even overriding mandatory rules) that constitute ordre public. Then why is one category defined as “international”, whereas the other one is not? This is primarily a question of terminology. In some systems the term ordre public is used in a domestic context and is deemed to have a wider scope than the one that we explained in the previous section. It is deemed to extend to cover also the overriding mandatory rules of that legal system. The extensive concept of ordre public is also known as “positive ordre public”. This is because ordre public, in the extensive sense, has a wider function than excluding an interference with the basic principles of the legal system (which is the function of ordre public in the narrow sense). The wider ordre public has also the function of ensuring the application of the legal system’s overriding mandatory rules: the positive public policy, therefore, is a vehicle for actively applying certain rules of the judge’s legal system. Since this is in contrast with the policies underlying the recognition and enforcement of foreign awards (as well as the application of foreign law under private international law), the positive ordre public has to be adapted when operating in an international concept. The extensive concept is therefore restricted, by adding the qualification of “international”. The meaning of international is not, in this context, that the ordre public stems from international sources: the meaning of international is that the (national) public policy is limited to those principles that are fundamental and that the judge cannot disregard even if the disputed matter has an international character.

If the concept of ordre public is used with the narrow scope described above, it is not necessary to add the qualification “international” to restrict it. The narrow concept, also known as negative ordre public, enjoys the wider recognition in international legal doctrine, judicial practice and legislation. It is defined as negative, because its function is to prevent recognition or enforcement of an award (or application of a foreign law), if the result of such recognition,

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129 Another way of defining this is through the concepts of relative ordre public or territoriality of ordre public. Both concepts aim at showing that ordre public should be given a narrow scope in international contexts: the weaker the connection between the subject matter and a certain legal system, the narrower that system’s ordre public should be construed. For a clear analysis of the origin of the various approaches, see THUE, Internasjonal Privatrett, op.cit., pp. 179f.

130 For further references see my International Commercial Arbitration, op.cit., footnote 248 and accompanying text.

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enforcement or application would violate fundamental principles of the judge’s legal system.

d) Truly International Ordre public

While the discrepancy between “ordre public” in its restrictive sense and “international ordre public” turns out to be simply a question of terminology, whereby in the substance there is no significant difference, the term “truly international ordre public” designates a different concept.

In this case, the qualification international does not refer to the context of the disputed matter, but to the sources from which the public policy stems. The idea is that the truly international ordre public does not originate from one single legal system: only if a principle is recognised as fundamental in a plurality of legal systems, it can be considered to be the expression of a policy that is truly international. The truly international public policy is a concept primarily recognised in some academic circles, and is considered to be more adequate to be applied to international transactions and international arbitration, than the national ordre public is, even in its restrictive sense.

However, the usefulness of this concept may be questioned. The concept aims at avoiding that a legal system uses its own fundamental principles to declare a foreign award invalid or to refuse its enforcement (or to restrict application of the governing foreign law), if such principles are particular to that specific legal system and do not enjoy recognition internationally. In such a situation, the peculiarity of that legal system undermines the ideals of international uniformity that inspire international commercial law and international arbitration. The aim of the theory underlying the truly international ordre public, therefore, is to disregard the fundamental principles that are proper only of one legal system, even if they represent the basic values upon which that society is relying. Instead, that legal system should look at what basic principles are recognised on a more international level, and prefer those principles to its own. It seems too ambitious to me, however, to expect that a state waives application of its own fundamental principles in the name of an ideal of harmonisation in international commerce. As long as the validity of an arbitral award is regulated by national arbitration laws, and the enforceability of an award is regulated by the New York Convention, the standard of reference will be the fundamental principles of the lex fori (though in the narrow, “negative” sense described above).

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131 For further references see my International Commercial Arbitration, op.cit., footnote 774 and accompanying text.
e) Conclusion

The definition of *ordre public* is relative, and may vary from state to state and, within the same state, with the lapse of time. What remains firm is that the exception of *ordre public* has to be applied restrictively; in particular, the simple violation of a rule is in itself not sufficient to trigger applicability of the public policy clause, not even if the violated rule is mandatory or overriding mandatory. *Ordre public* can be considered violated first if the result of that violation conflicts with the most fundamental principles of the society.

We will now verify the applicability of the *ordre public* exception to the scenarios described under section 6.1.3 (a) above. The assumption was that the award has disregarded mandatory rules of the governing law, namely the doctrine of consideration under English law. Would it be possible to invoke conflict with *ordre public* of the *lex fori* to obtain that the award is set aside (in the phase of challenge) or refused enforcement?

Taken the narrow scope of the *ordre public* clause, it seems not appropriate to consider the award as falling under the relevant grounds for annulment or refusal of enforcement. Certainly, the award would not be deemed to run counter the *ordre public* of Sweden (in case challenge before the courts of Sweden) or of Russia (in case of proceeding to obtain enforcement before the courts of Russia). None of these laws has the doctrine of consideration. It does not seem likely, furthermore, that either of these systems would consider as a violation of their own fundamental principles (for example, the principle of comity of nations), if the award has disregarded a rule of the foreign governing law which does not have any parallel concept in those systems. It would not seem correct to consider the award as violating against the public policy of England either (should the award be sought enforced before the courts of England). The award violates mandatory rules of English law, according to which a contract must contain bilateral advantages and detriments to be binding; but is this rule to be deemed a fundamental principle of the English society? Would the sense of justice of an Englishman be offended, if the carpenter were ordered to pay the price that it agreed to pay? Rather than a basic principle of the English order, this seems to be a technical rule, even if it is an important rule in the English legal system. This opinion is enhanced by the fact that the English legal system itself has developed equitable remedies to temperate the effects of the doctrine of consideration, as seen above under section 3.1.2(b). The promissory estoppel does not fully neutralise the effects of the doctrine of consideration in cases similar to ours, but it probably indicates that violation of the doctrine of consideration in this situation does not amount to violation of a fundamental principle of the English legal system.

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The answer would have been different, if the award had disregarded principles according to which a contract is not binding if it was entered into on the basis of error, or under duress. Such an award might well be deemed to offend the sense of justice of both the Swedish, the Russian and the English systems, since it would assume that courts of law lend their authority to give effect to fraudulent behaviours of one party to the detriment of another party. Other cases where the *ordre public* has been deemed violated are mentioned under item (a) above.

### 6.2.2 Contrast with Arbitrability Rule

Another defence that possibly could have been invoked to obtain annulment or prevent enforcement of the award mentioned under section 6.2(a) above is that the dispute was not arbitrable. We will below verify the scope of the arbitrability clause, and whether it could be applied to our scenario.

#### a) Scope of the Arbitrability Rule

There are various rules of state law that restrict the ability of the parties to submit to arbitration disputes between them. One of the main effects of submitting a dispute to arbitration is, as known, that the parties exclude the jurisdiction of courts of law on the same dispute. The other important effect of arbitration is that the winning party can present the award for enforcement to any court in a state where the losing party has assets. Arbitration enjoys such a significant recognition as long as the disputed matters concern areas that national legal systems consider suitable for self-regulation by private parties. As soon as matters of public policy or of special economic or social interest are touched on, however, it can seem less appropriate for a state to waive jurisdiction or to lend its courts’ authority to enforce private awards. In such areas with important policy implications, the states desire to preserve the jurisdiction of their own courts of law: this preference is based on the assumption that an arbitral tribunal would not be able or willing to apply the law as accurately as a judicial court would.

The above does not mean, however, that an arbitral tribunal does not have the jurisdiction to apply or take into consideration mandatory rules or even overriding mandatory rules. An arbitral tribunal is empowered to apply in its totality the law that governs the dispute, as long as this application remains within the sphere of the private law. It does not matter if a provision of the governing law is mandatory, such as the provision on limitation of rights, or overriding mandatory, such as the provision on unfair contract terms. As long as these provisions regulate the private law consequences of a dispute, and the

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dispute has been submitted to arbitration, the tribunal is empowered to apply
them. This circumstance has been the object of debate, specially in connection
with disputes involving questions of competition law.\textsuperscript{132} Competition law
contains, as known, provisions that are overriding mandatory; moreover, special
bodies have the authority to impose fines and otherwise sanction the violation of
these provisions. Hence, the question has been debated whether an arbitral
tribunal has jurisdiction on disputes involving matters of competition law. An
arbitral tribunal does not have the jurisdiction to impose a fine or otherwise
sanction the violation of a provision of competition law: this jurisdiction lies
with the competent authorities, and has a public law character. Therefore, if one
party to a licence agreement requests an arbitral tribunal to impose a fine on the
other party because the licence agreement or that party’s actions violate
competition law, the arbitral tribunal must decline jurisdiction. However, if that
party requests the arbitral tribunal to rule on the contractual consequences of that
violation, the arbitral tribunal has jurisdiction: the tribunal may evaluate whether
competition law has been violated, and may decide on the consequences that
that violation has between the parties. For example, it may decide that a certain
contractual clause is invalid due to its conflict with competition law, and that
therefore non-compliance therewith by one party does not constitute default
under the contract. Similarly, an arbitral tribunal may not rule on the validity of
a patent, because this decision is under the exclusive jurisdiction of the
competent patent authorities. However, an arbitral tribunal may take into
consideration patent legislation to determine whether the patent has been
violated, and what consequences this violation has between the parties. In such a
case, the arbitral tribunal assumes that a valid patent exists and is valid.\textsuperscript{133}

In order to avoid any doubts on the jurisdiction of an arbitral tribunal on the
contractual and private law aspects of the dispute, even if the dispute involves
also matters regulated by overriding mandatory rules, some modern arbitration
laws have expressly confirmed this circumstance. The Norwegian Bill on
Arbitration, section 2-1(2), expressly specifies this circumstance in respect of
competition law: a dispute would be arbitrable under Norwegian law even if it
relates to competition law, as long as the tribunal is requested to decide on the
civil law effects of the competition law. The same rule is to be found also in the
Swedish Arbitration Act, section 1.3. It might be wondered whether the
legislators have intended to exclude arbitrability of the civil effects of any other
regulatory provision such as patent law, since they have expressly mentioned
only the civil law effects of competition law. The report to the Norwegian bill,

\textsuperscript{132} See the comments made in the preparatory works to the Norwegian Arbitration Bill (NOU
\textsuperscript{133} Some Norwegian Supreme Court decisions have confirmed this approach: Rt. 1979 s.
1117, and Rt. 1977 s. 577.
however, specifies that there was no intention to exclude arbitrability of the civil law consequences of other rules, rather a desire to confirm that specifically for competition rules, which have often been the subject of disputes internationally.\textsuperscript{134}

We can observe a clear trend towards reducing the areas in which disputes are not deemed arbitrable. In the past decades, for example, the US legal system has undergone a clear shift from an expressed suspicion against arbitration, to an arbitration-friendly attitude;\textsuperscript{135} the same evolution can be observed in other legal systems, such as, for example, the Swedish system.\textsuperscript{136} Notwithstanding this trend in favour of arbitrability, however, various areas of law are still deemed to be for the exclusive competence of courts of law. The areas where arbitrability is excluded vary from state to state: as a general rule, arbitration is usually permitted in all matters that fall within the boundaries of private law. This would exclude from the scope of arbitration matters such as taxation, import and export regulations, concession of rights by administrative authorities, bankruptcy, the protection of intellectual property. These matters are mostly regulated by mandatory rules from which the parties cannot derogate. Disputes concerning aspects of commercial transactions falling within the scope of the freedom to contract, as seen above, should be arbitrable even if the solution of the dispute assumes that the tribunal takes into consideration these mandatory rules. As long as the tribunal is requested to decide upon the private law consequences of these rules’ existence, and is not required to apply or enforce any of these rules, there should be no obstacles to arbitrability.

The scenario presented in section 6.2(a) above does not seem to be falling within the scope of the arbitrability rule. The doctrine of consideration is mandatory under English law, and cannot therefore be derogated from by the parties; however, the dispute cannot be looked upon as being outside the freedom of the parties. The dispute regards a construction contract, which is a kind of commercial contract and as such arbitrable. Construction agreements are not

\textsuperscript{134} Report on the Bill on Arbitration, NOU 2001:33, comment on section 2-1(2).

\textsuperscript{135} The first Supreme Court judgement recognising the arbitrability of matters that previously were deemed to be for the exclusive competence of courts of law, was \textit{Scherk v Alberto-Culver}, 417 US 506 (1974). See, for further references, CARRINGTON, P.D., and HAGEN, P.H., \textit{Contract and Jurisdiction}, in (8) \textit{The Supreme Court Review}, 1997, pp. 331ff., 362f., and STERNLIGHT, J.R., \textit{Panacea or Corporate Tool? Debuking the Supreme Court’s Preference for Binding Arbitration}, in 74 \textit{Washington University Law Quarterly} 3, 1996, pp. 637ff., 652.

\textsuperscript{136} See, for example, the evolution regarding the validity of arbitration clauses entered into in the framework of general conditions of contract, as it appears from the comparison of three Swedish Supreme Court decisions rendered in 1949, 1969 and 1980: HEUMAN, L., \textit{Current Issues in Swedish Arbitration}, op.cit., pp. 22ff.

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subject to regulatory constraints or particularly stringent policies, unless, possibly, if they are in the framework of some relationship within areas of public law, such as for example mining or petroleum activity. Commercial contracts can, generally, be arbitrated; therefore, the arbitrability would not affect the award rendered in the described scenario.

Since the arbitrability rule may have a different scope according to the law it belongs to, it is necessary to find out which law determines whether the subject of the dispute was arbitrable or not. The answer to this question differs, according to whether the question is asked during the phase of challenge of the award’s validity, or during the phase of enforcement.

b) The Law Governing Arbitrability in the Phase of Challenge of an Award

State laws may vary from state to state when it comes to determining what state’s law is applicable to the question of arbitrability in connection with a challenge of an award.

As an illustration, we can assume that a USA oil company has entered into a contract with the Russian Government for the exploration, development and production of oil on the territory of Russia. The transaction is in the form of a Production Sharing Agreement (“PSA”), a type of contract that assumes that the oil company and the Government of the host state enter into a contract that regulates all major aspects of the relationship, including also, in particular, the amount of taxes that the investor is supposed to pay out of the income generated in connection with the transaction. The PSA contains also a so-called grandfathering clause, providing for certain compensation to be paid to the investor, if certain taxes are increased during the term of the contract. PSAs are regulated in Russia by a specific statute on PSAs, specifying in article 22 that disputes arising out of the contract may be arbitrated, also in states other than Russia, as long as they regard rights and obligations that are to be considered of private law nature. The PSA statute specifies also that the contracts shall be governed by Russian law.

We can assume that the PSA between the USA investor and the Russian Government contains an arbitration clause submitting disputes to the Arbitration Institute of the Stockholm Chamber of Commerce, and we can assume that a dispute arises between the parties in connection with the introduction of some new taxes on oil activity in Russia. The Russian Government claims that the arbitral tribunal has no jurisdiction, because the dispute regards the introduction of taxes by the Russian Government, which is not an arbitrable matter under Russian law (Russian law being the law governing the merits of the dispute).
The US oil company claims that the arbitral tribunal has jurisdiction, because the lack of arbitrability under Russian law does not affect the Swedish arbitral tribunal. We can further assume that the arbitral tribunal concludes that it has jurisdiction, and renders an award.

We can imagine two scenarios:

(i) The arbitral tribunal interprets the grandfathering clause contained in the PSA and determines what compensation the Russian Government shall pay to the investor under the contract, as a consequence of the introduction of the new tax; and

(ii) The arbitral tribunal determines that the introduction of the new tax is against the contractual obligations undertaken by the Russian Government, and rules that the new tax is not applicable to the US investor.

We can assume that the Russian Government, in both scenarios, challenges the validity of the arbitral award before the Swedish courts, claiming that the dispute was not arbitrable under Russian law governing the PSA and therefore the merits of the dispute. The question is: what law should determine whether the dispute is arbitrable or not, and, consequently, whether the award is invalid or not?

As already mentioned, the answer varies according to the applicable arbitration law. As explained under section 6.1.2 above, an arbitral proceeding is subject to the arbitration law of the state where it has its seat. Under some laws, the parties may choose to apply rules of procedures of other states, but this does not apply to the rule of arbitrability, that sets the borderline between the jurisdiction of the courts of law and the jurisdiction of the arbitral tribunal.

The Swedish court would apply Swedish arbitration law (the Arbitration Act of 1999), which in article 33.1 designates the law of the arbitral seat for the purpose of determining the arbitrability of the dispute. In addition to the law of the arbitral seat, the question of arbitrability may be proven also under the law applicable to the arbitration agreement (article 34.1):137 this would be the law chosen by the parties to govern the arbitration agreement, or the law of the arbitral seat.138 Therefore, in the case of oil dispute submitted to Swedish arbitration, the Swedish court deciding on the validity of the award shall

138 See above, item (c) in section 6.1.2.

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determine the arbitrability of the dispute on the basis of the *lex arbitri* (Swedish law), and not on the basis of the law governing the merits (Russian law).

The law of the arbitral seat is expressly designated also by article 34.2.(b)(i) of the UNCITRAL Model Law (upon which also the Norwegian bill on arbitration is based). If the question of arbitrability is deemed to affect also the validity of the arbitration agreement, then arbitrability of the dispute has to be verified also in respect of the law chosen by the parties to govern (not the dispute, but) the arbitration agreement. If the parties have not chosen the law applicable to the arbitration agreement (which is not a choice usually made), the law of the state where the award was made will be applicable to the validity of the arbitration agreement.

Other state laws do not mention expressly what law is applicable to the question of arbitrability. Sometimes, it is possible to designate the law of the arbitral seat by way of a systematic construction of each arbitration law. For example, the Swiss Private International Law Act defines in article 177 what disputes are arbitrable, and determines in article 176 that Swiss arbitration law is applicable to any arbitration that take place in Switzerland. The law that governs the merits of the dispute is not mentioned in any of these arbitration laws, and is therefore not relevant when the court verifies the validity of an arbitral award.

c) The Law Governing Arbitrability in the Phase of Enforcement of an Award

Lack of arbitrability is also mentioned by the New York Convention as a ground upon which the court of enforcement may refuse enforcement of an award. The New York Convention clearly determines the law governing arbitrability: enforcement by a court of an award may be refused if “the subject matter of the difference is not capable of settlement by arbitration under the law of that state”. It is the law of the enforcement court that governs whether the dispute was arbitrable or not. In respect of the New York Convention it is rather controversial whether arbitrability might fall also under the scope of article V.1.(a) of the New York Convention, which provides that invalidity of the arbitration agreement is one of the grounds that may justify a refusal to enforce the award. If this view is accepted, then arbitrability of the dispute has to be verified not only in respect of the law of the enforcement court, but also in respect of the law governing the arbitration agreement. The New York

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139 The most authoritative commentator to the New York Convention excludes that the question of arbitrability can be considered as falling also within the scope of the validity of the arbitration agreement: see VAN DEN BERG, A.J., *The New York Arbitration Convention of 1958*, Deventer, 1981, 288f.
Convention determines the law governing the arbitration agreement as the law chosen by the parties to govern specifically the arbitration agreement (and not, generally, the dispute)\textsuperscript{140} or, failing a choice by the parties, the law of the state where the award was made.

Also the New York Convention, as the national arbitration laws seen above, does not mention the law governing the merits of the dispute as relevant to the question of arbitrability. Therefore, in the case of enforcement of the Swedish award rendered in the oil dispute, the enforcement court shall determine the arbitrability of the dispute on the basis of its own law, and not on the basis of the 
lex arbitri
(Swedish law), or of the law governing the merits (Russian law).

d) The Law Governing the Dispute is Irrelevant

The lack of arbitrability may lead to annulment or refusal to enforce the award only if the dispute was not arbitrable according to the law of the arbitral seat, or the law of the enforcement court, or the law chosen by the parties to govern the arbitration agreement. The law that governs the merits of the dispute, on the contrary, is not applicable to the question of arbitrability.

In our example of the Swedish arbitral award rendered on a dispute concerning a PSA governed by Russian law, this means that Russian rules on arbitrability may affect the validity of the award only in the following two cases: (i) if the award is sought enforced in the territory of Russia, or (ii) if the parties have subjected the arbitration agreement to Russian law.

In respect of the former case, it may be sufficient to mention that an arbitral award does not necessarily have to be enforced in the state where the losing party has its residence or main place of business; the New York Convention permits to enforce an award in any state where the losing party has some assets.

In respect of the latter case, it must be mentioned that it is extremely unusual and not recommendable to subject an arbitration agreement to a law different from the law of the state where the arbitration will take place.\textsuperscript{141} It is extremely important to have a neutral and independent arbitration, in cases when the relationship between the contractual parties is not balanced. When one of the parties is the Government of the host state, for example, by modifying the legislation or pressing the competent authorities it may influence the outcome of

\textsuperscript{140} See, for example, VAN DEN BERG, The New York Arbitration Convention, op.cit., 291 ff. In respect of Swedish law, see HEUMAN, Skiljemannarätt, op.cit., 697f.

\textsuperscript{141} See above, item (c) in section 6.1.2.
the dispute to which it is a party. In this context, it is important that arbitration is geographically placed in a third state, but even more important is that the arbitration has an independent legal framework. Therefore, choice of the arbitral seat and choice of the arbitral seat’s arbitration law should go hand in hand. The arbitration procedure and the arbitration agreement are governed by the law of the arbitral seat, unless the parties decide otherwise. And I would like to remind that choice by the parties of another law to govern the commercial agreement and the merits of the dispute does not imply that the parties have chosen that law also to govern the arbitration agreement.

e) Arbitrability is Equal to *Ordre public* in International Disputes

In our example of the Swedish arbitral award rendered in a dispute concerning a PSA, therefore, the losing party may claim (for example, in the phase of challenge of the award’s validity) that the award is invalid because it violates the arbitrability rule contained in Swedish law. The Swedish Arbitration Act (article 1) permits to arbitrate only disputes on matters where the parties enjoy contractual freedom: therefore, matters of public law are not arbitrable.\(^{142}\) Would an award rendered in Stockholm on a dispute between the US oil company and the Russian state, arising out of a Production Sharing Agreement, be deemed invalid by a Swedish court on the ground that the disputed matter was not arbitrable under Swedish law?

To answer the question it may be useful to remind of the rationale of the arbitrability rule: the arbitrability rule is meant to preserve the jurisdiction of the courts of law in certain areas of law that are deemed to deserve a particularly accurate application of the law. This affects particularly areas of law with public policy implications, where the public interest is deemed to prevail against the freedom of the parties to regulate their own interests. The legal system does not consider private mechanisms of dispute resolution as sufficiently reliable in this context, and wishes to maintain the jurisdiction of its own national courts of law. How does this rationale apply to our US-Russian arbitration in Stockholm? The dispute regards the application by Russian authorities of tax law. Disputes regarding taxation are not arbitrable under Swedish law; the Swedish legal system does not intend to renounce to the jurisdiction of Swedish courts of law in favour of a private arbitration. Assuming that the Swedish court set aside the Swedish arbitral award, on the ground that the dispute was not arbitrable: would that mean that Swedish courts of law have jurisdiction on the dispute? Of course not: Swedish courts have no jurisdiction and no interest in exercising

\(^{142}\) For more extensive comments on the scope of the arbitrability rule under Swedish law, see HEUMAN, *Skiljemannarätt*, op.cit., pp. 156ff.
jurisdiction on that dispute, because the subject-matter has no connection with Sweden and is not subject to Swedish law. The rationale of the arbitrability rule, in short, is not applicable if the dispute has no contact with the state where the arbitration takes place. Then why should the arbitrability rule be applicable?

If a dispute has no connection with the legal system of the arbitral seat, the arbitrability rule should be applicable to set aside an award only if the annulment of the award is necessary to avoid an unacceptable result to which the arbitral tribunal has come. In itself, the fact that the arbitral tribunal has resolved a dispute that is not arbitrable under the law of the arbitral seat would not be unacceptable: the courts of the arbitral seat would have neither the interest nor the competence to apply their own law to that dispute. What would be unacceptable is a decision made in a specific case, for example, because it has given effect to an agreement that violated a UN embargo. In short, what should be an annulment ground in this situation is not the fact that the tribunal has exercised jurisdiction on the dispute, but the fact that the result of the decision conflicts with the fundamental principles of the court’s law. In situations where the dispute does not have any links with the legal system of the arbitral seat, therefore, the arbitrability clause would overlap with the ordre public clause. The evaluation of the award’s validity, in other words, cannot be made in advance, automatically applying an abstract measure of arbitrability. The evaluation of the award’s validity has to be made on the basis of the specific decision rendered in the particular case, and measuring the actual decision against fundamental principles of the court’s law.

Consequently, the court of challenge should conclude, in the second scenario described above, that the award runs against the fundamental principles of the court’s legal system, because it decided on matters clearly belonging to the sphere of sovereignty of the host state (in our example, Russian law). An award deciding that the investor is not subject to paying certain taxes introduced by Russian law, would be an award that decides on matters that belong to the sphere of Russian sovereignty. A court of challenge may consider this award as

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143 For a more extensive analysis of the matter see VAN DEN BERG, A.J., The New York Arbitration Convention op.cit., pp. 360, 368 ff., III-5.1, footnote 337, who considers the arbitrability rule as a sub-concept of the ordre public rule, and therefore superfluous. Partially in the same direction, within Swedish law, HEUMAN, Skiljemannarätt, op.cit., p. 701, stating that a dispute that would not be deemed arbitrable if it was domestic, may still be arbitrated if it has an international character. Implying that the arbitrability rule of domestic law coincides with the international public policy of the seat of arbitration, B. HANOTIAU, The Law Applicable to Arbitrability, in ICCA Congress Series no. 9, 40 Years of Application of the New York Convention, The Hague etc. 1999, pp.146-167, 158. For a more extensive discussion, as well as references to some judicial decisions confirming this theory, see my International Commercial Arbitration, op.cit., pp. 293f.
running against the principles of comity between nations; therefore, the award may be set aside because it violates the principle of comity in the court’s legal system.

In the first described scenario, however, the court of challenge should conclude that the award is valid, even if it decided on matters that are not arbitrable under the court’s law. An award deciding that the investor is entitled to a certain compensation as a consequence of modifications to Russian taxation law, would be an award that decides on matters relating to taxation, therefore not arbitrable. However, the award would be aimed not at restricting the sphere of sovereignty of the Russian state, but at reinstating the balance of interests in the contract between the investor and the state. Even if the dispute is not arbitrable under the court’s law, the award may still be deemed valid. Violation of the arbitrability rule is not, in itself, sufficient to annul an award (when the court has no jurisdiction on the dispute); as long as the award does not violate other fundamental principles of the court’s legal system, the award is valid.

f) Conclusion

The arbitrability rule, in conclusion, does not always present an independent obstacle to the effectiveness of international arbitral awards, for two reasons. Firstly, the scope of what is deemed by state laws as not arbitrable is relatively reduced, and is shrinking constantly. Secondly, if the dispute has no points of contact with the *lex fori*, so that the courts would not obtain jurisdiction by excluding the admissibility of the arbitration clause, then the courts have no interest in enforcing the arbitrability rule. In this situation, the grounds for considering award invalid or not enforceable will have to be based on the award’s violation of the court’s *ordre public*, rather than on the simple fact that the award regards a dispute belonging to the list of not arbitrable areas.

6.2.3 Excess of Power

The last two scenarios made in section 6.2 above assume that the arbitral tribunal has acted on its own initiative, applying, respectively, state law and trans-national law, notwithstanding that the parties had not invoked these sources to solve the dispute. The question is whether the award is effective, even if the tribunal has not based its decision on the law or rules relied upon by the parties.

We may remember that the arbitral tribunal owes its very existence to the will of the parties. Consequently, it must follow the parties’ instructions as to its
composition, the procedure that it will follow, its jurisdiction, the scope of the dispute that it is called upon to solve, 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 on the arbitral tribunal. The parties’ instructions being the only source of the tribunal’s power, an award that is affected by excess of power does not have a legal basis, and is ineffective.

This is the rationale of the exception of excess of power, that is listed both in the UNCITRAL Model Law, article 34.2(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 is whether the exception of excess of power can be invoked to sanction the tribunal’s application of law.

a) The Scope of the Excess-of-power Defence

The normal scope of application of the exception of excess of power relates not to the applicable law, but to the object of the dispute. We can assume, 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 of 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 of excess of power. The mandate that the tribunal had received was to decide whether the price 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 part of the dispute submitted to that arbitral tribunal, and could not be decided upon by that award.

b) The Difficult Borderline between Review of the Merits and Review of the Applicability of the Law

The excess of power is relatively easy to ascertain, as long as it is confined to the object of the dispute. More difficult it becomes if the question regards the applicable law if, as in the scenarios made in section 6.2 (b) and (c) above, the award is on an object within the borders of the tribunal’s power, but applies a law different from the law requested by the parties. We have already mentioned
that 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. The award may not be reviewed, whether this is in respect of the tribunal’s assessment of the facts or in respect of its application of the law.\textsuperscript{144} It may not always be easy to determine the border 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 authority of the court, the latter might be considered as excess of power, and therefore be within the scope of authority 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.\textsuperscript{145} 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.

c) Delocalisation of International Contracts and Excess of Power

It might be particularly interesting to look at the scope of the arbitrators’ power in the context of the question that we have been dealing with during this course: is an international contract a phenomenon that floats in a trans-national system of law, detached from national systems of law? Often the term “delocalisation” is used, to express the independence of international contracts and of international arbitration from national legal systems.

We have seen in chapters 3 and 4 that international contracts ultimately have to be localised under a state law. However, we have also seen that international contracts containing an arbitration clause have less contact points with national courts of law, and that therefore there are fewer occasions to verify and act upon any disregard of state law. In arbitration, moreover, there is the possibility for the parties to request the tribunal a decision as amiable compositeur (often also called \textit{ex bono et aequo}), as opposed to the more common decision at law. This

\textsuperscript{144} With the exception of English law: The English Arbitration Act of 1996 has retained the possibility of appealing an award on questions of law, although the regime now is considerably more restrictive than it was in the previous versions of English arbitration law. Section 69.1 of the Act provides for the appeal of an award on points of law, but it provides also for the possibility of the parties to enter into agreements excluding the appeal on points of law. Section 69.2 sets restrictive conditions for filing the appeal.

\textsuperscript{145} See my \textit{International Commercial Arbitration}, op.cit., pp. 274 ff. and 289f., with some examples of cases where the excess of power exception was applied.

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assumes that the parties do not expect the tribunal to strictly apply the rules of a specific system of law, but rather to decide on the basis of the circumstances of the case and its own sense of justice. This kind of decision, however, even if not based on a specific law, remains nevertheless subject to the fundamental principles that might be applicable, like an arbitral decision made at law.

As a general rule, only major defects of an award would be sanctioned, under the rules of *ordre public* or of arbitrability examined in the previous sections. Therefore, the opinion that sees international contracts subject to arbitration as detached from national systems of law has a certain fundament. We will below assess the scope of applicability of the defence of excess of power, in respect of the applicable law. This will help us verifying to what extent the parties are free to instruct the arbitral tribunal in aiding them to avoid the applicable law or, on the contrary, to what extent an arbitral tribunal is free to disregard the governing law on its own initiative.

d) Application of State law on the Tribunal’s Own Initiative

The first question arising in connection with the evaluation of the scope of the arbitrators’ power is: may the parties willingly disregard the applicable law, and even expect an arbitral tribunal to do so? What happens if the arbitral tribunal resolves nevertheless to apply the governing law?

To illustrate the matter, we can assume a contract entered into by two competing manufacturers, for the licensing of certain technology; 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 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 the Swiss governing law was meant specifically to avoid 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, chosen by the parties, it runs the risk of rendering an award that is not enforceable in any European Union state: as we remember, an award that violates the public policy of the court of enforcement may not be refused enforcement, and this award would violate EC *ordre public* (EC competition law having been qualified by the European Court of Justice as *ordre public*, see above, section 6.2.1(b)).
Consequently, the tribunal might be inclined to take into consideration EC competition law, thus avoiding to render an unenforceable award. Does the arbitral tribunal run the risk to exceed its power, if it takes into consideration EC competition law? As we have seen in chapter 5 above, 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 *force majeure*), 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 mandatory rules). A variety of approaches is thinkable, as we will see below.

(i) Violation of the *ordre public* of the *lex arbitri*?

If the tribunal is located in a European Union state, it could not be expected that it disregards its own *ordre public*; the award would be annulled by the courts of the state where it was rendered. 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 correspondingly.

(ii) 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 and permitting to disregard a choice of law made by the parties that leads to violating mandatory rules of foreign law. In this way, 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.

(iii) Application of the private international law

The tribunal might verify 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, 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 such rules. We have seen under section 6.1.2 (d) above that there is no uniform answer to the question of the applicable choice-of-law rules. The arbitral tribunal might have a plurality of methods available to integrate or restrict the choice of law made by the parties, ranging from the full application of the chosen law (when it makes directly or indirectly reference to the effects or

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the violation of foreign laws), to the application of conflict rules giving the possibility to give effect to rules of foreign law. This variety of approaches and the wide discretion that is given to the arbitral tribunal in a series of these approaches, combined with the exclusion of any judicial review of the application of law made by the tribunal, explain why the defence of excess-of-power is so seldom used to sanction the tribunal’s choice of law.

Based on the foregoing it seems unlikely that, in the example made here, the award 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 fears the lack of enforceability of the award in case of disregard of 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.

Therefore, in the scenario presented in section 6.2(b) above, it seems unlikely that an award would be set aside or refused enforcement for excess of power, even if the tribunal has applied the governing law on its own initiative. The tribunal might have exceeded its power if the parties had requested it to act as an amiable compositeur, rather than making a decision at law. If, in such case, the tribunal had reasoned strictly in terms of the technical legal rule on consideration, without corroborating the decision with any consideration of justice or of the circumstances of the case, the defence of excess-of-power might be successful.

e) Application of Trans-national law on the Tribunal’s Own Initiative

The opposite scenario of the defence of excess of power regards the freedom that the arbitral tribunal may take to disregard the applicable state law and to apply trans-national rules instead. In the scenario presented under section 6.2(c) above, the parties to a contract realise, after the contract has entered into force, that the agreed price was too low, and 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 effect 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 amendment contract may be deemed not binding for lack of consideration (although this might be partly accommodated by the equitable remedy of promissory estoppel, as seen under section 3.1.2(b) above). What if the parties have not given any instructions to the arbitral tribunal in respect of the applicable law: 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 the 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 amendment contract. What happens if the arbitral tribunal decides to disregard this peculiarity of one national system of law, and applies instead the generally recognised principle of trans-national law: *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 for excess of power?

The considerations made in the previous sections may be made also here, *mutatis mutandis*. Generally, the courts of law have no jurisdiction to review the application of the law made by the arbitral tribunal (English arbitration law does contain, as a matter of fact, the possibility for a court to annul an award rendered in England for error of law, but this possibility is restricted). Therefore, to the extent the excess-of-power defence may be applied to sanction the choice of law made by the tribunal, it must not go over to becoming a control of the tribunal’s appropriate application of the law. As already mentioned, it may be difficult to draw the borderline between excess of power and error in law, thus making the applicability of the defence uncertain. After having warned against the difficulty to find the appropriate basis for applying the excess-of-power defence, it remains to see whether the application of trans-national sources by the arbitral tribunal may be founded only on the express choice of the parties, or whether there are other fundaments. Only in the former case, and not in the latter, an unsolicited application of trans-national law may be deemed to be beyond the tribunal’s powers.

On the basis of the explanation made in subsection 6.1.2 (e) above, and if we accept the therein mentioned theory about the implications for trans-national law of the distinction between “rules of law” and “law”, we may conclude that there is no uniform answer to the question of excess of power in the scenario made in section 6.2(c) above. If the parties had adopted for their dispute the rules of

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146 See above, footnote 144.
arbitration of the International Chamber of Commerce, the tribunal would have been indirectly empowered by the parties to apply trans-national sources. Therefore, the disregard of the English doctrine of consideration and the application of the principle *pacta sunt servanda* would not go beyond the powers that were conferred on the tribunal. If, however, the parties had adopted the UNCITRAL arbitration rules for their arbitration, the tribunal would have been bound to apply the governing law, and an application of trans-national sources would have exceeded the powers of the tribunal. It remains to be seen, however, whether the courts would be willing to exercise their control on 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).
6. CONCLUSION

The excursus made in this course was meant to determine the relationship between an international contract and the sources of law that regulate it. Even if the parties have not thought of any governing law, even if the parties have expressly intended to avoid a certain governing law, even if the parties have chosen a certain set of trans-national rules to govern their transaction, even if the parties have made use of model contracts that may be considered to express customary regulation of the underlying transaction, the contract may nevertheless be subject to the mandatory rules, or the overriding mandatory rules, or the ordre public of the state law that the parties had not taken into consideration or had intended to avoid.

What I have tried to show is that an international contract is not necessarily a “strange animal”, that has to be written in a completely different way from a domestic contract. It is, admittedly, a widespread habit to adopt a different style when the contract is international, and to draft in accordance with English/American contract models; but this may create more problems than it solves, particularly in connection with the interaction between a common law contract style and a civil law governing law. It is, however, fully possible to draft an international contract as if it were a domestic contract (after having established what national legal system will govern the relationship); the difference between the domestic and the international contract will then consist in necessity, for the latter, to regulate those aspects that are typical for an international transaction (principally, cross-border payments and cross-border deliveries).

This does not mean that the sources of regulation of international contracts that practice, legislation or the academy have produced, are irrelevant: many of such regulations, whether they are stemming from international conventions or trans-national sources, are extremely useful, and should definitely be taken into serious consideration. However, they should not be adopted blindly, in the certainty that these sources are in any case effective and exhaustive regulation of the transaction: the interaction with the governing law (that is not being replaced, but simply integrated by these trans-national sources) will determine to what extent this regulation is effective, and whether other principles or rules will also have to be taken into consideration.

The relationship between the international contract and the state law will depend on many variables, among which the most important are the nature of the rules that are supposed to integrate or replace the contract, the applicable choice-of-
law rules, the *forum* that is to decide on the dispute. Therefore, and in spite of a strong tendency to consider international contracts as governed by a system of trans-national law, detached by national systems, it is not possible to ascertain in general terms whether a contract will prevail over the laws that are closely connected with it, or vice versa. It is for the parties, before drafting the text of contract, to verify all the above mentioned aspects of the specific transaction, that will permit to determine to what extent the contractual terms or any chosen trans-national sources might be effective in spite of a differing state law. The governing law, the existence of overriding mandatory rules of other laws, the scope of party autonomy according to the applicable private international law, the *forum* that will have jurisdiction to decide upon disputes or, in case of an arbitration clause, the *forum* that will have jurisdiction to verify the validity of the award, as well as the *forum* where the award might be enforced, will all affect the validity and enforceability of a contract. The parties should have these aspects in mind, while drafting the terms and conditions of their agreement, in order to find a form and a structure that make the contractual terms enforceable. If the parties simply draft a contract on the basis of the commercial agreement between them, without taking into consideration the governing law and the *forum* for possible disputes, they run the risk to sign a contract that is invalid or unenforceable, or to loose the protection that they would otherwise have under the governing law.

These considerations are less stringent if the parties include an arbitration clause in their contract; however, we have seen that the parties and the arbitral tribunal may be freer from state laws than a national court of law, but they are not completely detached from state law. Therefore, the parties should be aware of the relationship between an international contract and state law, even if they have included an arbitration clause. Moreover, an abuse of the freedom that the parties enjoy in arbitration would in the long term undermine the trust that national legal systems have shown towards arbitration. It is this trust that permits an extensive recognition and enforceability of arbitral awards in the vast majority of national systems of law, for example by interpreting restrictively the exceptions of *ordre public* and arbitrability. An extensive use of arbitration for the purpose of avoiding mandatory rules of applicable laws would be basis for re-evaluating the trustworthiness of arbitration as a mechanism for solving disputes, thus inducing national courts to interpret less narrowly the mentioned exceptions, and reducing correspondingly the usefulness of arbitration.


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**USEFUL ELECTRONIC LINKS**

*International Organisations:*

- [www.cbrd.com](http://www.cbrd.com)
- [www.ilo.org](http://www.ilo.org)
- [www.imo.org](http://www.imo.org)
- [www.oecd.org](http://www.oecd.org)
- [www.opec.org](http://www.opec.org)
- [www.un.org](http://www.un.org)
- [www.wipo.org](http://www.wipo.org)
- [www.worldbank.org](http://www.worldbank.org)
- [www.wto.org](http://www.wto.org)

*International Trade:*

- [www.asser.nl](http://www.asser.nl) (links and full texts)
- [www.cisg.law.pace.edu](http://www.cisg.law.pace.edu) (Database on CISG)
- [www.hcch.net](http://www.hcch.net) (Hague Conference on Private International Law)
- [www.lexmercatoria.org](http://www.lexmercatoria.org) (links and texts on a vast range of matters)
- [www.uncitral.org](http://www.uncitral.org)
- [www.unidroit.org](http://www.unidroit.org)
- [www.unidroit.org/english/principles/pr-main.htm](http://www.unidroit.org/english/principles/pr-main.htm) (UNIDROIT Principles)

*International Courts:*

- [www.icj-cij.org/](http://www.icj-cij.org/) (International Court of Justice)
- [www.pca-cpa.org/](http://www.pca-cpa.org/) (Hague Permanent Court of Arbitration)

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arbiter.wipo.int/domains/index.html (WIPO Dispute resolution)
www.worldbank.org/icsid/ (International Centre for Settlement of Investment Disputes)
www.wto.org/english/tratop_e/dispu_e/distab_e.htm (WTO dispute resolution)

Arbitration:

www.adr.org (American Arbitration Association)
http://www.chamber.se/arbitration/english/index.html (Arbitration Institute of the Stockholm Chamber of Commerce)
www.iccwbo.org/court/english/arbitration/introduction/asp (ICC International Court of Arbitration)
www.internationalADR.com (links, full texts, cases, model clauses)
www.lcia-arbitration.com/town/square/xvc24/ (London Court of International Arbitration)
www.uncitral.org
www.worldbank.org/icsid

Internet Resources:

www.asil.org/info (American Society of International Law Library-provides i.a. list of links)
www.asil.org/resource/Home (Guide to Internet Resources for Int’l Law)
www.asser.nl (Research Institute with useful links and full texts)
www.europa.eu.int (The European Union on line)
www.europa.eu.int/comm/off/green/index_en.htm (The EC Green Papers)
www.laweye.de (Links)
www.lexmercatoria.org (links and full texts)
www.tldb.de (Transnational law database)
www.law.nyu.edu/library/foreign_intl (Guide to databases)